



The

— Freedom *and*

Prosperity —
Equation

Exploring the most durable path
to development for countries
around the world

Edited by Dan Negrea,
Brad Lips, and Kris Mauren

“As the world confronts sharp economic and political challenges, there is a great need for exploring the most promising paths to prosperity. The contributors to this volume make a persuasive case that the best way to unlock human potential is in free societies.”

Fred Kempe, President and Chief Executive Officer of the Atlantic Council of the United States

“Freedom and prosperity are both highly sought after by global citizens but is there a causal relationship? These essays examine this question and highlight the importance of the Atlantic Council’s Freedom and Prosperity Indexes, which utilize data from 164 countries to explore the relationship between freedom and prosperity.”

Aigboje Aig-Imoukhuede, Chairman and Co-Founder, and Ofovwe Aig-Imoukhuede, Executive Vice-Chair and Co-Founder, Aig-Imoukhuede Foundation, Nigeria

“This volume offers both theoretical analyses and policy suggestions for agents of change who want to improve the life of all people, and especially of the poor and marginalized. The essays suggest that economic freedom, the rule of law, and representative government lead to human flourishing.”

Michael Fisch, Founder and Chief Executive Officer, American Securities

“There is no sustainable prosperity without trust. Trust is the basis of every relationship. You do business with people you trust. You partner with people you trust. You buy from people you trust. Trust is how deals are made, friendships are forged, and families are founded. Trust is the world’s most important currency. Trust requires freedom. When it’s in abundance, everyone prospers. When it’s scarce, everyone suffers. These essays demonstrate the simplicity and purity of this concept and how something so small, so unassuming, has the power to change everything. In this way, trust is like a spark, lighting all the beacons of the world.”

Keith Krach, Chairman of the Krach Institute for Tech Diplomacy at Purdue and former Under Secretary of the U.S. Department of State and CEO of DocuSign

“One of the features of the world today is the emergence of democratically elected populist leaders that, once in power, concentrate it, undermining checks and balances and corroding the very democratic foundations that anoint them. This volume offers a diverse set of perspectives on how to align freedom and prosperity as the determinants of the democratic equation.”

Vanessa Rubio-Márquez, Professor at the London School of Economics, and former Mexican Senator and Under Secretary of the Departments of Finance, Social Development, and Foreign Affairs

“This wide collection of essays demonstrates how true freedom and prosperity can only be achieved through policies that prioritize the empowerment of individuals and promotion of entrepreneurship, innovation, and inclusive growth. For Asia, freedom and prosperity are the two wings of a bird that can soar to greater heights, and we must nurture and protect both to ensure sustainable development and progress for all its people.”

Lakshmi Goyal, Chief Executive Officer, Center for Civil Society, India

The Freedom and Prosperity Equation

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FREEDOM AND
PROSPERITY CENTER

The Freedom and Prosperity Center aims to increase the well-being of people everywhere and especially that of the poor and marginalized in developing countries through unbiased, data-based research on the relationship between prosperity and economic, political, and legal freedoms, in support of sound policy choices.

The Center analyzes some of the defining questions of our time and of all time. Do countries need freedom to achieve prosperity? Do democracies or autocracies have the better answers to the aspirations of the peoples of the world? What about countries that are not electoral democracies in the Western sense, but have high levels of economic and legal freedoms and leaders who appear to enjoy a high level of legitimacy among their citizens?

Central to answering these questions are the Freedom and Prosperity Indexes. The indexes measure the freedom and prosperity, respectively, of nearly every country in the world.

This collection of essays is written and published in accordance with the Atlantic Council Policy on Intellectual Independence. The authors are solely responsible for their analysis and recommendations. The Atlantic Council and its donors do not determine, nor do they necessarily endorse or advocate for, any of the essays' conclusions.

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Foreword

The Atlantic Council Freedom and Prosperity Center has assembled a collection of essays that highlight examples of well-designed and technically sound public policies. This volume convincingly shows that greater freedom is the path toward durable development for countries around the world.

As a former minister of finance and chief of staff of the president of El Salvador, and as former managing director of the World Bank Group, responsible for Africa, the Middle East, East Asia and the Pacific, and Latin America, I have seen in over 110 countries what does and doesn't work in economic development.

When individuals can take destiny into their own hands, and when government guarantees economic freedom, the most creative solutions are unleashed, and the most complex problems are resolved.

My own country, El Salvador, in the twelve years that followed the 1992 Peace Accords, went from economic hardship to "investment grade" by way of greater freedom.

In the late 1970s and the 1980s, the final, bloody chapter of the Cold War was fought in El Salvador. With Nicaragua having already fallen into Communist hands, the Soviet Union used Cuban and other terrorist organizations to kill Salvadorans and destroy our economy. Their objective was to turn free citizens into slaves of a system that has always failed: socialism.

The violent communist assault on El Salvador halted and reversed the process of development: 45 percent of the population was left in extreme poverty and 50 percent did not have access to

public services. To obtain a telephone line took five years. The rate of unemployment and underemployment was above 40 percent.

A vast quantity of human talent fled the country during the war, never to return, leaving families separated and the economy crippled. The country struggled under high levels of public debt and corruption. The international community viewed post-war El Salvador as a shattered country with low growth and zero credibility.

But Salvadorans wanted a better future. Most importantly, we had faith that it could be achieved. Thanks to President Reagan, Pope John Paul II, and the resilience of our people, we had not fallen into Communist hands. After signing the Peace Accords, we rolled up our sleeves and started a process of profound reforms based on prioritizing economic freedom. We looked to Chile and Singapore as our examples.

Our comprehensive reforms transformed multiple sectors of the economy. We restructured, deregulated, and privatized banks, energy, telecoms, ports, and pensions. And to help bulletproof the reforms, promote macroeconomic stability, contain the rates of interest and inflation—and especially to remove from populist politicians the temptation of printing money at will—we formally and officially dollarized the economy.

At the heart of our reforms was a set of basic principles: (a) remove obstacles that prevent people from taking destiny into their own hands; (b) instead of providing handouts, promote opportunities; (c) an imperfect market is better than a perfect bureaucrat telling people what to do; (d) change the role of government from that of an orchestra conductor to that of a referee; and (e) maximize competition and minimize regulation.

These reforms allowed El Salvador, in a relatively short period of time, to reduce extreme poverty to less than 19 percent, unemployment and underemployment were cut by a half, access to public services reached close to 90 percent, and phone penetration

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soared to 150 percent. We cut debt, boosted economic growth, and our country, viewed in 1992 as a “hardship” case, was reclassified twelve years later as investment grade.

The success of El Salvador was based on our decision to pursue economic freedom. We did it with democracy. We did it transparently. We did it with the support of the public. Our results are clear. In 2000 and 2001, *The Index of Economic Freedom*, published by the *Wall Street Journal* and Heritage Foundation, ranked El Salvador ahead of our role model, Chile, and above Germany, Spain, and various other advanced economies.

The common thread between the Salvadoran experience and those compiled in this book is that the soundest path to prosperity is by way of greater economic freedom. The Atlantic Council Freedom and Prosperity Center presents the efforts of those who have made effective public policy possible, and the results are of extreme value for those embracing the challenge of changing their countries for the better.

It is with great pleasure that, at the request of Dan Negrea, I am able to contribute this foreword, knowing that this book will become a valued reference for professional reformers and economists, and, in general, for everyone interested in positive reforms in their own countries and around the world. For those who understand how effective reforms can transform people’s lives and livelihoods, this book is essential reading.

Juan José Daboub, PhD
February 2023

Introduction: The continuing debate about freedom and prosperity

Dan Negrea
Brad Lips
Kris Mauren

The freedom and prosperity debate at the end of the twentieth century

THE ESSAYS IN THIS BOOK address development economics questions that have been often asked over the centuries: Does freedom lead to prosperity or does the causation go the other way? Or, to use the words of Vanessa Rubio-Márquez in her essay, is prosperity the seed or the fruit of freedom? Or is there perhaps a virtuous cycle in which more freedom leads to a more prosperous society in which the citizenry demands yet more freedoms, and freedom and prosperity mutually reinforce each other?

The answers to the above questions have real-world implications because if more freedom leads to more prosperity, it behooves governments to adopt freedom policies if they care about the welfare of their citizens.

Dan Negrea is the senior director of the Freedom and Prosperity Center at the Atlantic Council.

Brad Lips is the CEO of Atlas Network.

Kris Mauren is the co-founder and president of Acton Institute.

At the end of the twentieth century, the debate appeared to have been settled. Two authoritarian models had been tried during that century in Europe and they had both failed spectacularly: fascism and communism. And the whole world saw it.

Mussolini and then Hitler had introduced state-directed public works and other economic policies to increase economic growth and employment during the Great Depression. But their unchecked absolute power ultimately led to the Second World War, horrendous crimes against humanity, millions of deaths, and the violent end of their regimes. The allure of fascism was gone after that, and no new fascist regimes were formed in Europe following the Second World War.

The Communist Party of the Soviet Union assumed power through the 1917 revolution and later imposed Communism by force in the Eastern European countries it had occupied after the Second World War. Communist parties in several countries on other continents also assumed power after the Second World War, most notably in China, North Korea, North Vietnam, and Cuba.

The Soviet Union achieved many impressive successes: it transformed Russia from an agrarian country to an industrial one; eradicated illiteracy and created a successful higher education system; and established a health system that was an improvement over the tsarist one. The Soviet Union also achieved stunning successes in science: it launched into space the first satellite, the first man, and the first woman; became a leading nuclear power for both civilian and military purposes; and developed a world-class aeronautic and military technology industry.

But these successes came at a grievous price in human suffering. Millions of people were murdered in Stalin's purges and thousands in the Soviet Union's military interventions in Hungary in 1956, Czechoslovakia in 1968, and Afghanistan in 1979.

And these successes were also limited: industrialization is not the same as development. The Soviet Union's industrialization

emphasized heavy industries and de-emphasized consumer products, leaving its citizens disappointed in their aspirations of a more comfortable life.

The story was similar in the other European Communist countries: many initial successes in industrialization, education, and health came at the price of great suffering under authoritarian regimes that imprisoned and killed political opponents and allowed no freedom of religion or expression.

After a few decades, economic growth in the Soviet Union and the Communist European countries plateaued. The plans of these authoritarian regimes to have their countries catching up to the level of development of the free Western European countries proved to be unattainable dreams. There were multiple causes for this economic failure, but one stands out: these oppressive regimes and their centrally planned economies in which the state owned all the means of production were not conducive to efficient investment, did not incentivize people to innovate, and did not create wealth or lead to increased productivity.

The Soviet Union failed economically before it also failed politically and militarily. The inability of these Communist regimes to offer increased prosperity to their peoples, especially when compared to the living standards in the United States and Western Europe, was plain for all to see. Even those in the repressive apparatus stopped supporting these regimes and all European Communist regimes collapsed.

The fall of the European Communist regimes started with Poland in 1989 and ended with the dissolution of the Soviet Union in 1991. When people in these countries were subsequently allowed to vote freely, they did not vote a Communist party into power in any of these countries. Most of the former Communist European countries have since made the profound democratic and free-market reforms required to become candidates for membership of the European Union, and many have been accepted.

Not only Communist authoritarianism but authoritarianism in general has been discredited in the former European Soviet bloc countries, except for Russia and Belarus. All the other European post-Communist countries have chosen democracy and free markets, albeit with varying levels of success.

Seen from the vantage point of the end of the twentieth century, even the People's Republic of China (PRC) seemed to be moving away from its Communist governance model. The Chinese Communist Party (CCP) led by Mao had assumed power in 1949 and Mao maintained absolute power in a cult-of-personality regime until his death in 1976. He practically closed China to most of the rest of the world and led it according to strict Marxist-Leninist principles: there was no private ownership of the means of production, the economy was centrally planned, and there was no political, religious, or personal freedom for citizens. Between 1952 and 1978, China started industrializing and expanding education and healthcare, and real annual GDP growth was about 6 percent.¹ But Mao's personal dictatorship caused political turmoil, economic mismanagement, and harsh oppression of political dissent, whether real or imagined. During this period tens of millions of people died in prisons and labor camps, through executions, and from starvation directly linked to Mao's policies.

One of history's darkest chapters was then followed by one its most astounding success stories. Under Deng Xiaoping, local markets were allowed to emerge, and then reforms were put in place to open China to the world. The role of the CCP in economic planning was reduced, elements of free markets and private ownership were introduced, and term limits and other limitations on politicians' power were put into place. The result: between 1980 and 2020, real annual GDP growth was almost 10 percent.² In the positive environment created by the free-market reforms, the PRC was becoming a major global industrial power and was also achieving successes in science and technology.

As shown in a study by the PRC and the World Bank, between 1980 and 2020, the number of people in China with incomes below US\$1.90 per day—the World Bank’s defining line for global extreme poverty—has fallen by almost 800 million.³

At the end of the twentieth century the verdict seemed to be very clear: authoritarianism had been definitively discredited in Europe—no country was following its path on that continent. The same seemed to be true even outside Europe: Communist China, the largest authoritarian country in the world, appeared to be moving toward free markets and more political freedom.

The spirit of the times was captured in 1992 by Francis Fukuyama in his highly influential book *The End of History and the Last Man*: liberal democracy had triumphed in its ideological struggle with Communism and had “emerged as the final form of human government.”⁴

The freedom and prosperity debate today— the China development model

But the debate is not over. The CCP is now offering its current development strategy as a model for developing countries anywhere in the world.

The example of China was followed by several Asian economies, most notably Vietnam. Vietnam’s leaders too have attempted to develop a quasi-market economy, opened to international trade while maintaining a strict one-party system of political governance. Vietnam’s poverty-reduction story is compelling, with progress in social indicators like education and children’s health rivaling those of upper-middle-income countries.

A number of countries in Central Asia, South Asia, and Africa that had followed the Soviet model to some extent—for example Ethiopia, Ghana, Guinea, Kazakhstan, Senegal, Sri Lanka, and

Tanzania—looked at parts of the China model as worthy of consideration. China encouraged such potential followers through the One Belt One Road (OBOR) initiative, which finances projects in resource-rich economies. At its peak before the COVID-19 pandemic, OBOR investment proposals totaled US\$150 billion—more than the combined official development assistance provided by advanced democracies.

The China development path had a dual appeal: First, financial resources seemed available outside the Washington consensus network of international development institutions and their conditionalities. Second, it promised a faster way to prosperity.

Xi Jinping became the leader of the CCP in 2013 and has since reversed many of the reforms inspired by Deng Xiaoping. In the political sphere, collective leadership at the top of the CCP has been replaced by Xi's absolute power and a personality cult resembling that of Mao; high-tech government surveillance of citizens is becoming ubiquitous; and the CCP has waged a brutal and widespread oppression of China's Uighur minority.

In the economic sphere, the Xi era has seen an increase in the control of the CCP in the economy and a preference for state-owned enterprises over private ones. International economic relations have suffered because of sharp practices sanctioned by the Chinese authorities, such as forced transfer of intellectual property and preferential treatment for Chinese companies over foreign ones doing business in the PRC. The country has also attracted international criticism for the extensive damage it is causing to the environment as a price for its economic growth.

Xi Jinping has been clear that he opposes a development model based on political freedom and free markets, and that he favors the PRC's authoritarian model based on the leadership role of the CCP. In a February 7, 2023 speech, President Xi rejected the idea that "modernization means Westernization." He touted China's "new modernization model" that is "different from the

West” and that “expands path choices for developing countries.” He made clear that the leadership role of the CCP is key and that the CCP will decide the “ultimate success or failure” of China’s effort to develop.

President Biden is keenly aware of the reopening of the debate and considers this an important matter. In his February 2021 address to the Munich Security Conference he noted:

We are in the midst of a fundamental debate about the future and direction of our world. We’re at an inflection point between those who argue that, given all the challenges we face – from the fourth industrial revolution to a global pandemic – that autocracy is the best way forward . . . and those who understand that democracy is essential – essential to meeting those challenges.⁵

President Biden sees this as the defining issue of our time: “It is clear, absolutely clear . . . this is a battle between the utility of democracies in the 21st century and autocracies,” Biden said. “That’s what’s at stake here. We’ve got to prove democracy works.”⁶

In December 2021, President Biden hosted a Summit for Democracy, attended by over 100 countries. Notably, the PRC was not invited. In his opening remarks he noted that the world’s complex challenges are exacerbated by autocrats that “seek to advance their own power, export and advance their influence around the world, and justify their repressive policies and practices as a more efficient way to address today’s challenges.” But, he added, “History and common sense tell us that liberty, opportunity, and justice thrive in a democracy, not in an autocracy.”

Quantitative evaluation of the Chinese development model

How can we evaluate the performance of the PRC in increasing the freedom and prosperity of their people relative to other countries?

One way is to use the Atlantic Council's Freedom and Prosperity Indexes of 164 countries. The Freedom Index takes a broad view of freedom, measured through sub-indexes of economic, political, and legal freedom. This approach allows a separate exploration of the effect of each of these freedoms on prosperity. The Legal Freedom sub-index measures the strength of key institutions on which the other two freedoms depend; it ascertains, for example, if the government and judiciary are effective and free of corruption.

The Prosperity Index also takes a comprehensive view. It measures not just the GDP per capita of a country, but also its performance on several other criteria such as health, education, the environment, inequality, and the treatment of minorities.

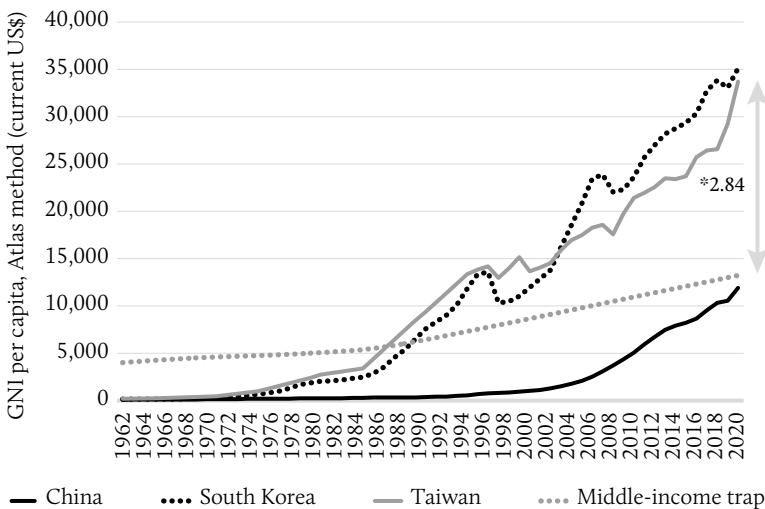
We thought it edifying to compare the performance of the PRC against that of Taiwan and South Korea, two other highly successful Asian countries that were at a development level comparable to that of the PRC at the end of the Second World War, and against that of the developed countries belonging to the Organisation for Economic Co-operation and Development (OECD). The OECD average only includes data for the 1995 member countries: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Mexico, Portugal, Spain, Turkey, Sweden, Switzerland, USA, UK.

At the end of the Second World War, China, South Korea, and Taiwan were all poor. In 1962, the gross national income (GNI) per capita for the PRC, South Korea, and Taiwan was \$70, \$120, and \$163 respectively. But their political and economic paths were different. From the end of the Second World War to the early 1990s they were all autocracies: the PRC was a dictatorship of the CCP,

while Taiwan and South Korea were military dictatorships. But in the early 1990s, both Taiwan and South Korea became democracies, while the PRC did not change.

Figure 1 has a narrow focus and explores just the relative performance of the GNI per capita for these three countries. It shows that the PRC, South Korea, and Taiwan had a similarly low starting point in 1962. The two countries that had free markets at the beginning of this period and maintained it, and also chose democracy in the early 1990s, grew much faster than the PRC. By the early 1990s, South Korea and Taiwan had escaped the “middle-income trap”: they had crossed the World Bank’s threshold between middle-income and high-income countries. The PRC remained below this threshold in 2020.

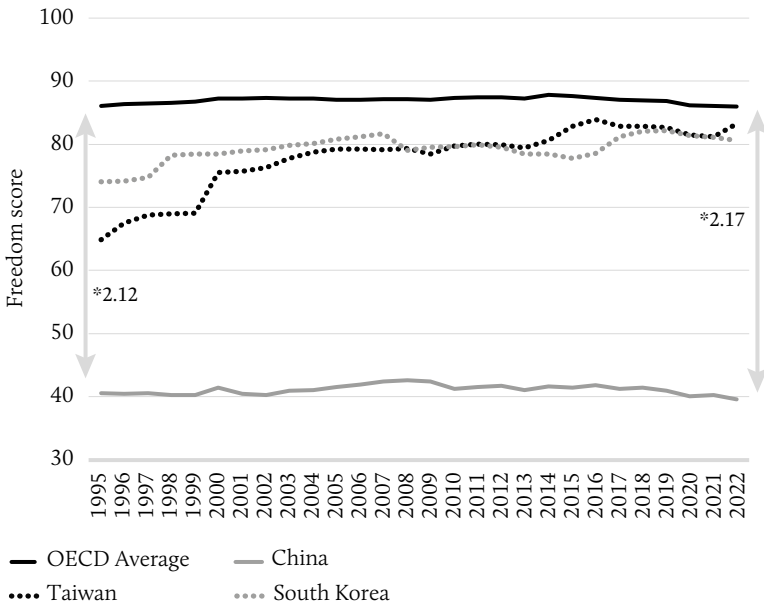
Figure 1. Comparison of GNI per capita in China, South Korea, and Taiwan, 1962–2020



Source: “GNI Per Capita, Atlas Method (Current US\$),” World Bank, <https://data.worldbank.org/indicator/NY.GNP.PCAP.CD>; National Statistics, Republic of China (Taiwan), <https://eng.stat.gov.tw>.

Figure 2 explores the PRC’s relative performance over time in the Atlantic Council’s Freedom Index—which measures economic, political, and legal freedom—from 1995 to 2022. In 1995, the PRC’s freedom score was less than half that of the OECD average. Over this period, the OECD freedom score remained stable and the PRC score decreased by more than 2 percent. The ratio between the two remained just as large at the end of the period. But South Korea increased its freedom score by 9 percent over this period and improved its relative ratio from 1.16 to 1.07. Taiwan’s freedom score increased by 28 percent and its relative ratio improved from 1.33 to 1.03.

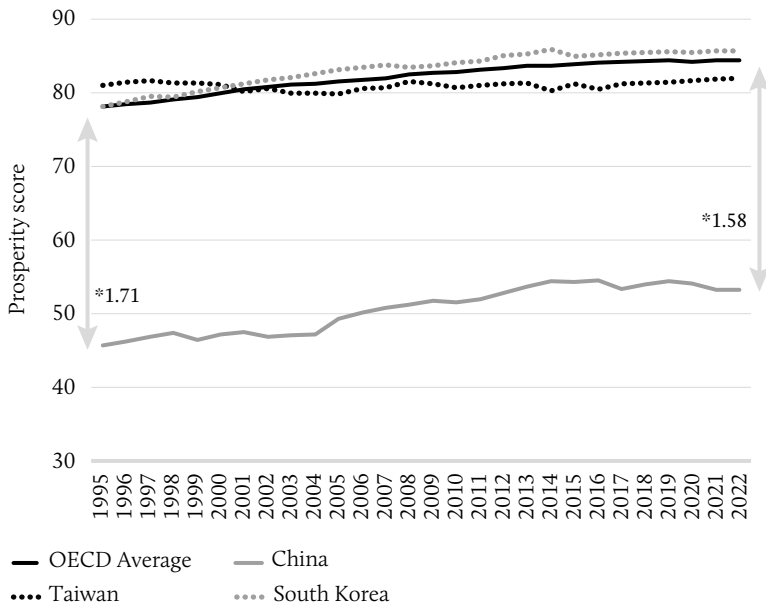
Figure 2. Comparison of freedom scores for OECD, China, South Korea, and Taiwan, 1995–2022



Source: Atlantic Council Freedom and Prosperity Indexes.

Figure 3 explores the PRC’s relative performance in the Prosperity Index. The PRC started behind the OECD in 1995, increased its score by 16 percent, and closed the ratio-gap somewhat, from 1.71 to 1.58. South Korea started very close to the OECD score and exceeded it by the end of the period, increasing its score by 10 percent. Taiwan already outperformed the OECD on prosperity in 1995 and increased its score by another 1 percent over the period. The OECD countries improved by 8 percent.

Figure 3. Comparison of prosperity scores for OECD, China, South Korea, and Taiwan, 1995–2022



Source: Atlantic Council Freedom and Prosperity Indexes.

The discussion above is not meant to minimize the successes of the Chinese Communist Party in leading the development of the People’s Republic of China. Just like the Soviet Union decades

earlier, the PRC has been transformed from a poor and backward country to one of the most consequential countries of the world due to its industrialization and progress in many other aspects of its society. Its rapid economic development and accomplishments in education, science, and healthcare are undeniable.

But it is very important to note that this has been achieved in the context of an authoritarian regime that denies basic freedoms to its citizens and deals harshly with dissent. One of the questions this raises is whether the repression and suffering were a price worth paying for the rapid economic growth and if this was the only way to achieve development.

Taiwan and South Korea show that neighboring countries—from a comparable level of development sixty years ago—were able to achieve more economic growth than the PRC over that period. Both Taiwan and South Korea ensured relative economic freedom throughout those years, combining this with political freedom for the latter thirty.

A related key question is whether the PRC's economic success is durable. This question is certainly relevant in light of the recent reversal of the freedom reforms of the 1980s that caused the PRC's 10 percent growth. The PRC's growth is currently at 5 percent and trending downward.

Can the innovation and entrepreneurship needed for economic growth blossom in an authoritarian regime? There are very few examples of countries with both advanced economies and authoritarian regimes for extended periods of time. Singapore, with a population of just 5.5 million, is perhaps the most prominent outlier. It blossomed under the leadership of Lee Kuan Yew for thirty-one years as prime minister and for another twenty-one in which he served as a cabinet minister. The two prime ministers that followed him were also effective.

But there is no guarantee that a system without effective checks and balances will continue to produce good leaders.

Democracy, despite all its imperfections, has proven itself the form of government that is best at producing good leaders and removing bad leaders, and thereby leading to durable prosperity.

This volume's reflections on freedom and prosperity

The question of whether people should live in freedom or not deserves careful study given the enormous consequences it has for history and human well-being. The aim of this book is to offer essays on various aspects of the relationship between freedom and prosperity and how they can be achieved.

In his foreword, **Juan José Daboub** reflects on his experience as a former minister of finance and chief of staff to the president of El Salvador, and as former managing director of the World Bank Group. He recalls El Salvador's impressive economic gains after it adopted free-market reforms in the late 1990s. The author argues that an imperfect market will always be better than a perfect bureaucrat telling people what to do. To achieve freedom, the role of government should be that of a referee that maximizes competition and minimizes regulation.

Some of the essays examine theoretical questions.

In chapter 1, **Ignacio P. Campomanes** points out that democracy can (and should) be defended on ethical and moral grounds, as the system that best upholds the dignity of every citizen, but that the case for democracy can be strengthened significantly if we can rigorously show that free societies are also superior to autocracies in producing higher overall prosperity. He posits that, in order to make progress in the empirical assessment of the freedom-prosperity relationship, we need to dig deeper into the constitutive attributes of free societies. In his essay, he assesses the theoretical soundness of the analytical framework proposed by the Atlantic Council's Freedom and Prosperity

Indexes that measure separately economic, political, and legal freedom, and provides preliminary evidence of the empirical relevance of this division.

In chapter 2, **Markus Jaeger** argues that historically oriented, qualitative studies can help shed light on the often complex and complicated interactions among structural factors (e.g., geography, demographics), institutions (e.g., political freedom, free markets), and policies and their contribution to successful economic development. He points out that free societies and market-based economic systems are important factors underpinning productivity and prosperity, particularly once countries reach middle- and high-income levels.

In chapter 3, **Michael Klein** explores the various mechanisms that drive development. He discusses how societies need freedom to prosper, while firms and markets need cooperation to reach their full potential. Finding the right balance between freedom and cooperation is not always easy, and the author talks about finding a “good mix” of rules, discretionary power, and freedom.

In chapter 4, **Vladimir Fernandes Maciel, Ulisses Monteiro Ruiz de Gamboa, Paulo Rogério Scarano, and Julian Alexienco Portillo** examine the relationship between freedom and prosperity around the world by using the Freedom and Prosperity Indexes and a neo-institutionalist analysis approach. They find a symbiosis between freedom and prosperity: a virtuous cycle (higher levels of freedom and prosperity lead to more freedom and prosperity) and a vicious cycle (lower levels of freedom and prosperity lead to less freedom and prosperity), with these cycles tending to reinforce each other.

In chapter 5, **Jamie Bologna Pavlik, Benjamin Powell, and Andrew Young** provide evidence that economic freedom not only correlates with prosperity, but that it is also an important predictor of prosperity. The authors apply the Mahalanobis Distance

Matching method to the Atlantic Council's Economic Freedom sub-index to analyze the causal statistical relationships between improvements in economic freedom and subsequent prosperity. The researchers find that meaningful increases in economic freedom led to large increases in GDP per capita over a five-year time horizon, supporting Adam Smith's assertion that increased economic freedom is an essential precondition for greater prosperity.

In chapter 6, **Luis Ravina Bohórquez** discusses the role of elites in a country's prosperity and development. He defines elites to include politicians, government officials, and other people with influence in civil and economic circles. He argues that the elites have a responsibility to foster strong institutions and government policies, including those that prevent nepotism and corruption. Bohórquez highlights the role elites played in Kenya in promoting investment in good education and how education helped the country's development.

In chapter 7, **Elakiya Ananthakrishnan** looks at the impact of the informal economy on countries' overall prosperity. She also reviews the main reasons leading citizens to conduct business outside of regulated markets, especially the avoidance of taxes and social security contributions. Other reasons include escaping government bureaucracy or regulatory burdens, and bypassing corruption, all of which relate to inefficient public institutions and weak rule of law.

In chapter 8, **Julio Amador Díaz López** looks at innovation and misinformation as they relate to economic development. He argues that the Western system—characterized by risk taking, a diverse population, and less restrictive policies—is better suited for promoting innovation than the authoritarian model, which is more restrictive and risk averse. Protecting rule of law, free markets, and diversity of people and ideas remain essential to harnessing new technologies—the key to prosperity in our time.

Other essays offer reflections focused on certain countries and regions.

In chapter 9, **Khémaies Jhinaoui** examines the ongoing struggle for freedom and prosperity in the Middle East and North Africa region. The author argues that the lack of realism and the inexperience of the region's regimes hindered social progress following the Arab Spring. The author suggests three lessons: that the quest for freedom does not have to be radical; that gradual reform is more effective; and that foreign influence shapes the pace and intensity of the struggle for freedom and prosperity in the region.

In chapter 10, **Mohamed M. Farid** examines Egypt's development over the last fifteen years and the effects of extensive government intervention in the economy. Farid argues that to increase prosperity, Egypt must reduce the role of the state in the economy, implement free-market reforms, and focus public investments in human capital.

In chapter 11, **Sergio M. Alcocer and Jeziret S. González** examine the decrease in press freedom in Mexico and how this might result in less prosperity. The authors review current Mexican policies to protect journalists and they recommend improvements. They argue that prosperity cannot be achieved without freedom of the press.

In chapter 12, **Vanessa Rubio-Márquez** investigates the use of the Freedom and Prosperity Indexes in real-life policy debates and policy making. The author finds the Indexes useful in identifying the factors which make a country free and prosperous, and in providing benchmarks for comparisons with other countries. But she also calls for alertness to signs of freedom retrenchment and institutional deterioration not yet captured by the Indexes.

In chapter 13, **Prashant Narang and Parth J. Shah** examine India's current economic situation and its rankings on the Freedom and Prosperity Indexes. To identify areas where India can

improve, the authors compare its performance to the global averages, to that of countries in the same income category, and to the South Asia regional averages. They also identify improvement opportunities for India.

In chapter 14, **Clara Volintiru, Camelia Crişan, and George Ştefan** assert that achieving long-term prosperity and stability in Eastern and Central Europe requires strategic engagement by Western allies. The authors argue that economic resilience is crucial to Eastern Europe's security strategy and propose three overlapping lines of effort: increasing European integration; transitioning to a new economic model; and engaging all societal actors in the pursuit of sustainable and shared prosperity.

In chapter 15, **Danladi Verheijen** explores the government's role in assuring economic and legal freedoms in Nigeria. The author suggests that the Nigerian government should be less involved in the economy and more involved in providing security.

In chapter 16, **Dan Negrea, Joseph Lemoine, and Yomna Gaafar** investigate freedom and prosperity trends in a group of Eastern European countries since the early 1990s. Using the scoring and rankings of the Freedom and Prosperity Indexes, the authors find that countries that instituted more political, economic, and legal freedoms since the 1990s enjoy greater prosperity today.

We hope that the essays in this book will be a useful tool for those promoting improvements in freedom and prosperity around the world.

PART I

Theoretical reflections
on freedom and prosperity

Dimensions of freedom and economic performance

Ignacio P. Campomanes

FRANCIS FUKUYAMA PROPOSED HIS HYPOTHESIS of an “end of history” more than thirty years ago. He argued in 1989 that, with the imminent collapse of the Soviet bloc, humanity had reached “the end point of mankind’s ideological evolution and the universalization of Western liberal democracy as the final form of human government.”¹ The “third wave” of democratization appeared to vindicate Fukuyama’s argument by the end of the twentieth century. Today, however, it is by no means clear that liberal democracy is the only game in town. The number of democracies in the world has stagnated in the last two decades, and many of the countries labeled as such are experiencing clear regressions.² Probably more worrisome, global opinion surveys show decreasing confidence in democratic institutions among the general public.³ This tendency is not only visible in developing nations, but also in the United States and Europe, the very birthplaces of modern democracy.

Democracy can (and should) be defended on ethical and moral grounds, as the system that best upholds the dignity of every citizen, based on the principles of individual freedom, equality, fairness, and justice. Nonetheless, what is in question today is not this intrinsic value of democratic institutions, but the capacity

Ignacio Campomanes is resident fellow of the Navarra Center for International Development at the Institute for Culture and Society at the University of Navarra.

of free societies to produce sustained improvements in material well-being and overall prosperity for all. It is thus as pressing as ever to deepen our understanding of the relationship between political regimes and economic outcomes, and the mechanisms through which democracy can truly deliver. To strengthen the case for liberal democracy we must therefore look at its consequences, especially in terms of economic development and growth.

Economists have worked on this task at least since Barro (1996).⁴ However, they have not yet reached a consensus regarding the effect of democratization on subsequent growth.⁵ Very recent and thoughtful studies disagree on the most basic conclusion. As an example, Acemoglu et al. conclude that democratization increases GDP per capita by 20 percent in the subsequent twenty-five years, compared to non-democracies.⁶ Instead, Coricelli et al. find that economic growth in democracies and autocracies is similar, while a third group of hybrid regimes perform significantly worse, generating a U-shaped relationship between political regimes and economic performance.⁷ There are different potential shortcomings of the literature that could explain the conflicting results, from measurement error to other technical econometric problems, such as omitted variable bias, unmodeled country-specific characteristics, reverse causality, and so on. All of these are relevant, but this essay will focus on a prior, foundational issue—one which is often overlooked by the empirical economics literature: the conceptualization of the variables of interest (i.e., freedom and democracy).

Previous works on the effect of democracy on growth have mostly used readily available composite indexes of democratic institutions without paying much attention to the underlying definitions embedded in them, which can vary widely.⁸ This is evident when we compare the two indexes most often used in the literature, produced by the Polity Project⁹ and Freedom House.¹⁰ The former is narrower, and focused tightly on two aspects of democracy:

the electoral component and the constraints on the executive. The latter takes a broad view of democracy, giving a dominant weighting (60 percent of the index) to individual liberties such as freedom of religion, freedom of movement, secure property rights, and so on, all of which are absent from the Polity Index. The obvious contrast between the different measurements of democratic institutions used in analyses of the democracy-growth relationship not only casts doubts on the comparability of the different studies, (which could partly explain the inconclusive results), but also clearly points to a lack of rigorous assessment of which specific aspects of democracy matter for economic growth, and through what channels.

This paper seeks to emphasize that, in order to adequately measure *how much* liberal democracy affects growth, it is of crucial importance to first clearly define *what it is*. As the great political scientist Giovanni Sartori pointed out more than fifty years ago, “concept formation stands prior to quantification”¹¹ and, we could add, both necessarily precede the assessment of the effects on other aspects of reality (economic or any other). I am by no means claiming that the endeavor of defining, conceptualizing, and identifying the necessary attributes of democracy has not been pursued before. Such a claim would obviate a whole field of political theory and philosophy going back to Plato and Aristotle! To the contrary, the suggestion of this essay is that in order to make progress on the quantification of the economic effects of liberal democracy, we need to take full stock of those theoretical investigations and open the black box of democracy, clearly linking its building blocks to sources and mechanisms that affect economic development. Thus, this essay aims to pick up the gauntlet proposed by Acemoglu et al. to study “*how* democracy alters economic incentives and organizations and *to pinpoint what aspects* of democratic institutions are more conducive to economic success,”¹² (emphasis added).

When we think about free and democratic societies, we have in mind much more than just countries in which government officials are appointed by some kind of electoral mechanism. We implicitly include neighboring concepts such as the rule of law, separation of powers, or a battery of individual rights (political, civil, economic, etc.). The interconnection of these concepts is clear, but the boundaries between them are fuzzy, and the definitions often overlap. It is not straightforward to decide how different aspects of free societies should be delineated, which attributes are necessary, or how the different pieces interact.

The Freedom Index, proposed recently by the Atlantic Council's Freedom and Prosperity Center (FPC), constitutes an appealing contribution to the debate. The Index is constructed around a comprehensive view of freedom, which tries to capture all the different ingredients that make up a free society. In particular, the Index is built out of three separate components: legal, economic, and political freedom (with legal freedom roughly analogous to the rule of law). Each of the three components is further divided into several sub-components, but this essay will only deal with the three primary components. The rationale for considering three separate components of freedom is that not all democracies are the same—and neither are all autocracies alike. By disaggregating freedom in this way, and analyzing separately these three dimensions of freedom, we may better capture the mechanisms through which different attributes of the institutional architecture of a country affect its economic performance.

The FPC proposal generates two preliminary questions: (a) Are the proposed components of freedom theoretically well-grounded?; and if so: (b) Are they empirically relevant? This essay tries to answer the first by reviewing the definitions offered in the academic literature on the rule of law, democracy, and economic freedom, before sketching a framework to jointly think about all three concepts. Regarding the second question, we go on

to provide a first test of the empirical relevance of the proposed structure by analyzing the situation of suitable empirical counterparts for the three concepts, considering today's situation among developing nations. Finally, we conclude by presenting some research ideas to deepen our understanding of the link between the institutions of free societies and economic development.

A review of conceptualizations

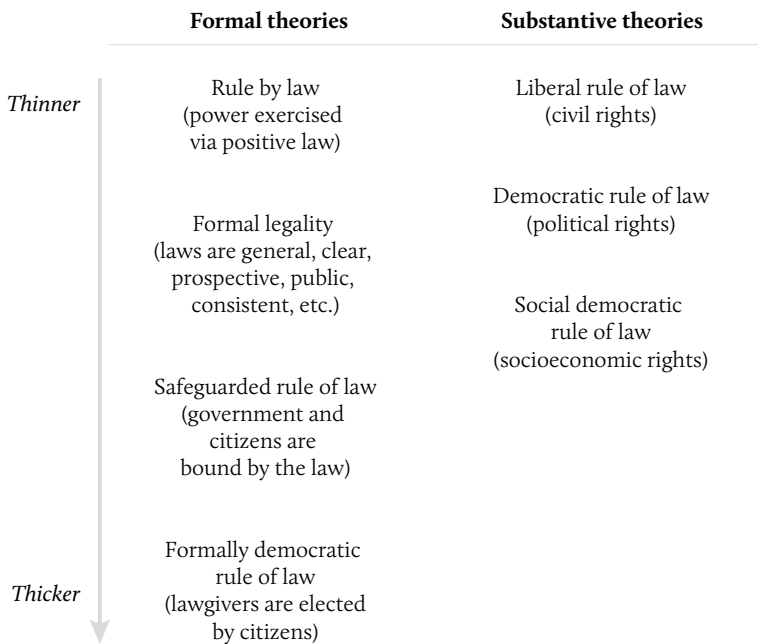
Legal scholars, political scientists, and economists have proposed a variety of definitions for each of our concepts of interest: democracy, rule of law, and economic freedom. The common notion of “essentially contested concepts” certainly applies to all three. In general, it is possible to start from a minimalist (narrow or “thin”) definition of each concept, which we gradually extend with additional attributes until we arrive at a maximalist (broad or “thick”) description. As we will see, more extensive definitions of one concept are likely to overlap with one or both of the other two. In the following sub-sections, I briefly review the most relevant conceptualizations of the three dimensions of freedom.

Rule of law

The rule of law is a political ideal about the legal system, and thus about the laws and their characteristics. A standard approach to systematizing different conceptions of the rule of law is to differentiate between formal requirements that the laws must possess, and characteristics that deal with the specific content of those laws. This distinction gives rise to what are usually labeled as “formal” and “substantive” formulations of the rule of law. Even within these two traditions, a variety of conceptualizations has been proposed in the literature, depending on the attributes required by different authors, in considering whether

a legal system abides by the rule of law. Following Tamanaha¹³ and Møller and Skaaning,¹⁴ Figure 1 depicts a schematic hierarchy of rule-of-law conceptualizations. As we move down each column, additional attributes are included in the concept and the definition becomes thicker.

Figure 1. Rule of law conceptualizations



Notes: Based on similar figures from Brian Z. Tamanaha, *On the Rule of Law: History, Politics, Theory* (Cambridge: Cambridge University Press, 2004); and Jørgen Møller and Svend-Erik Skaaning, “Systematizing Thin and Thick Conceptions of the Rule of Law,” *Justice System Journal* 33, no. 2 (2012), 136–53.

Starting with formal theories (left), a minimalist definition of rule of law only imposes that the exercise of power by the state is carried out via positive legal norms. That is, as long as all actions of government officials are authorized by law, we could say such

a state fulfils the requirements of the rule of law. The literature has tended to denote such a situation as mere *rule by law*, and pointed to an obvious flaw which makes it virtually useless: almost any state in the world today operates, at least *de jure*, through legal norms and decrees. A thicker version of the rule of law imposes certain formal criteria on the laws, which pivot around the idea of “universalizability.” This characterization of rule of law, usually denoted as “formal legality”, requires that government laws are general, publicly promulgated, non-retroactive, clear, consistent, and relatively stable. Similar lists of formal standards can be found in a variety of authors, especially prominent legal scholars such as Fuller,¹⁵ Raz,¹⁶ or Finnis.¹⁷ These necessary formal traits are required for laws to serve their basic function: to guide behavior of those subject to them. Intuitively, it is not possible for individuals to abide by the law if it is not public, or contradicts another norm, or is unintelligible, etc.

Now, a clear question emerges: Should laws bind only regular citizens, or also the government and its officials? This is a crucial element that not every author has solved successfully. Hobbes, in *Leviathan*, argues that the sovereign is not bound by the laws he himself promulgates, as “he that is bound to himself only is not bound.”¹⁸ The classical liberal solution of philosophers such as Montesquieu and the US Founding Fathers is to break up “the sovereign” into different branches, in particular separating the judicial arm of the state from the executive power, allowing the former to guarantee that the actions of the latter comply with the established law. The contemporary legal theorists named above agree that for a political system to fulfil the rule of law, the government and state apparatus should be subject to the legal system, and include conditions to ensure this is the case. Raz further stipulates that, for a state to be considered as following the rule of law, it must guarantee an independent judiciary with review powers, and prevent the discretion of crime-preventing agencies from

perverting the law. Fuller and Finnis reach a similar conclusion to Raz, requiring that government actions are congruent with declared rules, and public officials are responsible and accountable for compliance with the laws. Tamanaha¹⁹ gives a very simple and intuitive definition that synthesizes what Figure 1 denotes as “safeguarded rule of law.” He states that “the rule of law means that citizens and government officials are bound and abide by the law.”

The last attribute included in the formal theories of Figure 1 deals with the source of rules, that is, how rules are created, and by whom. This democratic requirement is rather different to the attributes discussed above—which all deal with general characteristics of the law—and thus does not seem to fit perfectly within formal definitions of rule of law. The addition to those definitions of a democratic source of the law only makes sense if we understand democracy in purely procedural terms; that is, something in line with the minimalist definition of democracy given by Schumpeter as a *modus procedendi*, by which lawgivers and government agents who apply those laws are selected “by means of a competitive struggle for people’s vote.”²⁰

The right column of Figure 1 summarizes substantive versions of the rule of law. They differ in the specific content that they require for a legal system to fulfil the ideal of rule of law. That is, these versions add to formal versions some necessary substantive content related to the recognition of individual or collective rights. Bingham is a clear exponent of this conception,²¹ but we could also include legal theorists such as Dworkin or Hart. The thinnest substantive version of rule of law would include fundamental human rights, especially those related to the judicial process. In a second step, negative liberal rights are added. These are individual civil rights, clearly envisioned to limit the scope of governmental action, generating a sphere of autonomy for the individual, free from state intervention. While liberal rights—such as freedom of expression, movement, religious freedom—are uncontroversial, others might

not be accepted by all. A clear case is that of private property rights. Some classical liberal philosophers such as Locke, and recent legal scholars such as Ronald Cass, would argue that property rights are inalienable individual rights equivalent to the others mentioned above, inextricably linking the rule of law with the legal definition and protection of property rights.

Those favoring the thicker substantive version of the rule of law, which includes socioeconomic positive rights, would certainly disagree. Second-generation rights, as they are sometimes called, would constitute an additional bundle of individual freedoms that would be required in even thicker conceptions of the rule of law. These are rights intimately linked to the democratic political process, such as freedom of association, demonstration, and active and passive suffrage. For this reason, some authors see the electoral component as part of this version of rule of law, and not as the last attribute of formal conceptualizations. In any case, it is clear by now how substantive thick conceptions of the rule of law begin to overlap with the neighboring concept of democracy. The thickest version of the idea of rule of law includes socioeconomic rights.

Third-generation rights are fundamentally different from those mentioned above. These are positive social rights which do not force the political power to abstain from intervention. To the contrary, socioeconomic rights typically compel the government to actively provide individuals with certain basic needs such as education, a social safety net, healthcare, etc. A clear issue arises when trying to organize the different sets of rights to come up with a hierarchical order of substantive versions of the rule of law. A particular problem is whether individual civil liberties should be placed before or after political rights. If we look at the historical political development of the Western world, we would favor the order presented in Figure 1, where the recognition of civil rights precedes political rights. Instead, in many developing

countries today it would seem that political rights are more generally operative than individual freedoms. This is also in line with the systematic review of the concept of democracy, to which I turn in the following section.

Democracy

The electoral component is at the core of any definition of democracy. A basic democratic requisite is that those holding political power have been appointed by citizens through some kind of voting mechanism. It is the ideal of “self-rule” or “rule by the people,” that generates a continuing responsiveness of the government to the preferences of its citizens.²² It is not only those who *apply* the law that are elected by citizens, but also those who *make* the law. Thus, the source of law is the sovereignty of the people, introducing an element of consent on the legal system and for the exercise of power, absent from autocratic systems.

Now, this is the democratic ideal. In real modern societies, what attributes are necessary if we are to label a country as democratic? As would be expected, there is no clear consensus among political scientists and philosophers. The task of organizing the different conceptions might be easier than with the concept of rule of law, because in the case of democracy the hierarchical ladder of abstraction has a clear starting point (the electoral core), and more extensive definitions require the addition of attributes that better guarantee the effectiveness of that core. Thus, the controversy among scholars is about where to draw the line to consider a given system as democratic, rather than on the categorized order of types.

A minimalist definition of democracy focused on electoral principle is given by Schumpeter, as “the institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people’s vote.”²³ The crucial aspect of this definition

is competition, the fact that different groups are allowed to enter a contest to gain people's support. Schumpeter does not require that such a contest be fully free, fair, and inclusive, in the sense that all citizens (or a large majority of them) are allowed to participate and freely express their preferences. The definition imposes some degree of competition for political support, and thus even electoral systems with moderate defects could be categorized as democracies. More demanding conditions on the electoral core—in terms of freer and relatively inclusive elections—situate us closer to the definitions of democracy of authors like Przeworski²⁴ or Vanhannen.²⁵ These definitions are still mainly procedural, and do not involve any systematic protection of individual rights besides a relatively ample suffrage. In particular, rights such as freedom of assembly or freedom of speech—rights that directly favor practical electoral competition—are not specifically protected. Intuitively, democracy is understood as “a system in which governments lose elections.”²⁶ A system of general, free, and fair elections, that is decisive in the choice of political leaders but lacks an adequate protection and respect for individual rights, has been denoted as “electoral democracy”²⁷ or “illiberal democracy.”²⁸

Thicker definitions of democracy add individual rights and guarantees to the electoral core described above. We can think of individual rights as serving two purposes in relation to democracy. On one hand, political rights significantly improve the electoral mechanism and thus the identification of those in power and the policies they enact with the population they govern. On the other, civil or liberal rights serve as a limit to the majority principle embedded in the democratic process. Including different sets of these rights generates the two thicker conceptualizations of democracy generally referred to in the literature. Probably the most widely accepted definition of democracy is that of Robert Dahl.²⁹ If governments are to be responsive to their peoples, Dahl argues, then citizens must have effective opportunities to formulate, signify,

and have those preferences weighted equally. In Dahl's view, such opportunities not only require free and fair elections but a series of guarantees in the form of individual political liberties. In particular, he enumerates eight guaranteed liberties: (1) freedom to form and join organizations, (2) freedom of expression, (3) right to vote, (4) eligibility for public office, (5) right of political leaders to compete for support/votes, (6) alternative sources of information, (7) free and fair elections, and (8) institutions for making government policies depend on votes. The individual rights contained in guarantees 1, 2, 3 and 6 are eminently political, in the sense that they are considered here as instrumental for the electoral political process. Dahl denotes a system that safeguards free and fair elections through a general respect for political liberties as "polyarchy."

We can better understand the difference between "electoral democracies" and Dahl's polyarchies through the ideas of contestation and inclusiveness. Electoral democracies require a significant degree of inclusiveness, as epitomized by the extension of the franchise to large fractions of the population, but are less demanding in terms of the degree of allowed public contestation. Polyarchies require both ample suffrage and opportunities to oppose, contest, and compete in the political arena—qualities that are only effectively attained if political rights are sufficiently protected.

Finally, the thickest definition of democracy incorporates liberal civil rights. As already mentioned in the discussion about the rule of law, these rights serve a different purpose from political rights. The primary objective of liberal civil rights is to limit the scope of governmental action, and by doing so guarantee an area of individual autonomy and freedom; this applies to both autocratic or democratically elected governments. In the latter case, individual liberal rights limit the risk of the tyranny of the majority. It is important to notice that authors that propose this thick conceptualization of democracy, incorporating political and civil

rights, usually assume an independent judiciary capable of enforcing such rights. Thus, an all-embracing definition of “liberal democracy” subsumes the idea of safeguarded rule of law discussed above (see O’Donnell for examples³⁰). It is clear that the hierarchy of democracy types sketched here visibly resembles the outline of the different substantive conceptions of rule of law, showing again the difficulty of disentangling these concepts.

Economic freedom

Economic freedom is a concept clearly associated with economists such as Milton Friedman and Friedrich Hayek, but we can trace its origins to the classical liberal thinkers of earlier centuries. This is because, for many of them, private property rights were just one among many civil liberties. Thus, the theoretical rationale for economic freedom is similar to that of other liberal freedoms such as expression, movement, or religion, and is based on the principle of personal individual choice. In this way, economic freedom is viewed as a negative right that requires others (especially the government) to abstain from interference. That is, economic freedom implies absence of coercion in the sphere of economic decisions. Understood in this way, it is not possible to discern a hierarchical structure of economic freedom definitions, starting from a minimalist definition and subsequently adding attributes in order to form thicker versions of the concept, as we were able to do with the concepts of rule of law and democracy. Conceptualizing economic freedom as a dichotomous attribute that societies may possess or not is not a convincing solution either. It seems that the way to make progress is to think about economic freedom as a continuum between two polar cases, along which societies are situated. This is how modern thinkers and pundits of economic freedom like Hayek, Mises or Friedman have understood the concept. Moreover, this is also the theoretical foundation behind the construction of the two most widely

used indexes of economic freedom; namely, the Economic Freedom of the World Index produced by the Fraser Institute,³¹ and the Heritage Foundation's Economic Freedom Index.³²

According to Friedman, the crucial issue is whether economic decisions are guided by the market principle or the political principle. The former relies on individual choice, voluntary exchange, and free competition. The latter instead relies on the coercive power of the state to decide on economic affairs. Notice that both principles are compatible with any kind of political system, whether democratic or not. Hayek would use the distinction between decentralized and centralized economies, again referring to the source of economic decisions: private individuals or the government. On one hand, the polar case in which a society is fully free in economic terms would be identified with the anarcho-capitalist views of authors like Rothbard, where all economic decisions are in the hands of private individuals, and the state has no role.³³ On the other hand, a society in which the state owns all the means of production (even labor) and centrally decides all economic affairs would be denoted as completely unfree in economic terms. Both extreme cases are hardly empirically relevant. If we want to apply the concept to modern economies, we need first to acknowledge that these are extremely complex machineries composed of a myriad of sectors and markets, and the involvement or intervention of the state in each of them might differ widely, or even be unavoidable in some cases. As is recognized by some of the most ardent promoters of economic freedom, there are areas in which government action is necessary to generate the conditions for the full exercise of individual economic freedom. Here, the government's protection of property rights plays a crucial role, not only requiring the recognition of private ownership and the bundle of rights associated with it, but also the enforcement of private contracts that formalize economic activities. Both economic freedom indexes mentioned above admit this necessary

involvement of the state in economic affairs as a precondition for individual private action and choice, and include in their measurements of economic freedom a metric that captures the degree to which governments are capable of generating such conditions.

Notwithstanding the previous discussion, the bulk of the theoretical concept of economic freedom deals with the activities from which governments should refrain. Generally, we can think of government intervention in economic affairs in two distinct ways: regulation and taxation. Regulations limit the full exercise of the rights derived from private ownership by restricting certain activities or imposing additional requirements on private economic relationships. Taxation directly extracts resources from private individuals and places them under public administration. Both cases generate distortions in the functioning of the market mechanism by affecting relative prices and/or quantities. Given the difficulty in assessing the degree of governmental intervention through regulation in all sectors and activities of modern economies, the literature has focused on just a few especially relevant markets. In particular, both the Fraser Institute and Heritage Foundation indexes give prominent importance to the level of public regulation of international trade and investment, labor markets, and financial markets. Considering countries that have less restrictive regulations in these areas to be more economically free is not controversial. However, there is much less of a consensus when it comes to assessing the value of government taxation and how it relates to economic freedom. The two indexes mentioned both include metrics that capture the fiscal size of government, and give this a significant weight (20 percent for the Fraser index, 25 percent for the Heritage index). Government taxation, these organisations argue, reduces the resources available to private individuals to allocate and distorts relative prices and thus the functioning of the market mechanism. As a consequence, higher levels of overall taxation are assumed to reduce economic freedom.

The opposition to this view is usually based on an empirical regularity. When we look at the disaggregated data provided by economic freedom indexes, government size is positively correlated with the rest of the metrics (market institutions and regulations). That is, we observe that countries with high economic freedom scores—in terms of low market regulations and high protection of property rights—usually present relatively large governments in fiscal terms. Given this evidence, the question posed by Leschke³⁴ or Ott,³⁵ among others, is whether government size is a useful metric for measuring the concept of economic freedom at all, or whether it should be simply removed. The discussion has one aspect that is worth examining. The removal of government size from the conceptualization of economic freedom is based on the idea that at least some fiscal activities carried out by the government can foster economic freedom (besides those already mentioned: securing property rights and the functioning of markets). That is, government taxes and spending can generate economic opportunities for some individuals. This argument resembles a positive conception of freedom as the capability to choose, epitomized by the writings of Amartya Sen. The problematic aspect of this view is that it radically contradicts the premise of the overall idea of economic freedom, which is based on a negative conception of freedom as absence of coercion. If the argument—that government size can be ignored in the measurement of economic freedom—is accepted, then the same logic would require that we dismiss other areas of the concept, such as tariffs on international trade, taxes on financial transactions, or specific government regulations that may be considered as opportunity enhancing for some individuals. It would seem that what is behind the rejection of including government size in a measure of economic freedom is to purge the concept of public interventions that are viewed as desirable, efficient, or positive. So, economic freedom would only be hampered by undesirable

government interventions, however these can be identified. But then we would be trying to conceptualize a very different object. Not to what extent economic activity is guided by free individual choices and the market mechanism, but whether government interventions can improve economic outcomes. The fact that authors such as Friedman and Hayek believed that less government involvement in the economy was the surest path to sustained economic growth and prosperity is ultimately a hypothesis that must be empirically settled, but clearly does not invalidate the formative construction of the concept. Consequently, government size appears to fit well in a conception of economic freedom based on the idea of negative liberty applied to economic aspects of life.

A framework on freedom dimensions

Having reviewed, even if succinctly, the wide variety of conceptualizations proposed by the literature on our three dimensions of freedom, the natural next step is to decide which specific definition to pick. That is, where do we draw the boundaries of each concept? And, even more importantly, how do we justify our choices? Here, it is important to recall that the hypothesis proposed in the introduction of this essay is that we can better understand the relation between liberal democracy and economic performance if we dig deeper into the constitutive attributes of free societies. Therefore, the guiding principle for our delineation of concepts should be functional, aimed at isolating the mechanisms that link each dimension to economic outcomes. Ideally, we would want to define each concept so that none of them implies or requires the others, and are therefore as independent as possible. This does not imply that all three concepts are completely disconnected, or that our framework should eliminate any interaction among them. To the contrary, such linkages and interactions are

at the core of the analysis proposed in this essay. Independence is understood here as the possibility, at least at a theoretical level, that a society may possess any degree of freedom in one dimension irrespective of the other two, that is, we want definitions that allow a country to have any combination of scores for each of the concepts. Finally, we need to keep in mind that the ultimate goal is to take the theoretical framework to the data, and therefore our choice of definitions should try to be empirically relevant.

When analyzing the economic effects of the rule of law, economists have usually identified the concept with the safeguarding of property rights, especially against government expropriation. Obviously, this generates an overlap with a fundamental aspect of economic freedom. Nonetheless, the implicit function given to the rule of law in such a conception provides a clear insight: the economic effects of the rule of law are related to the idea of certainty. If laws are clear, general, stable, etc., and citizens and governments generally follow them, then everyone knows what to expect, and individuals can form rational expectations about the potential consequences of their actions and decisions (economic or else). This is exactly what Hayek alludes to when he provides his idea of the concept:

Stripped of all technicalities, [the rule of law] means that government in all its actions is bound by rules fixed and announced beforehand—rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one's individual affairs on the basis of this knowledge.³⁶

It is clear that this uncertainty-reducing function of the rule of law operates regardless of the specific political system in place. That is, the rule of law implies that the law is followed, not that the law is good. Raz, who begins his discussion about the ideal of rule

of law precisely with Hayek's quote, is very plain in this respect when he asserts that "the law can violate people's dignity in many ways. Observing the rule of law by no means guarantees that such violations do not occur."³⁷ The specific content of the laws that individuals can expect to be applied will be included in the other two dimensions of freedom. Excluding the formal democratic principle in our rule-of-law definition allows for the possibility that autocracies may abide by the rule of law and, conversely, that democracies may fail to establish the rule of law. Both are situations that are empirically relevant if we look at the world today, strengthening the prospect that such formal definition of the rule of law can have strong explanatory power.

As we said in the previous section, the essence of democracy is that it is a political system in which governments are responsive to the citizens' demands. The more inclusive a system, and the more it allows for citizens to oppose and contest those in power, the more closely its public policies are expected to reflect the preferences of a majority of the population. Now, how does the democratic principle affect economic outcomes? It clearly depends on the economic and social environment or, using a term commonly employed among political scientists, the cleavages present in a specific society.

In this regard, distributive aspects have been identified by economists as key factors affecting the relationship between democratic politics and economic performance—in particular, the level of inequality in terms of wealth, productive assets (land, capital, etc.), or income. The general intuition is that, if fiscal policy is decided democratically, higher levels of inequality should generate stronger pressures for redistributive taxation. Nonetheless, the empirical evidence around the distributive aspect is not generally conclusive. Furthermore, it is not even clear whether higher levels of taxation reduce or enhance economic growth. On one hand, higher taxes introduce distortionary costs and may reduce the

incentives to work and invest, thus hampering economic growth. On the other, in the presence of credit or insurance market frictions, redistributive taxation may produce higher growth if it removes barriers that generate underinvestment in some sectors or activities. We can think of several other aspects that link the degree to which government policies reflect citizens' preferences to economic results (public goods provision, publicly provided private goods such as education and health, public debt management, etc.). Given that we have defined the rule of law in purely formal terms, the democratic dimension of freedom can subsume the different sets of individual rights discussed above. Consequently, we can include both political and civil rights in our definition of democracy, only excluding property rights from the latter, as these will be taken care of as part of "economic freedom." In this way, the boundaries between rule of law and democracy are well defined, and again we can at least theoretically envision any possible combination among them.

Finally, the definition of economic freedom in the terms described above does not present any overlap with the chosen conceptualizations of rule of law and democracy. The link between economic freedom and economic growth is created by the incentives and opportunities to invest, trade, start a business, and carry out any other economic activity in an environment of (as perfect as possible) market competition. Again, it is important to recall that any degree of economic freedom is compatible with any combination of rule of law and democracy as defined above. For example, we can imagine a dictatorship in which democracy is absent and that generally abides by the rule of law, with the highest degree of economic freedom (e.g., Singapore), or a full democracy with a strong rule of law that scores poorly in economic freedom (e.g., France).

Overall, the framework sketched in this section is in line with the one proposed by the Atlantic Council's Freedom and

Prosperity Center, and conveys similar intuitions. In particular, the idea that the rule of law is a precondition for the other two freedoms is adequately captured by the formal definition chosen. Notice that, in a society where citizens and governments do not generally abide by the law, the substantive content embedded in the legal system becomes irrelevant. That is, a society that has not secured a sufficient level of rule of law cannot *de facto* defend fundamental or property rights, nor will it translate its citizens' demands effectively through the democratic process, even if these features are consecrated *de jure* in a written norm or constitution.

Empirical relevance of the conceptualization

The conceptualization developed in the previous section would be a futile theoretical disquisition if the empirical counterparts of those concepts (rule of law, democracy, and economic freedom) were all highly correlated across countries. That is, when we look at the data, do we observe countries systematically obtaining high/low scores in all three dimensions? If that were the case, then differentiating among dimensions of freedom would not be helpful in order to shed light on the liberal democracy-growth nexus. Instead, if the three dimensions of freedom do not necessarily move together, and we observe countries scoring high in one aspect while low in others, then it might be worth exploring in more depth the combinations of our concepts that are more likely to produce good economic outcomes. This section carries out a first test of the usefulness of the proposed framework by assessing the empirical variability observed across countries in terms of the three different dimensions.

There is a wide variety of indexes created by academics, research centers, think tanks, international organizations, and others that include our three concepts of interest. Each index

implicitly or explicitly assumes a specific definition of the concept at hand. Thus, the decision about which indexes to use is not trivial. For the exploratory purposes of this essay, I will choose indexes that: are readily available; are as close as possible to the preferred conceptualizations of each concept discussed above; and that provide ample global coverage, especially for developing and less developed countries.

Regarding the rule of law measure, I rely on the V-Dem project database, which includes a rule-of-law index that is very close to the safeguarded rule of law conceptualization of Raz or Tamanaha discussed before.³⁸ In particular, it includes variables that measure the degree of predictability of the laws (formal legality), as well as indicators that measure the independence and impartiality of the judicial system, whether the executive power complies with the judiciary, the rigor and impartiality of public officials in the application of the law, and a series of indicators that measure the degree of corruption in the public sector. It is worth noting that the V-Dem index does not measure any substantive content in the form of individual rights of any kind, nor whether the source of the laws is democratic or not. The index is continuous, and normalized for the interval $[0,1]$, with 1 denoting the highest adherence to the rule-of-law ideal.

The main objective of the empirical exercise presented below is to assess whether democracies and autocracies present substantial variability in the rule of law and economic freedom dimensions. Thus, it seems natural to use a dichotomous measure of democracy that allows clear differentiation between both groups. Among such measures, the closest to Dahl's conceptualization (with ample coverage across countries) is provided by the Lexical Index of Electoral Democracy (LIED).³⁹ It is an ordinal index with eight levels (from zero to seven), in which the highest category is attained when a country satisfies all of Dahl's polyarchy attributes. The previous level (six), is similar to the electoral democracy conceptualization

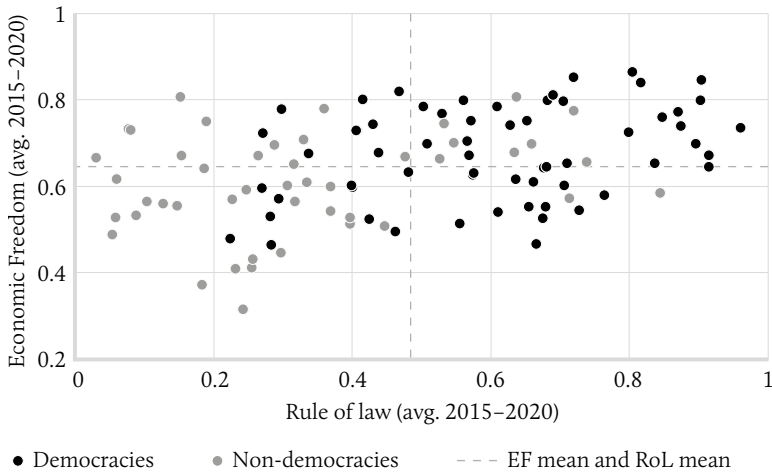
of Przeworski or Vanhannen, that is, a country in which meaningful competitive elections with ample suffrage are present, but political rights are not sufficiently protected.

Finally, the most widely used index on economic freedom is the one created by the Fraser Institute.⁴⁰ This index is composed of five major areas: size of government, legal system and property rights, sound money, trade freedom, and regulation. As discussed above, there is some debate about whether all these areas should be included in an index of economic freedom, and it is certainly worthwhile to explore how alternative constructions relate to the rule of law and democracy, but such an exercise is left for future research. For the purposes of this essay, I will only slightly modify Fraser's second area (legal system and property rights), as it includes a series of sub-components related to the independence and impartiality of the judiciary that are already measured in the rule-of-law indicator. For this reason I will recalculate this area of the index, keeping only the sub-components on "protection of property rights" and "enforcement of contracts." The rest of the areas are not affected, and the overall index construction follows the same methodology as the original version.

The total sample, for which data are available for our three variables, covers 123 countries. These are all countries with available data, excluding OECD members. Among them, in 2020 a total of sixty-four countries were classified as electoral democracies according to LIED, and fifty-nine as non-democracies (or autocracies). For the rule of law and economic freedom measures, country averages for the period 2015–2020 are calculated. Thus, we have a cross-section of countries that allows us to compare the levels of our indicators for rule of law and economic freedom, discriminating by the democracy-autocracy categorization. The results are depicted in Figure 2. White circles represent countries classified as electoral democracies, while black ones as non-democracies. Dotted lines mark the average levels of economic freedom

(horizontal) and rule of law (vertical) across the full sample. This simple plot conveys a series of interesting insights. First, there is ample variability in both dimensions, for the full sample and also within the sub-samples of democracies and autocracies. This is especially apparent in the rule-of-law variable, which covers almost the full range $[0,1]$. Focusing on this variable, the picture clearly reflects the positive correlation between rule of law and democracy. A majority of democracies score above average on rule of law, while a majority of autocracies have below average scores. This is not surprising given the expected reinforcing effect of democratic consent from citizens, and the additional controls on the executive represented by the legislative branch and the press in a democratic system. Nonetheless, we still observe a significant number of democracies scoring below the all-country average in the rule-of-law indicator: eighteen countries in total, which equates to 28 percent of all democracies in the sample. Conversely, fourteen autocracies have above average values for rule of law, almost a quarter of all autocracies. Second, when looking at the distribution of economic freedom scores, we also observe significant dispersion, and smaller systematic differences between democracies and autocracies. The average level of economic freedom is only slightly higher among democracies (0.678), than among non-democracies (0.590). The results show that a significant share of democracies have levels of economic freedom below the sample average (36 percent), and more than 40 percent of autocracies have above average scores. Finally, looking at the joint distribution of rule of law and economic freedom further confirms that all three dimensions of freedom are far from moving together. Half of the countries labeled as democracies have below average scores on at least one of the other two dimensions, and 47 percent of autocracies present above average scores for either rule of law or economic freedom.

Figure 2. Rule of law, democracy, and economic freedom across countries



Note: Singapore and Venezuela are excluded from the graph to facilitate visualization. Sources: “Varieties of Democracy (V-Dem),” accessed March 13, 2023, <https://www.v-dem.net>; Svend-Erik Skaaning, John Gerring, and Henrikas Bartusevicius, “A Lexical Index of Electoral Democracy,” (LIED), Harvard Dataverse, 2015, <https://doi.org/10.7910/DVN/29106>; “Economic Freedom,” Fraser Institute, January 26, 2023, <https://www.fraserinstitute.org/studies/economic-freedom>.

Conclusions

Even if merely descriptive of the current situation, the results presented in the simple exercise of the previous section suggest that the differentiation between rule of law, democracy, and economic freedom proposed in this essay can be a promising avenue for future research. Intuitively, it is likely that a full panel analysis that considers the development of these variables across time may generate even more variability. Consequently, a rigorous econometric investigation that jointly considers all three dimensions of freedom and their interactions is called for. A natural first step would be to replicate the most recent empirical studies on the

relationship between democracy and economic growth (especially Acemoglu et al.), trying to capture the interdependency of democracy and the rule of law (through an interaction term, or at least controlling for initial levels at the time of democratization). From an economic theory perspective, a potential avenue for future research would be to extend the standard growth models of Solow or Romer, introducing mechanisms that capture the level of institutional development in our three dimensions of freedom. In this way, we could gain insights about the specific transmission channels that link different institutional arrangements with economic growth, which could then be translated into practical policy advice regarding the most efficient policy reforms available to less developed countries.

Pathways to economic prosperity: Theoretical, methodological, and evidential considerations

Markus Jaeger

Contextualizing the “freedom leads to prosperity” hypothesis

THIS PAPER PROVIDES AN OVERVIEW of the diverse ways in which scholars have sought to account for differing levels of economic prosperity in order to place the freedom and prosperity hypothesis in a broader historical-empirical and theoretical context. The first section provides an overview of the most prominent theoretical models of economic growth and economic development. The second section surveys a variety of accounts of why different countries enjoy different levels of economic prosperity today. The third section provides a hyper-stylized history of successful cases of state-led (rather than market-oriented) and institutions-focused economic development in order to shed light on the question of how—in the context of the freedom-leads-to-prosperity hypothesis—ostensibly “Unfree” countries were able to become relatively prosperous. The last section discusses the theoretical, conceptual, and methodological implications of the preceding discussion for broadly institutionalist explanations of national economic prosperity.

Markus Jaeger is an adjunct associate professor of international and public affairs at Columbia University.

Some countries are more prosperous than others

Some countries are more economically prosperous than others, if economic prosperity is narrowly defined in terms of per capita income. Differences in economic prosperity are the consequence of differing per capita economic growth rates over an extended time horizon. Economic growth is a multi-causal phenomenon, meaning it is influenced by a variety of factors. Different levels of long-term economic growth have been variously attributed to political, financial, economic, social, cultural, institutional, geographic, and demographic factors—to mention just a few—or any combination thereof. It is an empirical question whether and to what extent these factors have explanatory power. Answering empirical questions by necessity involves crucial decisions in terms of methodology.

Historically, countries have experienced different levels of economic growth and development. Beginning in the middle of the eighteenth century, the industrial revolution propelled England and later northwest Europe and then North America, to relative economic prosperity. Japan's rapid economic ascent following the Meiji Restoration and East Asia's even more rapid rise during the last quarter of the twentieth and the first quarter of the twenty-first century are other examples of successful economic development.

There is little consensus among researchers as to what best explains differences in economic prosperity. At risk of over-simplification, economists seek to understand the underlying mechanics of economic growth and development and seek to identify ways to activate these mechanisms. Economic historians and political economists are equally, if not more interested in the non-economic factors affecting prosperity in order to explain why some countries managed to pursue successful pro-growth policies while others did not. This often includes "exogenous" factors,

such as geography, the availability of natural resources, and so on. These two approaches are not necessarily incompatible. Assuming economists identify the economic mechanism (or mechanisms) necessary to generate sustained economic growth, the question as to why some countries have succeeded in activating it (or them) and what structural factors may have constrained or facilitated their activation are related, yet analytically separate questions.

Frequently, answers differ because the questions differ. Explaining, for example, why the industrial revolution of the eighteenth century occurred at all, why it occurred in Britain rather than in China, or why some countries were subsequently able to replicate Britain's economic success (while others were not) may elicit very different answers.¹ Similarly, the answer as to why a low-income country is able to sustain economic growth may differ from the answer to what supports superior economic growth in a technologically advanced economy. Assuming that the same factors affect economic growth equally across all countries and at all times is just that: an assumption. This is worth bearing in mind when seeking to explain the relative economic success of countries, and especially when providing policy recommendations.

The causal importance of a particular factor or set of factors, such as economic, legal, and political freedom, may vary depending on a country's characteristics, such as its level of development, political stability or socioeconomic structures, the level of international economic integration, or the availability of technology. In methodological terms, it is difficult-to-impossible to control for all these potentially relevant factors. In a low-income country, expanding the physical capital stock (characterized by high marginal productivity) may have a greater impact on economic growth than in a high-income country with a large capital stock (and rapidly diminishing capital productivity). Smart policies, such as those that support innovation, may be more important in the latter case, while such policies may be less impactful, or less necessary, in

countries that seek to catch up economically by adopting existing technologies. As will be shown in greater detail below, this is often discussed in the context of so-called “latecomers” (countries that are, relatively, economically and technologically backward) and advanced economies (operating near the so-called “technological frontier”) In technologically advanced economies, economic growth is primarily driven by innovation and technological progress. In less advanced economies, it is driven by extensive (rather than intensive) capital accumulation and the incorporation of “off-the-shelf” technologies into the production process.² Different factors may account for economic growth at different levels of economic development. More on this later.

Economic models of economic development

The standard economic growth model, the so-called Solow–Swan model, sees long-run economic growth as the consequence of capital accumulation, labor force growth and productivity increases (or technological progress). In this model, economic growth is exogenous. A high level of per capita income is a reflection of a large physical capital stock as well as the efficiency with which the factors of production are deployed. Technology is exogenous. Successful countries rely on a virtuous cycle of increased investment, accelerating economic growth, rising incomes and increasing savings, which in turn helps sustain high levels of investment, and so on. It discounts the importance of economic policy and what economists call “endogenous factors,” namely factors that are conducive to furthering innovation, creating knowledge, and enhancing human capital, including the quality of public policies.³

This somewhat mirrors the distinction between liberal-institutionalist and state-interventionist theories of

economic development. Broadly liberal accounts of economic development emphasize the role of private economic agents, functioning markets, and private-sector investment, while statist or “development state” accounts highlight the role played by public-sector policies, particularly in the presence of market failures or in areas where social returns exceed private returns.⁴ Liberal accounts attribute economic development to self-interested economic agents acting in the context of political and economic stability and freedom, the rule of law, and market competition. In this respect, the nineteenth-century “nightwatchman” state, which guarantees economic stability and provides political stability, and the so-called Washington consensus, with its emphasis on market reform and curtailing the role of the state, are variations of a theme.

By contrast, many development economists see the state as playing an important role in economic development that goes beyond the provision of legal, economic, and political freedom and stability. The “big push model” is fairly representative of this literature. Models, like Rostow’s “linear stages of growth model,” emphasize the need for governments to stimulate “economic take-off” through large, up-front, government-financed infrastructure investment.⁵ Starting from a low level of income, putting a country on a path of sustained economic growth requires large, catalytic, government-financed infrastructure investment to lower transaction costs and make (some) markets economically viable, thus overcoming market failure.

Many of these models emphasize the existence of market failures and coordination costs as well as the ability of the state to help overcome them. For example, a private firm may want to produce tires. But this requires a large up-front investment. This only makes economic sense if there is sufficient demand for tires from a car manufacturer. The car manufacturer faces the same problem. The government can then step in to help overcome the

coordination problem by supporting investment or guaranteeing demand, ultimately assuming financial risks to reduce economic and financial uncertainty for private economic agents. Related to the coordination problem and market failure is the notion that the social returns of government-supported investment may exceed the economic returns of private investment. As the private sector will not make the socially optimal level of investment because of its inability to internalize profits, the government has an important role in supporting investment and thereby supporting economic development.

Another prominent model sees economic development as a process whereby increased agricultural productivity allows rural workers to move into more capital-intensive industries in urban areas. The so-called “dual-sector Lewis model” posits the transfer of surplus labor in the agricultural sector to the higher-productivity, capital-intensive industrial sector, thereby promoting industrialization, productivity, and development.⁶ Here again, it is easy to see how government has a role to play in terms of providing adequate infrastructure to support urbanization, for example. This is perhaps best illustrated by the contrast between Latin America’s favelas and China’s more successful urbanization, supported in part by controls of rural–urban migration in the latter case.

Liberal economists point to government failure (or economic inefficiencies caused by government intervention)—often but not always in the context of rent-seeking interests that weaken a government’s ability to pursue a successful long-term economic development policy—as a major explanation for the lack of economic growth. In this vision, significant government intervention in the economy is bound to fail because private interests capture policies and influence them to their benefit, at the expense of long-term economic growth. In other words, the importance of market failure versus government failure underpins different visions of

the role played by market-oriented versus state-interventionist policies in fostering economic growth and development.

Economic models, as opposed to political-economic accounts, do not typically consider political-economic institutions, socio-cultural attitudes, or other exogenous factors to play a role in economic development. Instead, they seek to identify the basic economic mechanism that allows countries to generate sustained economic growth and raise income levels. Endogenous growth models do allow for the incorporation of factors other than capital accumulation, labor force growth, and technological progress, but often do so in rather abstract ways. Meanwhile, political-economic accounts often focus on factors, such as social attitudes or geography, that are hypothesized to be more or less conducive to successful economic development, even if the basic underlying growth mechanism in terms of a self-reinforcing “economic growth/investment” cycle is generally assumed to be the same. In other words, political-economic accounts are more concerned with the question of what factors or policies help activate the mechanism necessary to generate sustained economic growth.

So far for theory; now a data point. Whether economists have misidentified relevant mechanisms, or political economists have failed to identify the relevant factors, or countries have been unable or unwilling to implement growth-enhancing policies and reforms, economic development policies have generated disappointing outcomes. According to the World Bank, of the 101 middle-income economies in 1960 only thirteen had become high-income economies by 2008 (including Hong Kong, Japan, Korea, Singapore, and Taiwan). Some analysts have taken this to mean that “despite the best efforts of generations of economists, the deep mechanisms of persistent economic growth remain elusive.”⁷ But this may be too defeatist. Countries may not have reached high-income status, but per capita income in many (but not all) of the world’s economies has increased, whether they have

“caught up” with high-income economies or not. According to the World Bank, China, Romania, and Ethiopia have seen their per capita income (in international dollars at purchasing power exchange rates) quadruple over the past twenty years. Surely, this must count as a success, whether or not they are classified by the World Bank as high-income countries.

Geography, climate, institutions and economic prosperity

Even if one accepts that economic well-being comes about as a consequence of capital accumulation and productivity growth, regardless of what role, if any, the government has to play in this process, it is a fact that some countries have higher per capita income levels than others. Some countries have obviously been more successful than others. This has been variously attributed to structural factors, such as geography, or discretionary actions, such as good policies. Again, capital accumulation (and productivity growth) is the basic underlying mechanism that paves the path to prosperity. But both endogenous and exogenous factors can be conceptualized as being more or less conducive to this mechanism being activated.

For a start, geography and climate may help account for pronounced income differences.⁸ Coincidence or not, most high per capita income countries are located in moderate climate zones in North America, Europe, and East Asia. Landlocked countries are typically less prosperous than countries with access to seaborne trade. The climate may create more or less favorable conditions for economic development, and it may affect the prevalence of disease agents (like malaria); indirectly, it may affect health conditions, the productivity of the workforce and the ability to generate agricultural surpluses and thereby a country’s ability to support population growth and urbanization—all other things being equal.⁹ Such factors do not represent insurmountable obstacles,

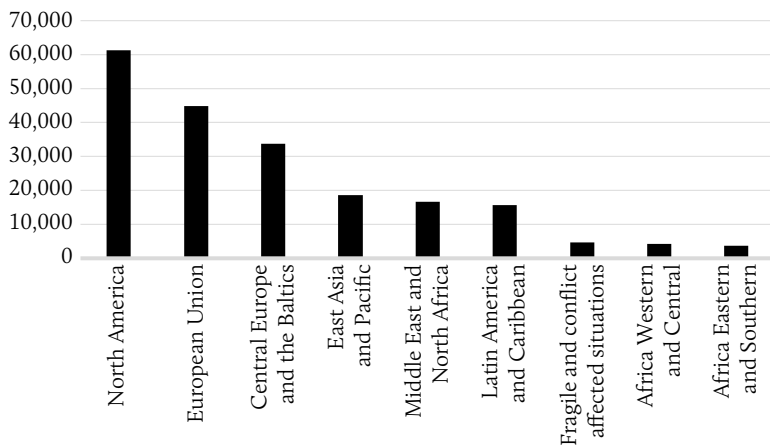
as in many instances public policies can help overcome them.¹⁰ But unfavorable starting conditions—or “factor endowment”—can help explain the relative economic backwardness of certain countries and regions.

Geographic features also affect the availability of fertile, arable land, the availability of natural resources, the existence of navigable rivers, and access to seaborne trade. Countries with access to navigable rivers or seaborne trade have easier access to international commerce and face lower transportation and transaction costs, allowing for greater internal and international market integration and economies of scale—all other things being equal. In Russia, many rivers run south-to-north and flow into the Arctic. In Western Europe, rivers crisscross the continent and flow into ice-free waters, allowing for lower transportation costs and facilitating market integration. Again, much of course depends on policies. For instance, an extensive coastline and access to overseas markets are of little use if policies prohibit trade, as they did in pre-Meiji Japan; and a lack of navigable rivers can to some extent be overcome by building railways. Similarly, malaria was once rampant in parts of Southern Europe until public policies helped eliminate it.¹¹ But the fact that some of these structural impediments can be overcome by policies does not mean they do not have an effect on long-term economic prosperity or affect the historical trajectory of an economy’s development.

Climatic conditions and geographic circumstances may also interact with economic development in complex (non-linear) and complicated (multi-causal) ways (which are difficult to model statistically). Some path-dependent historical accounts—accounts where previous conditions strongly affect subsequent outcomes—attribute North America’s economic success to the prevalence of a settler colonialism (New England), while the climatic and agricultural conditions in the American South, the Caribbean, parts of South America, and especially Sub-Saharan Africa led to the emergence

of an extractive, exploitative type of colonialism, centered around slave-based agriculture or the extraction of mineral resources.¹² This, in turn, favored the emergence of business-friendly and liberal-democratic institutions in the case of settler colonialism and non-liberal, non-market institutions benefiting a narrow elite, in the case of extractive colonialism. Similarly, slave-holding economies were far less likely to move toward democratic governance and lean toward exploitation by conservative ruling elites with little to no interest in economic modernization. Research shows that regions with low settler mortality two centuries ago benefit from business-friendly institutions and higher per capita income *today*.¹³ Path dependency may not foreclose certain historical trajectories, but it may make it less likely that countries end up on them. This goes to show that economic development can be regarded as a function of a country's institutional evolution, but this evolution itself owed much to exogenous climatic and agricultural conditions and, ultimately, its history.

Figure 1. Geography and economic prosperity (per capita income, USD, PPP, 2020)



Source: World Bank.

Similarly, different types of legal regimes related to different colonial histories (British common law versus French Napoleonic code) have been hypothesized to have affected the subsequent economic development of postcolonial regimes in Africa. And different economic and political regimes have given rise to wildly different levels of economic prosperity, as geographically adjacent cities across the US–Mexican border, or East and West Germany during the Cold War, or North and South Korea today, suggest.¹⁴ But even here, the reasons for such pronounced differences are more multi-faceted, including not just institutions but also access to internal and foreign markets, the provision of economic aid, and so on.

The availability of abundant natural resources, sometimes called the “resource curse,” may be more likely to lead to the emergence of autocratic “rentier economies.” Natural resources can often be more easily controlled by a government. This creates greater incentives to gain political control of these resources than it does in economies relying on manufacturing, market competition, and technological innovation.¹⁵ Abundant, easy-to-control natural resources may also lead to greater corruption and nepotism, which are detrimental to economic development. It may even crowd out human capital formation, as rent-seeking, as opposed to market-oriented economies, may be more prevalent, lowering the economic returns to education. As the benefits of controlling resources are greater than in non-resource economies, countries with abundant resources may also experience higher-intensity political conflict and civil strife.¹⁶

In addition to geography, climate, and natural resources, demographic factors, such as population density or population age, may be more or less conducive to economic growth and innovation.¹⁷ A higher population density has also been identified as being conducive to technological innovation.¹⁸ Leaving aside the impact of rapid demographic change on political and social

stability (e.g., a “youth bulge”) and its indirect effect on economic growth, demographic change can affect aggregate savings behavior and the cost of investment. A falling dependency ratio, that is, the ratio of people of non-working to working age, allows an economy to generate greater savings than a country with an increasing dependency ratio, all other things being equal. The one-child policy, for example, may in part help explain the dramatic increase in savings and investment—and economic growth—in China since its introduction in 1980. As always, whether favorable demographic trends affect economic growth will in part be affected by public policies. For example, the population must want to save, and high inflation may deter it from doing so. Many factors, most prominently policies, affect savings behavior, and policies themselves are likely to be a function of monetary stability, political stability, and so on.

Importantly, political and economic stability is almost universally regarded as being conducive to economic prosperity. Easterly and Levine, for example, demonstrate in the case of Africa how a high degree of ethnic diversity is correlated with low education levels, inadequate infrastructure, and underdeveloped financial systems.¹⁹ Foreign or civil wars, high levels of domestic crime, and recurrent financial and economic crises constrain economic growth, as they render investment decisions riskier and require higher returns, if the risk can be quantified at all.²⁰ And these factors may condition each other and translate into a negative feedback loop, which can make it difficult to model statistically.

Following Max Weber’s work on the Protestant work ethic, some scholars have sought to demonstrate that socio-cultural values, such as achievement orientation versus post-materialist values and the implications of this in attitudes toward economic prosperity, can explain differences in economic growth. But, leaving aside the fact that cultural attitudes can be difficult to quantify, scholars have wrestled with the direction of causality (as they do in

so many other cases).²¹ Similarly, the impact of religion, and especially monotheistic religion, has been hypothesized to systemically impact economic growth due to the hypothesized link between organized religion, political power, beliefs, and human capital development, particularly in terms of the Protestant Reformation.²² Related explanatory approaches focus on the socio-historical trajectory and economic history of a country determining discount rates and hence savings behavior.²³ Even more controversially, differential demographic growth among different social groups has been credited with paving the way for Britain's industrialization.²⁴

Last but certainly not least, most economists regard institutions as affecting growth and prosperity. Institutions, for example, have been seen as the cause of the differential economic performance of Rhenish stakeholder—as opposed short-term US-style shareholder—capitalism.²⁵ They have been identified as explaining macroeconomic stability or the relative success of Keynesian economic policies—to name just two examples.²⁶ Conceptually, economic freedom, political freedom, and the rule of law are seen as being conducive to economic prosperity, as they lower transaction costs and limit economic risk. Sound regulation and predictable institutions are widely seen as enhancing economic competition, investment efficiency, and innovation by limiting rent-seeking opportunities and the emergence of non-competitive economic structures.

The emergence of efficiency- and growth-enhancing economic institutions has in turn been linked to liberal-democratic institutions, the underlying rationale being that “[e]conomic institutions encouraging economic growth emerge when political institutions allocate power to groups with interests in broad-based property rights enforcement, when they create effective constraints on power-holders, and when there are relatively few rents to be captured by powerholders.”²⁷ In the context of such economic institutions, self-interested economic agents are free to

pursue their economic interests, which, thanks to J.S. Mill’s “invisible hand,” will lead to the pursuit of enlightened self-interest, efficient capital allocation and long-run economic growth.

The above discussion does not constitute a comprehensive survey of the economic development and growth literature. The literature is vast. Rather, it is meant to provide a flavor of what other factors have been hypothesized, or empirically found, to be conducive to long-run economic prosperity. If nothing else, the survey suggests that there are theoretical grounds for assuming that a whole range of factors has the potential to affect the long-term economic development of a country, and that these factors often interact in a variety of complicated and sometimes complex ways. This raises the question, discussed in more detail below, of whether any surgical policy intervention can be effective, given the large number of complicated and interrelated background conditions that impact the effectiveness of such interventions.

Nevertheless, institutions feature prominently in many explanatory approaches to economic growth and development. In addition to geography, demographics, climatic conditions, and political stability, many economists and political economists see the quality of policies as crucial in terms of economic success. If economic prosperity is best explained by past levels of investment, then the question necessarily arises: Are there policies, tied to varying domestic political-institutional arrangements, that have proven more or less conducive to long-term economic growth?

Liberal versus state developmentalist accounts of economic development

An important debate in the literature on economic development has focused on the role of the state. Politically, this debate—more or less helpfully—is sometimes cast in terms of “Beijing consensus”

versus “Washington consensus.” The Beijing consensus represents politically authoritarian state-led development policies accompanied by a hefty dose of state intervention, while the Washington consensus puts the emphasis on institutions and policies that limit state intervention and foster the free play of market forces. The liberal strand of scholarship ascribes economic growth and development to a broadly market-oriented economic system, where private economic agents are free to pursue their economic interests and where the government’s role is limited to providing political stability and underwriting the rule of law. This classical-liberal strand of scholarship has come in for criticism from the “developmental state” literature, which emphasizes the benefits of an interventionist state in furthering economic development.

Much of this scholarly debate is related to the notion of “latecomers” in development economics.²⁸ The main features of “economic backwardness” are: banks or the state channel capital to strategic sectors; a focus on production rather than consumption; an emphasis on capital- rather than labor-intensive production; a reliance on borrowed rather than indigenous technologies; a reliance on productivity growth; and a modest contribution of the agricultural sector to economic growth. This economic strategy was pursued in countries such as Imperial Germany or early Soviet Russia. In practice, the latecomer and certainly the “developmentalist” models are also often thought to include interventionist governments that subsidize and allocate credit in line with developmental preferences (as opposed to market-based credit allocation), pursue a strategic trade policy (as opposed to trade liberalization), as well as extensive industrial policies (aimed at “picking winners”), large-scale infrastructure investment, and public spending on education (as opposed to market-led development and private-sector investment and spending).²⁹

The “developmental state” literature emphasizes the importance of interventionist government policies relative to that of market-oriented policies, at least in the initial stages of economic development.³⁰ Historically, such policies have not always been successful, but when they were successful, they were very successful. (Market failure may exist, but so does government failure.) South Korea and China come to mind as examples of very successful state intervention. In the case of Japan, Chalmers Johnson has shown how a politically insulated bureaucracy capable of avoiding capture by rent-seeking interests very successfully guided the country’s post-war economic development.³¹ Other features of developmental state-driven development include political stability and economic instability, as well as (often) capital controls and a highly controlled exchange rate, which, importantly, allows for an export-driven industrialization strategy, flanked by strategic investment not just in infrastructure but also education.

This developmentalist account is not completely at odds with the liberal-institutionalist literature. But at a minimum, the former puts far greater emphasis on government intervention, and less on the market and concomitant political, legal, and economic freedom. One would think that the debate has been settled by now. But neither side in the debate has conceded. The evidence appears consistent with either explanatory approach, at least in the eyes of their defenders. The World Bank saw Asia’s economic success as the consequence of market-oriented reform,³² while developmentalist critics emphasized the importance of government intervention.³³ This may simply be a methodological problem: too many variables and too few cases.

What “deviant cases” have to say about freedom and prosperity

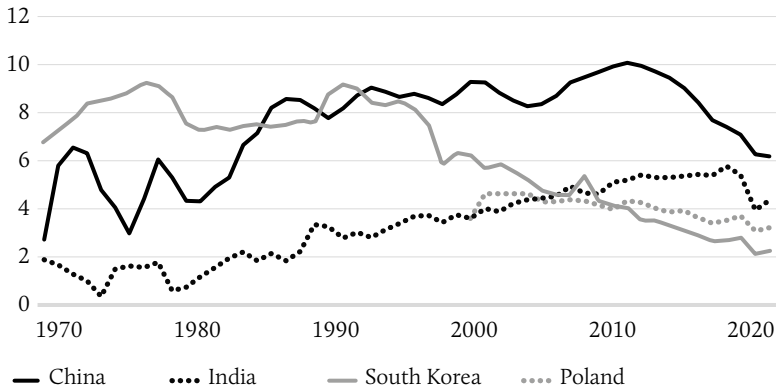
Some of the most successful examples of economic development over the past half-century were countries whose economic growth accelerated under illiberal political and broadly state-interventionist economic regimes. The so-called “East Asian miracle,” referring to the rapid economic rise of South Korea, Taiwan, and China, among others, largely took place under authoritarian regimes and in the context of interventionist economic policies, at least in the case of South Korea and China. On their face, these examples point to causality running from economic *modernization* to political freedom and democratization, rather than from political freedom to economic prosperity. More importantly, they suggest that political liberalization is not, at least not initially, a necessary precondition for sustained growth acceleration. Conversely, some important countries, such as India, have long been characterized by political and legal freedom, but have remained economically much less prosperous. India has only recently started to experience a tangible growth acceleration. This is why, according to the “freedom leads to prosperity” hypothesis, these countries are considered to be outliers, or “deviant cases.” What insights, if any, can be gleaned from these important deviant cases for the liberal approach to economic development?

In China, economic growth took off in the late seventies in the wake of the first steps toward greater *economic* liberalization, including reforms of so-called township and village enterprises (TVEs) as well as the selective opening of the Chinese economy to foreign investment. TVE reform effectively created private markets, in a partial shift away from a centrally planned economy. The second stage of reform saw significant privatization of state-owned industries as well as the lifting of price controls, again strengthening private markets. The third stage involved China joining the World Trade Organization, preceded by further—largely market- and

trade-oriented—economic reform, which increased the competitive pressure faced by the Chinese economy. To this day, political rights remain very restricted and the rule of law and its enforceability are somewhat limited. But (until recently) economic freedom and the role of markets and private enterprise continued to expand.

If nothing else, this is suggestive of the fact that partial, gradual economic liberalization contributed to China's economic development over the past four decades. This hyper-stylized description suggests that in the case of China political and legal freedom were not prerequisites for rapid economic development, at least not initially, when levels of per capita income were very low. It also suggests that developmentalist policies geared toward generating savings and investment (including financial repression), combined with gradual, liberalizing reform aimed at furthering private enterprise and competitive markets, contributed to high and sustained economic growth. It is, of course, impossible to say if more radical transformation would have translated into even faster economic growth. Finally, it remains to be seen whether China can manage to become a high-income country without further reform of its legal and political regime, and do so without relying more rather than less on private enterprise and markets, particularly given that it is facing the so-called middle-income trap.³⁴

Figure 2. Real GDP per capita for China, India, South Korea, and Poland, 1970–2020



Source: World Bank.

South Korea’s “economic takeoff” also took place in the context of non-democratic politics. As in China, it was characterized by extensive (if arguably less extensive than in China) government intervention. Central economic planning was never a core feature of the South Korean economy. But the government channeled cheap savings toward strategic industries, pursued selective and strategic trade liberalization, supported infrastructure investment, and kept labor demands at bay. Economic freedom was never quite as restricted as in China, nor was the role of state-owned enterprises nearly as prominent as in China. But *chaebols* (Korean conglomerates) maintained very close and privileged ties with the government and operated in less-than-competitive markets domestically, even if the government ensured that they were faced with foreign trade competition. The government did rely on firms, especially *chaebols*, in its pursuit of economic development. South Korean economic growth took off in the context of a heavy-handed, strategic, but ultimately successful economic policy. Economic reform began in the early sixties and generated rapid

economic growth, although political liberalization would not follow until the mid-nineties. Again, all of this can only be suggestive. It is impossible to say what would have happened if South Korea had become a democracy in the early seventies. But as far as the evidence goes, it is suggestive of reverse causality in terms of economic modernization leading to economic prosperity leading to political liberalization and democratization.

It is worth contrasting the experience of China and South Korea with that of India. Any contrast or comparison can only be suggestive, given the hyper-stylization of the models and a highly selective, if theoretically interesting, sample selection. Throughout the sixties, seventies and eighties, India was characterized by the so-called “Hindu rate of growth.” India was a democracy, characterized by the rule of law, but also by extensive economic restrictions. It is likely that these restrictions were the main reason for India’s poor economic performance, even though adverse demographic development may also have weighed on growth. Gradual economic reforms, or rather policy changes, arrived in fits and starts, beginning in the mid-eighties and including IMF-supervised partial trade liberalization in the early nineties, and preceded the gradual acceleration of economic growth. One can certainly debate the significance of economic liberalization in terms of growth. As always, an evaluation of the counterfactual will need to remain somewhat speculative but it seems reasonably clear that a significant degree of political and legal freedom were, by themselves, insufficient to push India onto a high-growth trajectory. Economic liberalization does seem to have had an effect, or at least it preceded accelerating economic growth.³⁵

These hyper-stylized accounts of economic development in apparently “deviant” cases of both types— “Unfree” countries (in the terminology of the Freedom and Prosperity Indexes) experiencing high and sustained economic growth, and one “Free” country experiencing low economic growth—suggest

that, at least in these instances and with no claim to generalizability, the relationship between freedom and prosperity is not as straightforward as might be expected. The cases were of course explicitly chosen because they do not conform to the expectation that extensive political or even legal freedom is a necessary precondition for high and sustained economic growth. But all three cases suggest that economic liberalization, or an increase in economic freedom, may have played a crucial role in accelerating economic growth. The case of India also suggests that even extensive political and legal freedom is insufficient to accelerate economic growth if economic freedom is restricted. The cases of China and South Korea also suggest that economic growth can be turbocharged through smart economic, including interventionist, policies. But it is also worth noting that these policies were flanked by gradual domestic and external liberalization and a shift toward “more market.” More detailed historical case studies are required to evaluate this conclusion.

Methodological and conceptual implications

The preceding sections have shown several things: (a) a large number of different factors has been invoked to explain different levels of prosperity; (b) scholarly opinion differs with respect to the (relative) importance of the factors bringing about prosperity; and (c) continued disagreement exists between liberal economists emphasizing the role of institutions and markets, and state-developmentalists emphasizing the role of interventionist, strategic developmental policies.

The Atlantic Council’s Freedom and Prosperity Indexes posit a relationship between political, economic, and legal freedom, embedded in institutions, and prosperity, broadly defined. It is concerned with the causal effect of economic, legal, and

political freedom on prosperity. Methodological choices are front and center in terms of assessing this relationship and generating policy recommendations. Statistical studies can never decisively establish a causal relationship. As statistician Richard Berk puts it: “Credible causal inferences cannot be made from a regression analysis alone. . . . A good overall fit does not demonstrate that a causal model is correct. . . . There are no regression diagnostics through which causal effects can be demonstrated. There are no specification tests through which causal effects can be demonstrated.”³⁶ Even the strongest statistical study design will not prove causation. True, but statistical studies, if well designed, can go some way to *suggesting* causation.

As for cross-country growth regressions, Banerjee and Duflo note that “[t]here is always going to be a million ways to do cross-country comparisons, depending on exactly which brave assumptions one is willing to swallow.”³⁷ They explain: “The game is to use data to predict growth, based on everything from education and investment to corruption and inequality, culture and religion, the distance to the sea or to the equator. The idea was to find what in a country’s policies could help predict (and hopefully affect) its economic growth. But that literature eventually hit a brick wall,” for “everything at the country level is a product of something else.” Or again, “both countries and country policies differ in so many that in effect we are trying to explain growth with more factors than the number of countries, including many we may not have thought of or cannot measure.”³⁸ Meta-studies suggest that the results of cross-country regression exercises are not very robust, with the exception of the relationship between the investment-to-GDP ratio and economic growth.³⁹ Empirically, it is also a fact that economic growth rates often change drastically from decade to decade without much apparent change in policies or reform.⁴⁰ The bottom line is that the level of investment appears to explain the level of economic growth quite well,

but that there is no clear sense as to what (best) explains investment levels.

A purely quantitative analysis, probing the link between freedom/institutions and prosperity, faces epistemic limitations.

1. Large-N, quantitative studies may provide support for the hypothesized relationship, suggesting the extent to which freedom/institutions affect prosperity—*on average*. What the researcher would like to know just as much though is the extent to which a specific institutional reform will affect economic growth in a *particular* case. This is related to another methodological problem.
1. Statistical studies cannot control for all relevant factors. But a failure to control for relevant “background” conditions generates biased estimates of the effects of policy changes and reform. Moreover, omitting important causal factors will lead to biased results.
2. Estimating the effect of individual factors is challenging. After all, some changes may have highly non-linear effects in the context of specific background conditions, while having no or much more limited effects under a different constellation. Average effects can only ever be so helpful. The estimates derived from statistical studies therefore depend greatly on model specification and the theoretical assumptions underpinning it.
3. If statistical models fail to address the issue of the direction of causality—namely whether greater freedom or institutional reform leads to (or precedes) greater prosperity (or vice versa)—it is obviously not warranted to interpret the results one way or the other. Qualitative, historical studies find it much easier to address this issue.
4. Statistical studies should therefore be complemented by case studies, to move beyond correlation and to allow for

a greater appreciation of potential causal complexity and multiple causation, as well as the direction of causality.

Qualitative, small-N studies or case studies are better suited to fully explaining differences in prosperity (effects). Statistical studies focus on what is called the “effects of causes,” while qualitative studies focus on the “causes of effects.” Qualitative studies are better suited to account for “complex” causation (wherein a large number of factors contributes to prosperity) and “multiple” causation (wherein the same phenomena can be induced by different causes or different combinations of causes). If combined with process tracing, this allows the researcher to address the issue of the direction of causality more readily and explore the potential existence of confounding and omitted variables and differing structural background conditions. Compared to statistical studies, with their focus on correlation, such an approach also allows for a better understanding of the trajectories of change. The drawback is that small-N studies do not allow for a broader generalization beyond the cases analyzed, and the carefully examined cases may not generate a pattern. Nevertheless, insights from historical case studies will help sensitize researchers to interaction effects and a greater appreciation of context. They should also serve as reminders not to read too much into, or be overconfident about, the results of statistical analyses.

Economic growth: It’s complicated!

Economic growth and development are multi-causal, complicated, and sometimes complex social phenomena, as the review of the literature on geography, disease agents, or types of colonialism suggests. Different countries seem to have taken different paths toward prosperity (nineteenth-century Britain versus today’s

China, for instance). The survey of the literature suggests that *policies* matter, or can matter. It also suggests that *institutions* matter, or can matter. It also suggests that “exogenous” structural factors, such as geography or climate, may have an effect. But there is disagreement as to which factors matter, how much they matter, and under what circumstances. This is not helped by the fact that institutions and policies are closely intertwined. Statistical and qualitative analysis can only advance our confidence in the importance of the various factors so much. The available evidence suggests that it is helpful to think of various factors interacting to generate sustained economic growth, including and especially policies and institutions. At the same time, it is worth acknowledging that institutions do not function in a vacuum, isolated from existing social, economic, political, and maybe even socio-cultural realities (background conditions). Nor do policies, whose implementation is very much dependent on institutions. Moreover, even if quantitative research managed to overcome additional challenges, such as sample selection, mismeasurement, misspecification, complexity, and non-linearity,⁴¹ history would counsel against construing the relationship between freedom/institutions and prosperity in an overly simplistic or deterministic way. All of this should caution against a “one-size-fits-all” approach in terms of policy advice.

A purely quantitative analysis will also have little to say about the right sequencing of reform, or which policy measures should be prioritized. Statistical analysis will almost inevitably translate into one-size-fits-all policy advice. This should be avoided, or at least tempered, given methodological limitations, lack of unambiguous empirical results, multiple causation and complex interaction effects. Institutions as well as policies interact with other factors in complicated, sometimes complex ways, unlikely to be fully captured by a statistical model. Moreover, institutions are embedded in a country’s broader historical-cultural context and their proper and

effective functioning is dependent on a government's willingness and ability to uphold them. Institutions are embedded in a country's social context, which affects the way they function as well as their effect on economic outcomes. And institutional strengthening is often a long-term process. The effects of institutional reform are contextual. How quickly and efficiently institutional reform translates into high-quality, growth-enhancing policies will depend on context. Some countries reform their institutions and move onto a higher-growth path (e.g., Eastern European transition countries).⁴² Others reform their institutions along similar lines and do not experience faster economic growth (e.g., Mexico). Yet others manage to generate rapid economic growth despite limiting reform to economic institutions alone (e.g., China).

However, accepting that we can never be one hundred percent confident about the effects of proposed reform measures does not mean that we do not have any grounds at all for being somewhat confident that market-oriented institutional reform, or the pursuit of high-quality public policies aimed at mobilizing savings and investment, or building infrastructure, or supporting human capital, are conducive to sustained economic growth. At a bare minimum, the evidence strongly suggests that any measure that manages to increase investment on a sustained basis supports long-term economic growth.

Another reason to think about the effectiveness of institutional and policy reform measures in a context-sensitive way is that a laundry list of reform fails to tell policymakers which reform they should prioritize. It is desirable to identify the so-called "most binding constraint," namely the factor holding back economic growth the most and whose removal generates the greatest return in terms of economic growth.⁴³ Prioritizing measures that address this constraint is desirable economically. It is also desirable politically, given that governments typically have limited amounts of political capital at their disposal as well as a limited technocratic

capacity to formulate and implement reform. In light of methodological challenges, ambiguous empirical results, and the need to provide case-specific policy advice, it is difficult to disagree with Ricardo Hausmann et al.:

[T]rying to come up with an identical growth strategy for all countries, regardless of their circumstances, is unlikely to prove productive. Growth strategies are likely to differ according to domestic opportunities and constraints. There are of course some general, abstract principles such as property rights, the rule of law, market-oriented incentives, sound money, and sustainable public finances which are desirable everywhere. But turning these general principles into operational policies requires considerable knowledge of local specificities.⁴⁴

Prosperity is the outcome of sustained investment and economic growth. The evidence also suggests that economic prosperity is best conceived of as a multi-causal phenomenon.⁴⁵ Many factors contribute to prosperity. Institutions and markets matter. But so do public policies. So do political and economic stability. It is not one factor that generates lasting economic growth. It is a combination of factors. For individual reform measures to be successful, they need to take context into account in both their design and implementation.

Institutional reform, allowing for market-based competition and efficient capital allocation, may help one to achieve prosperity, provided one can sidestep market failures. State interventionist policies may also get one there, provided one can avoid government failure. The available evidence suggests that there are different paths leading to economic prosperity. Countries can be nudged onto these paths by different types of reform, depending on circumstances. At a minimum, measures need to increase investment

on a sustained basis. This may not be very helpful but it is the most certain thing that we can infer from the evidence. This is one more reason why one-size-fits-all policy should be resisted and causal complexity and multiple causation taken seriously when offering policy advice in the real world.

Prosperity: Freedom and its twin, cooperation

Michael Klein

You can only understand life backward, but it has to be
lived forward.

—SØREN KIERKEGAARD

IN 1798 THOMAS MALTHUS PUBLISHED his famous *Essay on the Principle of Population*. Prosperity at an individual level is elusive, he argued. Countries may grow. Yet, whenever economic growth occurs, people just have more children. Life for most individuals remains miserable—at the mere subsistence level.

Malthus based his argument on the data and observations available to him at the time. He was right about the past—as modern studies based on the best available data suggest.¹ Hundreds of years of evidence turned out to be anything but a solid basis for predicting the future or shaping policy.

Today, with twenty-twenty hindsight, we know that the nineteenth century ushered in an era of rising individual prosperity, which accelerated in the twentieth century. The number of people

Michael Klein is a professor at the Frankfurt School of Finance and Management (Germany) and a senior adjunct professor at the School of Advanced International Studies at Johns Hopkins University.

in extreme poverty is now lower in absolute terms than 200 years ago, even though global population expanded from around 1 billion in 1800 to some 8 billion today. Global fertility rates are just above the replacement level, at which the world's total population would remain stable.²

We live in unprecedented times. Gone are stable systems like ancient Egypt, which saw little structural change for three thousand years.³ At the same time the belief that humans can shape “God-given” society has emerged as prosperity rose.⁴ Massive social experiments have been conducted with ostensible failures and successes—witness the attempts at central economic planning or the spread of democratic mechanisms for decision making. Currently, not a day goes by without someone suggesting to “reimagine capitalism.”

The best we can do to understand what is happening, and to inform policy, is to dive into the mechanisms that underlie economic development and discuss how they might change. This essay delves into the role of freedom—and its “twin,” cooperation—in generating prosperity. In doing so, cooperation and the pursuit of freedom are discussed as means to an end: prosperity.

Sources of prosperity

Resources and ideas

Prosperity is based on a supportive natural environment including land, minerals, and a propitious climate.⁵ Faced with their environment humans can just exploit it or make more of it. Ideas, and the ability to apply them, are the key.

Ideas create new things, building blocks so to speak. These can then be combined into ever new inventions.⁶ An example is the modern computer. It rests on prior inventions such as the calculating machine, symbolic logic, the punch card, Audion tubes, and the

binary system.⁷ The more building blocks are generated, the more experiments are possible. With more potential experiments, the possibilities for failing also increase. For example, 100,000 types of airplanes were flown in the 1920s and 1930s; of these, only about 100 survived to form the basis of modern aviation.⁸ Failures may lead to new learning, and successes often surprise.

Freedom to compete

Coming up with new ideas and applying them requires freedom to think, experiment, and create businesses. Freedom to enter a market allows new products and services to emerge. Underperforming businesses exit the market when failure, including bankruptcies, is allowed: “freedom to fail.” The combination creates strong incentives to generate new ideas and adopt good ones. These freedoms are the essence of competitive markets,⁹ making them powerful engines of innovation, and of the spread and realization of new ideas.

Competitive markets clearly have a role in generating prosperity but remain vulnerable to vested interests. As Adam Smith put it: “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”¹⁰ When vested interests protect their own achievements, new ideas are stifled. An eminent historian of the knowledge economy quotes an apposite example—a guild ordinance from eighteenth-century Prussia: “No artisan shall conceive, invent or use anything new.”¹¹ For prosperity to advance, there need to be social and political mechanisms that allow the new to emerge in the face of resistance from the old, hence the importance of rules such as pro-competition policies and mechanisms to replace people in government.

When markets are not kept competitive within a particular jurisdiction, prosperity may still advance through competition between jurisdictions. The origin of the industrial revolution is

a case in point. Around the year 1500 AD, China was the most technologically advanced society.¹² Yet, the industrial revolution made headway in Europe. Arguably, it was the very fractious nature of Europe—with hundreds of kingdoms, principalities, and cities—that enabled this. When a new idea confronted resistance, the innovator had options to migrate to another place where the new idea was welcomed or at least tolerated.¹³ It can be argued that the inability to reestablish a large empire after the fall of Rome gave Europe a leg up compared to China, where periods of internal strife were overcome by central authority.¹⁴

Cooperation: The twin of freedom

Openness to new ways is key for prosperity. Equally important is the ability to cooperate, however messy this may be. Even invention itself is rarely a solitary process. It thrives on discussion, sharing information and joint experimentation. The modern term “innovation cluster” captures part of this reality. The industrial revolution already featured such clusters in England. In eighteenth-century Birmingham inventors James Watt and Matthew Boulton (steam engine), Erasmus Darwin (physician and grandfather of Charles), Benjamin Franklin (bifocal glasses) and Josiah Wedgwood (pottery) were part of the “Lunar Men,” so named because they met on evenings when the moon shone them the way to meetings where they discussed their ideas.¹⁵

Solving information and commitment problems

To cooperate, people need to exchange information and make promises. Information and promises must be credible. Humans have developed ways to solve these information and commitment problems even under most challenging circumstances, albeit at a cost. Gambetta discusses the ways in which criminals try to ascertain that a prospective partner in crime is a genuine criminal and not a police informant.¹⁶ They may, for example, use a long

prison record as a sign that the partner is a real criminal. Then follows the problem of how to make sure a bona fide criminal actually follows through on their promises, for example, by getting “dirt” on someone as a form of blackmail to enforce agreements.

Informal markets are plagued by similar challenges. Investors need to trust that the land, building, and machinery they invest in will be theirs. Traders need to trust information about product quality and promises of delivery. Moneylenders need to trust promises of repayment. Repeated interaction among the concerned parties underpins a key mechanism for overcoming these information and commitment problems.

Reputational mechanisms and trust

Repeated interaction provides an incentive to maintain a useful reputation. In essence a reputational mechanism revolves around a promise. Information then needs to flow to assess whether the promise is kept.¹⁷ In case it is not, there needs to be a punishment, often an out-casting mechanism or sanction, or the threat of violence in more extreme cases. Traders in and around the Mediterranean, or among Hanseatic cities in northern Europe, used agents in various ports and cities to report on whether promises about prices, quantities, and quality were being kept. If not, traders or cities would be cast out from the trading relationship. Extending the interest in maintaining reputation, more formal mechanisms developed in time, for example, *lex mercatoria*—the law of trade or contracting. Reputational mechanisms pervade all collaborative arrangements to varying degrees, whether in organizations or the market.¹⁸

The limits of laissez-faire

Highly informal arrangements—with nothing more than reputational mechanisms to support cooperation—are the closest thing to true laissez-faire economic policy. Informal moneylending

illustrates the limits of such approaches. Borrowers from money-lenders have an incentive to pay back if they expect to borrow again in the future. Moneylenders in turn deal with people they know and whom they expect to deal with again. To manage repayment risk the amounts they lend are small, repayment frequent, and charges high on account of the costs of conducting the business. The result? It is hard to pool savings and borrow large amounts. Maturities of loans are very short term. Default rates are kept low. Risk sharing—like in venture capital, where a few successful projects cover the default of most—is near impossible.¹⁹

In the absence of formal property rights and contracting law, businesses remain small and ephemeral.²⁰ Subsistence entrepreneurs and families benefit, but transformational investment is scarce to nonexistent. This was the predominant landscape that Malthus's analysis reflected.

Rules, rules, rules: The rise of institutions

The first firm with more than 1,000 employees was founded in 1760, the Soho Manufactory in Birmingham, England. This was extraordinary for an era in which even the largest firms only employed a few hundred laborers.²¹ Today however, organizations with more than 100,000 employees can be successfully managed.

Firms and markets require cooperation. Specialization, the division of labor that Adam Smith highlighted as a source of prosperity, needs firms to contract and trade. Trading and contracting are needed to bring products and services to customers. Today, expanding markets allow trades across the globe between people and firms who barely know each other. People invest trillions of dollars in ventures they do not know about, much less fully understand, for example when they save for retirement. Cooperation may usefully go together with rivalry in competitive markets. Agreeing to play by the rules is a form of cooperation that makes freedom to compete most productive.

Cities are the setting for almost all innovations and most economic activity. In the words of economist Ed Glaeser, “The geographic proximity created by cities allows ideas to travel more rapidly . . . and ideas are what lies behind economic growth.”²² City management in turn requires cooperation to provide the platform on which interaction between individuals and businesses thrives.

For all of this to happen, trust in information and promises needed to be strengthened beyond simple reputational mechanisms. This took the form of new and ever more sophisticated rules expressed in laws and regulations. New concepts were invented, for example, legal persons without physical existence like the limited liability company.²³ Central authorities made those rules and enforced them. They established property rights, contracting systems and information systems, such as cadasters or credit bureaus, underpinned by the enforcement powers of the state. In the words of the historian of government, Jean Dunbabin, “What distinguishes modern government from personal control is its unremitting character. To be governed is to be subjected to the regular pressure of an authority operating to fixed rules . . . In the full sense of the word, it is arguable that nobody was governed before the later 19th century . . .”²⁴

“Hayek and the Swiss President”

Some narratives about the sources of prosperity emphasize the role of competitive markets and their superiority over central planning. From this perspective progress can be seen as moving from “Karl Marx to Friedrich Hayek”—from central planning to free markets. Taking a longer view, the more fundamental shift may be characterized as moving from “Louis XIV to today’s President of Switzerland.” The former is to have said “l’état c’est moi” (I am the state)—a ruler above the rules, whereas hardly anybody knows the latter by name. The post-holder changes yearly, making

them the epitome of modern rulers who are themselves subject to rules.

It has thus become commonplace to attribute the prosperity of modern times to the underlying “institutions” or “rules of the game.”²⁵ Nations with better institutions became more prosperous—see, for example, South Korea vs. North Korea. The likelihood of being poor in 1870 was mostly a function of the social class someone was born into. By 2000 it was overwhelmingly a function of the country where one was born.²⁶

Making and enforcing rules: Authority

Rules must be made and improved from time to time. Rulemaking and enforcement require the exercise of authority, but they also need to command an adequate degree of legitimacy—that is, they must be buttressed by a form of ethics. Without some degree of consensus about what is legitimate, rules are hard to make and difficult to enforce.²⁷

Those exercising authority are easily tempted to abuse their power, which raises the age-old issue of “who guards the guardians?” Therefore it is desirable to have mechanisms to check powers and allow for change when needed. This is the economic case for checks and balances through the rule of law and accountability to an electorate. Voters with the ability to replace underperforming people in power can, in principle, improve rulemaking and enforcement without just relying on “palace coups.”

However, societal consensus about ethics or rules cannot simply emerge from “democratic” aggregation of individual views without recourse to some “higher” authority. Nobel Prize-winning economist Kenneth Arrow has shown that there is no way of aggregating disparate individual preferences without resort to some form of discretionary authority.²⁸

Whatever rules reign, they are by nature incomplete as it is impossible to foresee all possible contingencies. Loopholes are

inevitable. Application requires a dose of discretionary authority. Principles can help guide the exercise of discretion. “Principles have no loopholes,” as the saying goes. Yet, principles need interpretation.

There is also no obvious path to clear-cut agreement on principles of justice, nor on which rules are “best.” For example, utilitarian, libertarian, and communitarian conceptions of justice all command some ethical power. At the same time, each one is incomplete and may conflict with the others.²⁹ Tragic choices arise that cannot be satisfactorily solved, such as when it becomes inevitable to trade off one life against another.³⁰

As Yuval Noah Harari puts it: “Much of history revolves around this question: how does one convince millions of people to believe particular stories about gods, or nations, or limited liability companies?”³¹ None of these entities can be “touched” like physical ones. Yet, they can be powerful in aligning human behavior. These stories by necessity include some mechanism to exercise discretionary power—by priesthoods, governments, or company managers.

The conundrum thus becomes: Prosperity needs freedoms. It also requires cooperation, and that requires authority that constrains freedoms. That authority is expressed not only in rules but also in discretionary authority.³² Managers of firms, government officials, police commanders: they all need some level of authority. And while that authority can be limited, the very checks in place to do so require some degree of discretionary authority.

The dark side

Freedom and authority both are powerful forces that together can render societies prosperous. The discussion so far dwelled on the good they can do. Yet, there are dark sides exemplified by several narratives. The following stories are examples of core narratives.

Dark stories: Freedom

One type of story equates freedom with being unshackled from rules. Yet, “no rules” means freedom for those with power at the expense of the downtrodden. The result is a “game of thrones” rather than a prosperous society. Places like today’s Haiti or the eastern part of the Democratic Republic of the Congo feature such politics. Prosperity remains a vain hope as multiple “roving bandits” exploit farmers, businesses, and merchants.³³ Property is insecure. Investment is vulnerable to theft. The results of productive effort are “taxed” away. When each bandit tries to extract as much as possible from people, they kill the proverbial goose that could lay the golden eggs.

Another type of story may be told in more prosperous societies. Even with some sensible rules, freedom can favor the powerful. Unshackled markets wreak destruction on jobs and businesses. Some of this may be “creative destruction,” leading eventually to greater prosperity, but quite possibly with a very long lag and with misery for many—as in the industrial revolution.³⁴ Inequality may rise excessively. The winners end up fortifying their position by tilting political power in their favor, for example, through election campaign finance. Prosperity remains the privilege of the few. Benefits may not “trickle down” to the many. Even when democratic elections prevail, the “tyranny of the majority” may run roughshod over many citizens’ well-being.

When rules protect the freedom of people against excessive power, yet another dark story emerges. The classic version was told by Plato over 2,000 years ago. Where all people are free to contract, to elect their government, and live their lives as they wish, society may become ungovernable. As each citizen asserts their version of freedom and their demands for change, people clash. As Plato put it: “These and other kindred characteristics are proper to democracy, which is a charming form of government, full of variety and disorder, and dispensing a sort of equality to

equals and unequals alike.”³⁵ Meeting disparate demands is fraught with problems. NIMBYism (a form of opposition to some new development, “not in my back yard”) paralyzes investment. Some groups of people hold values that are at odds with social cohesion. Plato argues that this creates fertile ground for populists, who are able to dupe citizens, exploit their unrealistic wishes, and promise a path out of disorder. As a result, populists set free societies on a path to tyranny.

Dark stories: Authority

There is also no lack of stories about the dark side of exercising authority. At the extreme, totalitarian rulers may suppress sensible approaches to innovation and expertise. Stalin’s rule provides ample examples, this one concerning a major construction project and a senior engineer named Peter Palchinsky: “The building of the White Sea Canal [. . .] was a nightmare. It not only ignored the engineering principles of Palchinsky and his colleagues but it was also an obscene violation of human rights.”³⁶ Almost all workers were political prisoners and more than two hundred thousand died during construction. The canal failed to live up to its specifications from the beginning: it would freeze for half the year, and water levels were too low in the dry summers. For political—rather than technical—reasons, Palchinsky was executed in 1929. After World War II, the entire canal was rebuilt, running parallel to the first one.

North Korea remains a prime case of a centralized authority suppressing markets, and with them the engine of prosperity that propelled neighboring South Korea to high-income living standards within little more than a generation. Venezuela’s income levels nosedived as market forces were suppressed in the years following the Chávez regime.

Authoritarian rulers can do much better than fragile societies like Somalia (especially areas “ruled” from Mogadishu).

In Mancur Olson's terminology they can behave like "stationary bandits," preventing the bleeding of the land by "roving bandits."³⁷ The ruler provides basic security of property and contracts and may make use of market forces. This increases overall prosperity and allows the ruler to skim off far greater wealth than any roving bandit might. The downside is that merit-based approaches become limited as the ruling elite fears outsiders that may gain too much power. The outcomes of market forces may not be acceptable to the ruling elite.

The ruling elites may exploit their position for private gain. Such corrupt behavior is often the reward for buttressing the regime. Rules are violated with a degree of impunity. At the same time rules put in place ostensibly to constrain bad behavior may in fact provide a lever for abuse. If one can accuse someone of rule-breaking, it is easier to blackmail him for corrupt purposes or to eliminate political rivals. As Laozi put it in the sixth century BC: "The more laws and restrictions there are, the poorer people become . . . The more rules and regulations, the more thieves, and robbers."³⁸

Even the most successful autocrat faces succession problems. Setting up a merit-based process to find successors risks taking power out of the hands of rulers' confidants. Rulers often look to family members to succeed them. These may or not be competent. Strife among the ruling elites following the death or incapacity of the autocrat risks undermining political stability and prosperity.

Blueprints for prosperity?

There is some truth in all of these narratives, as well as variants thereof, and they are not mutually exclusive. For societies to prosper, freedoms are needed as are rules and some measure of discretionary authority. Each element of the equation also has

potential downsides. Studies of the causes of prosperity use international comparisons as well as case studies to assess what mix of freedom and authority works best.

Capitalism, alone

Few hard-and-fast lessons emerge from existing studies of the causes of prosperity. There is no engineering manual for building and operating a prosperous society. Yet some broad patterns appear, one of the primary ones being that central planning and heavy-handed suppression of competitive markets have not worked in the past. As Branko Milanovic puts it, today there is “capitalism, alone.”³⁹ The main issue is—with markets and competition embedded in prospering societies in some fashion—how democratic or authoritarian those societies are.

Sound rules

Well-functioning markets are based on rules including adequate clarity about property rights and contracting systems. A hypothetical laissez-faire regime where all is left to unconstrained private interaction is no recipe for success. What matters is which rules are best, and the details of their implementation.

Practical policy may often be best framed as “making rules disappear.” Just as with the complex technology and programming embodied in smartphones or computers, the challenge is to make that complexity disappear through well-designed user interfaces. Scandinavian economies are rarely accused of an excess of laissez-faire. Yet, they provide many examples of functional rules that are relatively easy for businesses to use.⁴⁰

Competitive disciplines

Several countries, for example Japan and South Korea, developed fast while using significant government direction of the economy, or “industrial policy.” What transpires from analysis of the

“East Asian miracle” is the importance of market-type discipline in the background.⁴¹ The political miracle was that government support in the form of tax, trade, and financing advantages was effectively tied to success in international markets. Governments thus relied on forms of contests.⁴² Contests are also a feature of research support: for example, in the United States, the “challenges” promoted by the Defense Advanced Research Project Agency (DARPA). Much modern technology, including the internet and Global Positioning System (GPS), is the result of US government-sponsored efforts to enhance military capability.⁴³

Democracy or autocracy?

Most of today’s rich countries feature extensive use of competitive markets and democratic systems of government.⁴⁴ It is less clear to what extent democracy is a cause of prosperity or a result. For example, the democratic regimes in Japan, South Korea, and Taiwan were arguably instituted by elites that were confident in their own future, with that confidence based in part on the economic success they had achieved.⁴⁵

For developing economies, existing studies suggest that economic growth in democratic countries may be less variable in the short run than in autocracies and somewhat higher in the long run, mostly due to less-severe setbacks. Many autocracies have suffered from the dark side of discretionary power. Yet, several have yielded spectacular advances in prosperity, not least China. Autocracies with some level of checks and balances and processes for succession—for example, in the form of an effective ruling party—may approximate the performance of democratic systems.⁴⁶

Multiple social and political systems can underpin a measure of rising prosperity for developing economies. The variety is exemplified by such diverse cases as Bangladesh, Botswana, Cambodia, Chile, India, Mauritius, Uruguay, Singapore, Rwanda, and Vietnam.⁴⁷ In a sense, it is encouraging that multiple pathways

to prosperity can work. It suggests that the way to prosperity is somewhat robust, since it is often able to accommodate country peculiarities.

The China factor

So far, development models of the democratic type (cue Denmark) or the more authoritarian type (cue Singapore) provide the main beacons for aspiring economies. China is now asserting its approach as a model, just as it is changing it.

China has combined autocracy with astonishing economic success, lifting hundreds of millions of people out of poverty in record time. China's performance since 1978 was heavily driven by an expanding and significant role for competitive markets, both domestically and in international trade and foreign investment—at least until a few years ago.⁴⁸ Competition may also be behind the relatively improved productivity performance of state-owned firms up to 2012.⁴⁹

China is now asserting greater powers for the state in the economy. The Communist Party is exercising oversight over private firms through party committees that are taking on greater roles in companies' management. State-owned enterprises are more widely favored again. Productivity growth is suffering.⁵⁰

Up to now, market forces continue to exert some discipline. Competition has even been introduced in the electricity sector in several provinces among state-owned generation companies, notably in Guangdong.⁵¹ At the same time new technologies, including artificial intelligence, may enlarge the scope for centralized decisions and control.

China's economic performance may well stall. After all, effective competition rests on acceptance of market outcomes. Greater discretionary intervention by political authorities may undermine this. Yet, China may just succeed in composing a new form of centrally managed economy with elements of competition and

contests. It seems unlikely, based on the historical record, but it might not be wise to rule out such an outcome.

Shifting sands: New challenges from prosperity

Prosperity is a good thing. It means freedom from material want. It goes together with better health and higher life expectancy, as well as more education. Surveys suggest it also allows people to be happier.⁵² Prosperity arguably provides glue that holds societies together and promotes peace.⁵³

Yet, prosperity can also bring its own problems. A key concern is that economic growth will at some point run into some form of resource constraint. Currently the big concern is the stress on the earth's ecosphere and the concomitant worry about climate change. Worryingly, countries are arguably confronted with the need to devise ever more intricate rules while the domestic and global political basis to choose and adopt good rules is eroding. Consider first the need for rules.

The rise of non-competitive sectors

Sectors of the economy where competition provides opportunities and the incentives to perform, tend to see higher productivity growth than other parts of the economy. When production becomes more efficient, the share of such sectors in an economy can easily shrink as countries become more prosperous. This has been the case for agriculture. Where once more than half the population was needed to produce food, only a few percent of people are required today. Manufacturing's share of total economic activity is shrinking in many advanced economies, precisely because it takes relatively fewer resources to produce what is demanded than in sectors where productivity is more stagnant, like in healthcare or education. The relative scope for competitive

markets may thus shrink. This means more reliance on sectors relying more heavily on non-market mechanisms of production. In this sense more prosperity goes together with a relative increase in rules and discretionary authority.

Coping with greater complexity

Prosperity goes together with rising complexity and new coordination problems. To some degree greater complexity strengthens the case for market forces, yet with greater challenges for competition policy. Interface problems between government and private enterprise are becoming more intricate.

For example, modern infrastructure is required. Much of this needs to be regulated in some fashion due to inevitable market power issues. Even where competitive markets can play a role, intricate market design by government is a must, for example, in electricity markets.⁵⁴ Government investment is important too, notably for road infrastructure.

New products and services are stacked on top of others, like the information and entertainment services that are made possible by preexisting technology platforms. Supply chains become more complex. They rely on coordination between private as well as government players, for example, in port service provision or access regulation for all sorts of platforms—telecommunication networks or financial payment systems, for instance.⁵⁵

More and more people are dealing with each other, directly and indirectly, over vast distances and with limited in-person interaction. Coping with the arising information and commitment problems requires more intricate rules for consumer protection. Some, such as food safety regulations, are relatively widely accepted. Others, like access to internet infrastructure, remain hotly debated. Global challenges, notably climate change policies, become more acute and bring in a host of new rule-making challenges, notably how de facto to “price” the cost of greenhouse gas emissions.

Centrifugal forces

While the need for good rules rises, growing prosperity unleashes centrifugal forces that may make agreements more elusive. As individuals become richer, they can afford to pursue personal beliefs and desires that go beyond taking care of the basics such as food, shelter, and safety.⁵⁶ Whether they seek entertainment, political activism or other pursuits that hold meaning for them, people with time on their hands—backed by resources—make the world a more colorful, but also disparate, even polarized place. Rising incomes may help hold societies together, but governability issues may also increase. Revolutions happen when rising classes seek change: Witness the French bourgeoisie in the eighteenth century. Terror groups like al-Qaeda recruit from relatively better-off households.⁵⁷

The era of globalization after World War II ironically also saw the creation of many nation states—mostly because of decolonization and the dissolution of the Soviet Union—making international agreements more complex. As countries get richer and more powerful, they may feel more confident in asserting their national interests. Mutually beneficial economic interdependence may align interests. Yet, the very success of economic development may make it harder to agree on rules as states can more easily afford to hold on to their own positions. Even determined economic problem cases like North Korea can do so. The United Nations may not become more united by achieving official, desirable development goals.

What will the future bring? Basic scenarios

Today, a new experiment in constructing a prosperous society is unfolding in China. A key theme is further strengthening of authority via the ruling party, including more restraints on private

firms and markets. The direction reflects in part an attempt to curb the excesses resulting from unchecked freedom, such as excessive inequality. It also reflects fears of internal turmoil and beliefs that the more individualistic, liberal societies are destined to fray.⁵⁸ The vast social experiment can be seen as guarding particularly against the dark side of freedom.

The liberal model recognizes the need for authority such as an effective state but emphasizes checks and balances on authority through the rule of law and accountability through democratic elections.⁵⁹ It sees markets with private firms as part of the solution. Overall, it is more concerned about the dark side of authority.

The coming decades will shed light on how the balance between the bright and dark sides of different models plays out—what mix is more conducive to propelling prosperity as the world evolves. Four basic outcomes over this time frame are imaginable. Evolution may affirm the superiority of the liberal model. Or it may just show the superiority of the Chinese experiment and other authoritarian approaches. It may also lead to continued rivalry among multiple viable models. Finally, a dystopian outcome may come to pass with both models fraying under their own internal contradictions—with the dark sides of the respective models overpowering the bright sides in both cases. The fate of Malthus's predictions should give us pause before completely ruling out any of the outcomes.

And the moral of the story is?

Unsurprisingly, freedom and cooperation are both needed to achieve prosperity. Cooperation requires the exercise of authority that constrains freedom. Authority may be exercised based on rules or discretionary decisions. Some scope for discretionary authority is unavoidable. Effective implementation of authority is

needed, including an effective state. Any good mix of freedom and authority needs to command an adequate level of legitimacy to be sustainable, based on a sufficiently widely shared system of beliefs that provides the glue holding society together. The system needs to be flexible enough to cope with evolving challenges that result in part from the very success of the system. The issue is thus not “freedom or authority” but concocting a good mix thereof in the face of the challenges of the times.

Who came first: Freedom or prosperity? An inquiry about liberty and well-being

Vladimir Fernandes Maciel
Ulisses Monteiro Ruiz de Gamboa
Paulo Rogério Scarano
Julian Alexienco Portillo

Introduction

THE AIM OF THIS CHAPTER is to analyze the relationship between freedom and prosperity, inspired by the neo-institutionalist approach, which proposes a relationship between cause and the positive effect of freedom on prosperity. The first section presents the neo-institutionalist perspective, drawing on the work of North,¹ and Acemoglu and Robinson.² A brief review of the empirical literature follows, with the aim of presenting the different methodological strategies used in assessing freedom and prosperity, and exposing the lack of studies employing the Atlantic

Vladimir Fernandes Maciel is head of the Mackenzie Center for Economic Freedom at Mackenzie Presbyterian University (Brazil).

Ulisses Monteiro Ruiz de Gamboa is a researcher at the Mackenzie Center for Economic Freedom at Mackenzie Presbyterian University (Brazil).

Paulo Rogério Scarano is head of the graduate program in economics and markets at Mackenzie Presbyterian University (Brazil).

Julian Alexienco Portillo is a researcher at the Mackenzie Center for Economic Freedom at Mackenzie Presbyterian University (Brazil).

Council's own indicators. The following section details the methodological procedures used in the present study. They involve the analysis of panel data for (a) testing the existence of cause-and-effect relationships between freedom (and its components) and prosperity, and (b) testing the temporal precedence between the two variables. With the methodology presented, we move on to analysis and discussion of the results, and a final section summarizes the work and provides some final remarks.

The New Institutional Economics: The theoretical perspective

To understand the relationship between freedom and prosperity it is necessary to rescue the discussion about how institutions affect freedom. For North, institutions are the formal and informal rules in force in each society.³ Formal institutions are created rules, such as laws and regulations. Informal institutions, on the other hand, are those rules that evolve over time, such as conventions and codes of conduct. Thus, institutions establish restrictions on what individuals can do and on the conditions under which certain activities can be carried out. In this way, institutions reduce uncertainties and provide a stable (but not necessarily efficient) structure, shaping the incentive system and shaping human interaction. By affecting transaction and production costs they impact economic performance and, consequently, prosperity.

The key, therefore, is to understand how institutions affect transaction and production costs. In this context, Acemoglu and Robinson distinguish “inclusive economic institutions” from “extractive economic institutions.”⁴ Inclusive economic institutions encourage the participation of a large part of the population in economic activities, making use of their best skills and reaping the fruit of their efforts. Thus, inclusive institutions imply the security of private property, an impartial legal system, and equal access

to public services. Taken together, these guarantee the realization of exchanges, the establishment of contracts, and entrepreneurial activity, favoring economic performance. Extractive institutions, on the other hand, aim to extract wealth and income from one part of society in favor of another, disfavoring economic performance.

According to Acemoglu and Robinson, economic institutions are created by society, and the rules that will govern them are chosen through politics.⁵ Thus, political institutions—that is, the rules that define how rulers are chosen, the structure and powers of government, and the purposes for which these powers can be used—are fundamental for the configuration of economic institutions and, consequently, for a society's degree of prosperity. In this sense, extractive political institutions tend to generate extractive economic institutions and to disadvantage economic performance. On the other hand, inclusive political institutions tend to generate inclusive economic institutions and favor economic performance.

North considers that the institutions of a society, both economic and political, tend to be a heterogeneous mixture of those that induce and those that reduce the chances of increasing productivity.⁶ A nation's long-term economic performance depends on the extent to which extractive or inclusive economic institutions prevail.

North argues that the incentives provided by the institutional matrix, in addition to the traditional incentives established by economic theory, conceive organizations formed to take advantage of the opportunities arising from them.⁷ "Organizations" can mean political, economic, social, or educational bodies, and encompass people bound by a common purpose. Thus, the formation and evolution of organizations are strongly influenced by the institutional framework. However, because organizations also provide a framework for human interaction, they influence how the institutional framework evolves.

In this sense, for North, institutional change results from the interrelationship between institutions and organizations, and from the way in which people perceive and react to changes in the available opportunities. It is noteworthy that institutional change is a complex and usually incremental process, although North does not rule out the possibility of discontinuous changes (resulting, for example, from wars and revolutions). The slow and incremental nature of institutional change stems from the informal constraints that are rooted in a society.⁸

The relationship between freedom and economic performance: Review of the literature

The contribution of the field of New Institutional Economy—including authors such as North, Acemoglu, and Robinson—has been to provide an analytical system that integrated institutional analysis into science and economic history. The subsequent challenge was to instrumentalize this analytical system to measure the contribution of institutions to economic performance. The traditional economic approach emphasized factors such as capital accumulation, innovation, and the formation of human capital, but for neo-institutionalists it is the institutions that create incentives for people to save, use capital, innovate, and invest in the formation of human capital.

Moreover, the measurement of the contribution of institutions to economic performance, in addition to using controls related to the contribution of physical capital and human capital, involves clearly defined measures of institutional quality (i.e., how inclusive and, therefore, free are the institutions of a society) and economic performance. In this sense, Gwartney and Lawson point out that freedom indexes, such as the Fraser Institute's Economic Freedom of the World Index⁹ or the Atlantic Council's Freedom

Index,¹⁰ can be understood as measures of institutional quality.¹¹ It is noteworthy that the Atlantic Council's Freedom Index has the advantage of measuring freedom in the political, economic, and legal spheres. Likewise, there are several approaches to measuring prosperity, but most empirical work uses measures related to the UN's Human Development Index (HDI) or gross domestic product (GDP) per capita. The Atlantic Council's Prosperity Index has the advantage of going beyond GDP and healthcare, encompassing factors such as the quality of the environment, the treatment of minorities, and the nation's overall level of happiness.

Here, we present a brief review of the empirical literature on this subject: works that seek to relate freedom and some measure of prosperity. It is worth noting that, as a measure of freedom, in general, the economic freedom indexes of the Fraser Institute, the Heritage Foundation¹² and, to a lesser extent, Freedom House¹³ are used. In turn, GDP per capita is the most frequent measure of prosperity and few studies adopt measures that consider other dimensions, especially of a more subjective nature. Finally, most studies seek to measure the contribution of explanatory variables to explain the dependent variable, through regression models, often using panel data. It is worth mentioning that some studies also seek to test the Granger causal relationship¹⁴ between freedom and economic performance; see, for instance, the work of Heckelman,¹⁵ Vega-Gordillo and Alvarez-Arce,¹⁶ Verdon,¹⁷ Piątek et al.,¹⁸ and Kocevská and Disoska.¹⁹

Hanke and Walters review the discussion of the relationship between economic freedom, prosperity, and equality.²⁰ With regard to the relationship between economic freedom and prosperity they estimate, for the year 1996, ordinary least square models in which the natural logarithm of GDP per capita is the dependent variable and the Freedom House political and civil freedom index is one of the explanatory variables. In each model, a different indicator of economic freedom is used (e.g., indices

from the Fraser Institute, Freedom House, Heritage Foundation, World Economic Forum, or indices of multiple deprivation). The study confirmed the hypothesis—that more economic and political freedom implies more prosperity. The equations created in the research successfully explained between 54 and 74 percent of the expected variability of GDP per capita among the countries analyzed, with a 99 percent confidence level.

Ayal and Karras analyzed the relationships between thirteen disaggregated components of economic freedom (from the Fraser Institute index), for fifty-eight countries for the period 1975–90.²¹ The main results indicate that components such as free trade, monetary stability, and low state interference in the economy, are fundamental to improving economic freedom, these being the elements that have a stronger relationship with economic growth.

Heckelman analyzed the causal relationship, in the sense of Granger, between economic freedom (and its components), measured by the Heritage Foundation index and the average annual growth rate for the period 1991–97 for 147 countries.²² The results suggest that, on average, economic growth is preceded by increased economic freedom. However, this is not the case for every component of the index: while most components do precede economic growth, the government intervention component was found to come *after* growth. The analysis also found no causal relationship, in the sense of Granger, between trade policy or taxation and economic growth.

Vega-Gordillo and Alvarez-Arce analyzed the relationships between economic freedom, democracy (as an indicator of political freedom), and economic growth for 100 countries, for the period 1975–95.²³ Two estimation methods were used: one-stage Arellano-Bond, and the two-stage generalized moments method of the Anderson-Hsiao instrumental estimator. The results indicate that political and economic freedoms positively and significantly impact economic growth, although the impact of

economic freedom is almost twice the impact of political freedom. The authors point out, however, that economic freedom tends to expand political freedom, while political freedom tends to expand economic freedom.

Verdon sought to identify the impacts of democratic capital on prosperity, measured by GDP per capita, for a group of 161 countries, through panel data and Granger causality tests.²⁴ The results indicate that democracy acts indirectly, through economic freedom, to improve prosperity. The causal relationship between democracy, economic freedom, and prosperity seems to have some sort of virtuous cycle: democracy and economic freedom can lead to better institutions, more stable economies, and greater opportunities for entrepreneurship and innovation, resulting in higher levels of economic growth and prosperity.

Faria and Montesinos examined whether the Fraser Institute's Economic Freedom of the World index could be used to predict growth in GDP per capita.²⁵ They address the problems associated with ordinary least square models, which, in the presence of endogenous variables, do not allow for causality to be established, and produce biased and inconsistent estimates. This study aims to define the exogenous component of the Fraser Institute's Economic Freedom index by utilizing a two-stage least squares method with instrumental variables. By employing this method, the study provides a more accurate assessment of the exogenous component of the economic freedom index. The results indicate a positive, robust, and economically significant relationship between the Fraser Institute Economic Freedom index and economic growth.

Mahmood et al. investigated the contribution of economic freedom to the long-term growth of Asian countries through panel data analysis.²⁶ The results for the countries analyzed (Bangladesh, India, Nepal, Pakistan, and Sri Lanka) show that GDP is positively and significantly impacted by the degree of economic freedom.

Market opening and foreign direct investment are the factors that generate the most impact, as well as the existence of the free private market.

Cebula et al. explored the impact of economic freedom on real GDP per capita (real income increase) in OECD nations during the period 2002–06.²⁷ For this purpose, the study used fixed effect estimates based on partial least squares. The sample consisted of twenty-nine OECD member countries. Data on economic freedom were taken from the Heritage Foundation index, unemployment and interest rate information was obtained from the OECD, and data for real per capita income were obtained from the International Monetary Fund. The results show that the greater the degree of economic freedom, the greater is the economic growth of the nation. In addition, the higher the level of economic activity, the higher the level of real GDP per capita. It is noteworthy, however, that financial freedom, freedom of work, and fiscal freedom did not show a statistically significant relationship to real per capita income in OECD countries.

Bender Filho et al. sought to measure the differences between developed and developing countries in the relationship between the degree of economic freedom and the level of economic growth, from 2000 to 2007.²⁸ The sample consisted of thirty-three countries, of which twenty-two were developed and eleven in development. The Fraser Institute index was used as the measure of economic freedom. To examine the heterogeneity of countries, the classification between developed and developing countries was adopted, based on GDP per capita, using data from the International Monetary Fund. The estimates were obtained using the generalized method of moments (GMM) for panel data. The results indicate that the degree of economic freedom in the five areas analyzed has influenced economic growth. Among the results, one of the notable findings of the study was the specificity of international trade, which showed a positive relationship

with economic freedom for developing countries but a negative relationship for developed countries.

Piątek et al. investigated the causal relationships between political and economic freedoms and the economic growth of countries that transitioned from communism to capitalism.²⁹ The work analyzed twenty-five post-communist countries, for the period between 1990 and 2008, using twenty indicators of political and economic freedom to estimate Granger's causality tests. The results showed that while economic freedom has a positive impact on the economic growth of economies in transition, political freedom has a neutral impact on growth. In turn, economic growth Granger-causes changes in the political freedom of countries in transition.

Spruk and Kešeljević sought to verify the effects of institutional changes (measured by the Heritage Foundation's Index of Economic Freedom) on subjective well-being (happiness).³⁰ An exploratory data analysis was carried out, involving 138 countries, from 1996 to 2010. The happiness data were extracted from the World Bank and the Heritage Foundation's economic freedom index. Other variables, including unemployment, income, public health, civil liberties, political and religious freedoms, crime and violence, were part of the analysis. Countries with higher economic freedom were found to have high levels of subjective well-being. However, when income, unemployment, public health, and individual freedoms are lower, the level of happiness is reduced. Finally, the work suggests that increasing economic freedom can have a negative effect on happiness in the long run.

Hussain and Haque analyzed the impact of economic freedom (measured by the Heritage Foundation index) on economic growth (measured by the annual GDP growth rate and, alternatively, by the five-year growth rate, using data from the World Development Indicators of the World Bank).³¹ To do so, they built two sets of data panels. The first consists of a fixed effects model for a sample

of 186 countries, involving the years 2013, 2014 and 2015. The second consists of a random effects model for fifty-seven countries, encompassing the period 2004–14. The authors conclude that there is robust evidence of the positive relationship between the economic freedom index and the economic growth rate. Components measuring commercial, financial, business, labor, and fiscal freedoms all show a positive impact on economic growth.

Çifçi et al. investigated the effects of economic freedom on economic growth in a sample of thirty-five OECD countries, using a panel with annual data from 1996 to 2015.³² Their economic freedom data came from the Heritage Foundation index, and GDP per capita data from the World Bank's World Development Indicators. The econometric methodology was divided into three steps. First, a unit root test was performed for the variables, making them stationary by applying the first differences. In the second step, the long-term relationships between the variables were found. In the third step, the long-term relationships between the variables were estimated by dynamic least squares and fully modified ordinary least squares. The results reveal that economic freedom positively affects economic growth and that a one-point increase in a country's economic freedom index generates an increase in the expected variability of GDP per capita of between US\$857.73 and US\$861.41.

Attilio evaluated the relationship between economic freedom and the prosperity of countries (measured by economic growth).³³ For economic growth, the study used real GDP in purchasing power parity, made available by the Penn World Table, and to evaluate economic freedom, the Fraser Institute's economic freedom index was used. The work covers a sample of 107 countries—in Latin America, Europe, Asia, and Africa—for the years 1970–2014. Panel data with fixed effects were estimated in all regressions. Developed and developing economies are separated. The results suggest a positive relationship between the economic freedom index and economic growth. Even performing different robustness

tests, controls, specifications, and alternating samples and proxies, the results remained. The results indicate that the economic freedom index is associated with a higher growth of per capita income, a higher stock of capital per worker, higher productivity, and a higher level of investment.

Al-Gasaymeh et al. investigated the dimensions of economic freedom contributing to economic growth.³⁴ They used a sample of 13 countries in North Africa and the Middle East from 2010 to 2018, using the generalized method of moments for dynamic panel data. Economic freedom data were taken from the Heritage Foundation index, and annual GDP per capita data from the World Bank Development Indicators. The empirical results were consistent and revealed that all dimensions of economic freedom positively influence economic growth. The study also concluded that the greater the economic freedom, the faster the economic growth will be, increasing the quality of life of individuals.

Kocevska and Disoska examined the relationship between the Cato Institute's Human Freedom Index and economic growth for countries and for global regions. They used Granger's causality test for panel data, to determine the direction of the freedom/growth relationship.³⁵ The results for 160 economies analyzed are in line with similar studies described throughout this section, in showing that there is a long-term causal relationship between human freedom and GDP growth per capita. In turn, economic growth does not Granger-cause human freedom. On the other hand, the regional results were more heterogeneous. The authors note the difficulty in making regional comparisons, given that regions differ greatly in terms of the number of countries and, therefore, the number of possible observations for the statistical test. In this context, causation relationships were found between human freedom and economic growth only for the East Asia and Pacific region, and partially for Europe, Central Asia, and Latin America and the Caribbean.

It is worth noting that, although there is a significant amount of work that uses measures related to GDP per capita as a dependent variable, and indicators mainly of economic freedom as an explanatory variable of interest, there are few studies that address both freedom and prosperity from a broader perspective. It is this gap that the present work seeks to fill by adopting the rates of prosperity and freedom of the Atlantic Council's Freedom and Prosperity Indexes as analyzed variables. The next section details the methodological procedures used in this project.

Methodology

Data panel models

The methodology for analyzing the panel data follows the classic formulation explained in Wooldridge.³⁶ The data structure is the combination of cross-section observations over time (time series). The advantages of the panel methodology are not only the data structure, but also that it can treat both the common and individual factors of the groupings. There are 174 countries and four years (2006, 2011, 2016, and 2021), totaling 696 observations regarding freedom and prosperity measures. In addition, the panel methodology ends up having more degrees of freedom and variability than the pooled data method.

The first attempt to explore causal relationships between freedom and prosperity using Atlantic Council indexes was based on a simple model inspired by the literature and the empirical review discussed in the previous section: "prosperity is a function of freedom, human capital, and technological progress."

$$\begin{aligned} Prosperity_{i,t} = & \alpha_0 + \beta_1.Freedom_{i,t} + \beta_2.Human\ Capital_{i,t} \\ & + \beta_3.Technological\ Progress_{i,t} + \epsilon_{i,t} \end{aligned}$$

The indicators of prosperity and freedom are provided by the Atlantic Council. Human capital is measured by returns on human capital and technological progress is measured by the total productivity of the factors, both made available in version 10.0 of the Penn World Table.³⁷

This modeling is limited by data availability, not only because there are four years of observations, but because not all countries have information about human capital and factor productivity for the years 2006, 2011, 2016, and 2021. The descriptive statistics of the variables used are presented in Table 1 below.

Table 1. Descriptive statistics

Variable	Number of observations	Mean	Standard deviation	Minimum	Maximum
Prosperity	696	50.57	19.06	15.47	98.63
Freedom	696	56.28	19.30	10.26	92.45
Economic freedom	696	64.04	17.13	8.33	94.37
Legal freedom	696	46.81	18.92	3.78	90.56
Political freedom	696	57.98	26.20	0.78	100.00
Human capital	423	2.54	0.70	1.13	3.81
Years of schooling	691	8.27	3.31	0.97	14.13
Total factor productivity	345	1.00	0.14	0.45	2.04

Source: Authors' own data.

In addition to estimating these coefficients for the set of countries, a regionalized exercise was carried out, estimating the coefficients for a model that is more simplified and more appropriate to the limitations of the number of observations. Coefficients were estimated for the Americas, South Asia, Sub-Saharan Africa, Middle East and North Africa, Europe and Central Asia, East Asia and Pacific regions according to the equation below.

$$\ln(\text{Prosperity}_{i,t}) = \alpha_0 + \beta_1 \ln(\text{Freedom}_{i,t}) + \beta_2 \ln(\text{Human Capital}_{i,t}) + \epsilon_{i,t}$$

In this specific case, human capital was measured by the average years of schooling, using data from the United Nations Development Program.³⁸ This would maximize the number of observations without missing data for countries, which would enable regional estimates. Moreover, the model is log-log, so the interpretation of the coefficients is the elasticity (e.g., “sensitivity”).

Stata 17 software was used for all estimations (general model and regionalized models).

Granger causality test in panel data

From the empirical point of view, Granger causality tests in the panel data version constitute an extension of Granger’s pioneering work,³⁹ starting from the specification of a bivariate model of the following type:

$$y_{i,t} = \alpha_{0,i} + \alpha_{1,i} y_{i,t-1} + \dots + \alpha_{k,i} y_{i,t-k} + \beta_{1,i} x_{i,t-1} + \dots + \beta_{k,i} x_{i,t-k} + \epsilon_{i,t}$$

$$x_{i,t} = \alpha_{0,i} + \alpha_{1,i} x_{i,t-1} + \dots + \alpha_{k,i} x_{i,t-k} + \beta_{1,i} y_{i,t-1} + \dots + \beta_{k,i} y_{i,t-k} + \epsilon_{i,t}$$

Where y and x are stationary variables, t represents the temporal dimension of the panel, and i refers to the cross-sectional dimension of the same panel.

Additionally, we assume that the panel data is a large set of stacked data, with equal coefficients along all cross-sections:

Thus, the Granger causality test for panel data will be performed, which verifies the existence of temporal precedence between y and x . The null hypothesis for the test is that y does not Granger-cause x , and x does not Granger-cause y .

$$\alpha_{0,i} = \alpha_{0,j}, \alpha_{1,i} = \alpha_{1,j}, \dots, \alpha_{l,i} = \alpha_{l,j}, \forall i,j$$

$$\beta_{0,i} = \beta_{0,j}, \beta_{1,i} = \beta_{1,j}, \dots, \beta_{l,i} = \beta_{l,j}, \forall i,j$$

The test was performed for the complete data sample from 174 countries and for the regions, according to the World Bank classification: Europe and Central Asia, Latin America and Caribbean, Middle East and North Africa, North America, South Asia, East Asia and Pacific, and Sub-Saharan Africa. The software used was EViews 12.

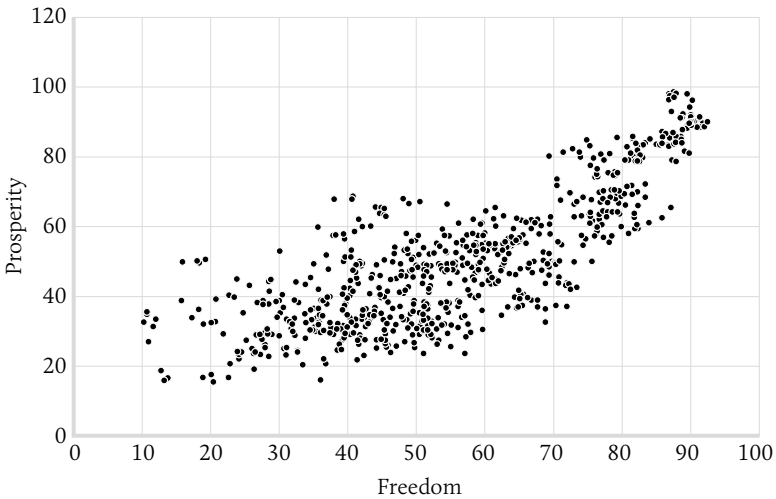
However, to perform the Granger causality tests, a linear interpolation was performed to fill the missing data gaps for all countries (in terms of the freedom and prosperity indices) for the years 2007, 2008, 2009, 2010, 2012, 2013, 2014, 2015, 2017, 2018, 2019, and 2020. Stata 17 was used for data interpolation.

Empirical results

Estimated panel data models

Figure 1 shows the existence of a strong association between prosperity and freedom indices. The calculated correlation is 0.81. However, it is necessary to explore the existence of a causal relationship and for this reason the coefficients of the models presented in the Methodology section were estimated.

Figure 1. Dispersion diagram: Prosperity and freedom



Source: Dan Negrea and Matthew Kroenig, “Do Countries Need Freedom to Achieve Prosperity? Introducing the Atlantic Council Freedom and Prosperity Indexes,” Atlantic Council, <https://www.atlanticcouncil.org/in-depth-research-reports/report/do-countries-need-freedom-to-achieve-prosperity>.

Among the panel data models there are two possibilities. The estimation of fixed effects models and the estimation of random effects models. As can be seen in Table 2, there is a substantial difference in magnitude between some coefficients for cases of fixed effects and random effects.

The estimated model had to have two binary variables (0 and 1) for the years 2011 and 2016, to capture specific effects of these years.

The resulting statistics were used to identify the type of panel model to be adopted. The result of the test was $\chi^2(5) = 139.82$, so $\text{prob} > \chi^2 = 0.000$. If this value is below 0.05, the predominant effect is fixed. In this case, the fixed-effect model therefore explores the relationship between the estimated variables and the results within a country. Each country has its own individual

characteristics, or idiosyncrasies, that may or may not influence the estimated dependent variable. If it were a model of random effects, explains Wooldridge, it would deal with the unobserved heterogeneity, if the specific individual effects correlated with the independent variables.

Table 2. Fixed effects and random effects

y = prosperity	Fixed effects	Random effects
Freedom	0.138*** (3.43)	0.377*** (10.84)
Human capital	0.168*** (4.29)	0.356*** (10.27)
Total factor productivity	0.027*** (3.64)	0.024*** (2.94)
Dummy 2011	0.003 (0.54)	-0.011** (-1.97)
Dummy 2016	-0.014* (-1.93)	-0.044*** (-6.38)
N	345	345
R ² within	0.222	0.193
R ² between	0.821	0.817
R ² overall	0.814	0.811

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Source: Authors' own data.

Therefore, two regressions were performed assuming that the coefficients are adequately estimated by a fixed effects model (see Table 3). The first regression used the synthesis index of freedom and the second regression replaced it with its components (economic freedom, legal freedom, and political freedom).

Table 3. Fixed effects panel regressions

y = prosperity	Regression 1	Regression 2
Freedom	0.138*** (3.26)	
Human capital	0.168*** (4.54)	0.168*** (4.74)
Total factor productivity	0.027*** (3.78)	0.026*** (3.94)
Dummy 2011	0.003 (0.76)	0.003 (0.68)
Dummy 2016	-0.014* (-1.72)	-0.014 (-1.55)
Economic freedom		0.027 (1.02)
Legal freedom		0.119* (1.90)
Political freedom		0.038 (0.94)
N	345	345
R ² within	0.222	0.230
R ² between	0.821	0.831
R ² overall	0.814	0.825

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Robust errors in parentheses.

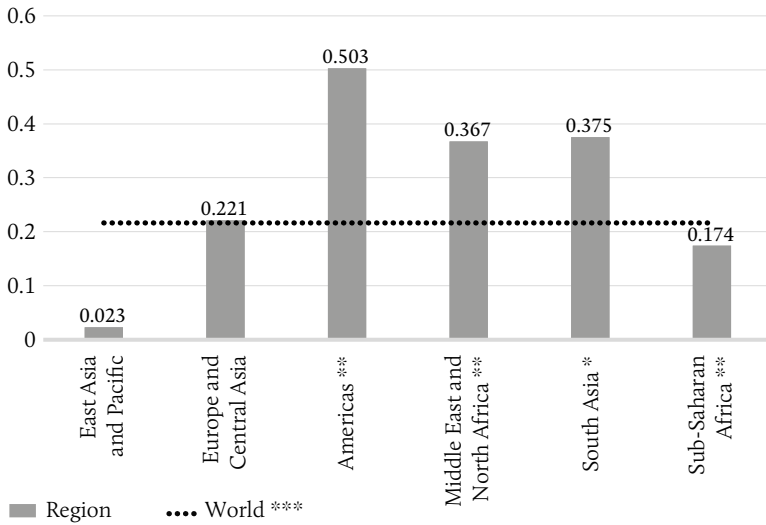
Source: Authors' own data.

This first exercise shows that, on the world average, the greater the degree of freedom of a country, the greater its prosperity, controlling for technical progress and human capital. This relationship, besides being positive, is statistically significant. Every one-point increase in the freedom index increases prosperity by 0.14 point. In addition, it is noted that human capital and technological progress also positively and significantly affect the prosperity of countries.

The second regression seeks to explore the components of freedom. It is perceived that legal freedom, which is related to the rule of law, is the component that affects prosperity in a more intense and statistically significant way.

Figure 2 and Table 4 show the results of regionalized grafting. As stated earlier, the estimated model is log-log type and coefficients can be interpreted as elasticities. In addition to freedom, the only variable of control that it was possible to introduce was human capital measured by years of schooling, given the limitations imposed by degrees of freedom.

Figure 2. Elasticities of freedom on prosperity



* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Source: Authors' own data; see Table 4.

Despite the restrictions imposed by the availability of observations, this exercise shows that the sensitivity of prosperity to freedom varies between the regions of the world. East Asia and

Table 4. Regional regressions

$y = \ln$ (prosperity)	World	East Asia and Pacific	Europe and Central Asia	Americas	Middle East and North Africa	South Asia	Sub-Saharan Africa
\ln (freedom)	0.216*** (3.41)	0.023 (0.18)	0.221 (0.87)	0.503** (2.39)	0.367** (2.22)	0.375* (2.01)	0.174** (2.06)
\ln (years of schooling)	0.139*** (3.38)	0.294*** (2.77)	0.051** (2.10)	0.029 (0.43)	0.059 (0.52)	-0.117 (-0.82)	0.330*** (3.23)
N	691	80	192	128	80	27	184
R ² within	0.123	0.314	0.0666	0.236	0.334	0.175	0.108
R ² between	0.748	0.789	0.714	0.187	0.572	0.467	0.442
R ² overall	0.731	0.768	0.698	0.188	0.553	0.442	0.413

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. Robust errors in parentheses.

Source: Authors' own data.

Pacific and Europe and Central Asia do not present statistically significant freedom coefficients, while the other regions do. The largest elasticity (sensitivity) of prosperity in relation to freedom occurs in the Americas (0.503), followed by South Asia (0.375) and Middle East and North Africa (0.367) respectively—all above the world average (0.216). Sub-Saharan Africa, on the other hand, has an elasticity of 0.174, lower than the world average, although statistically significant.

Granger causality tests in panel data

The first step to perform Granger causality tests is to verify whether the series of freedom and prosperity indices are stationary, because, as in the original version, the Granger causality test assumes that the variables under study do not contain a unity root.

For the total sample and for the regions, the panel unit root test used was the Levin-Lin-Chu, which assumes common roots for all cross-sections.⁴⁰ The most parsimonious determinist specification and Parzen kernel estimation method were used, and lags were defined by the modified Akaike information criterion.

The results of the unit root tests point to the rejection of the existence of a stochastic trend for freedom and prosperity indexes in practically all cases, as shown in Tables 5 and 6. The only exception occurred for the freedom index in the Sub-Saharan Africa region.

Given that almost all variables are stationary, it was possible to perform Granger causality tests with data at the original level. In the case of Sub-Saharan Africa, given the existence of a unit root in the case of the freedom index, the test was performed using this variable in first difference.⁴¹

There is no clear rule about the number of lags that this causality test should use, and therefore, given the data limitations of the samples used, we chose to perform the test for lags that were from one to five. In the North America region, the reduced sample

size did not allow more than two lags, and in the Sub-Saharan Africa region no more than four lags.

Table 5. Levin-Lin-Chu unit root tests for freedom

Sample	Statistic (5%)	Result
Total	-16.38	Stationarity
Europe and Central Asia	4.61	Stationarity
Latin America and Caribbean	-9.39	Stationarity
Middle East and North Africa	-4.09	Stationarity
North America	-2.08	Stationarity
South Asia	-3.28	Stationarity
East Asia and Pacific	-2.54	Stationarity
Sub-Saharan Africa	18.7	Non-stationarity

Source: Authors' own data.

Table 6. Levin-Lin-Chu unit root tests for prosperity

Sample	Statistic (5%)	Result
Total	-18.83	Stationarity
Europe and Central Asia	-2.13	Stationarity
Latin America and Caribbean	-6.21	Stationarity
Middle East and North Africa	-2.89	Stationarity
North America	-1.85	Stationarity
South Asia	-3.78	Stationarity
East Asia and Pacific	-2.74	Stationarity
Sub-Saharan Africa	-8.15	Stationarity

Source: Authors' own data.

Again, tests were performed for the total sample and for the seven previous regions. The results are shown in Tables 7 and 8. In almost

Table 7- Granger causality from prosperity to freedom

Sample	Statistic lag = 1 (5%)	Statistic lag = 2 (5%)	Statistic lag = 3 (5%)	Statistic lag = 4 (5%)	Statistic lag = 5 (5%)
Total	1,518.28*	1,344.29*	1,243.98*	1,722.15*	1.2e+20*
Europe and Central Asia	55.25*	176.76*	177.11*	265.75*	5.6e+19*
Latin America and Caribbean	651.47*	26.46*	26.11*	39.00*	1.1e+20*
Middle East and North Africa	40.03*	57.87*	59.88*	89.26*	7.7e+21*
North America	27.86*	1.93	-	-	-
South Asia	59.40*	57.14*	46.34*	62.13*	3.9e+21*
East Asia and Pacific	45.34*	11.99*	17.88*	37.17*	8.2e+16*
Sub-Saharan Africa	33.68*	325.62*	296.27*	374.18*	-

* indicates rejection of the null hypothesis of non-Granger causality.

Source: Authors' own data.

Table 8. Granger causality from freedom to prosperity

Sample	Statistic lag = 1 (5%)	Statistic lag = 2 (5%)	Statistic lag = 3 (5%)	Statistic lag = 4 (5%)	Statistic lag = 5 (5%)
Total	1,715.70*	864.39*	823.34*	1,154.99*	5.7e+20*
Europe and Central Asia	42.77*	108.32*	122.66*	205.19*	9.4e+19
Latin America and Caribbean	1,397.25*	133.26*	117.71*	154.56*	1.2e+20*
Middle East and North Africa	16.72*	11.51*	16.07*	34.08*	4.3e+21*
North America	99.67*	9.53*	-	-	-
South Asia	67.12*	33.07*	30.67*	41.67*	1.9e+21
East Asia and Pacific	33.67*	19.7*	25.97*	49.00*	3.2e+16*
Sub-Saharan Africa	370.25*	62.54*	53.78*	55.49*	-

* indicates rejection of the null hypothesis of non-Granger causality.

Source: Authors' own data.

all cases, the results point to a bicausality, like that found by Kocevská and Disoska, between economic freedom and economic development.⁴² In other words, freedom would precede prosperity and prosperity would precede freedom, constituting a feedback effect. The exception was the North America region, where the test with two lags points to the existence of Granger causality from freedom to prosperity, but not in the opposite direction.

Final remarks

This chapter sought to analyze the empirical relations between freedom and prosperity, both in a broad sense, as measured by the Atlantic Council. This analysis is based on the neo-institutionalist approach that points out the importance of institutions that favor the exchange of property rights through the market in improving the socioeconomic performance of nations. This is because, in freer societies in which individuals can reap the rewards of their choices, there are incentives for entrepreneurial activity, capital accumulation, innovation, and investment in human capital to meet the challenges of competition. It is noteworthy that, in addition to the economic dimension, prosperity also includes respect for minorities, care for the environment, and the health and happiness of citizens, which are also more easily provided by freer societies.

To perform the empirical study, this work adopted two methodological strategies. First, a panel data analysis was performed, which estimated the coefficients of freedom over prosperity, considering control variables, such as return on human capital, schooling, and total productivity of the factors. This was the adopted procedure for all countries and for different regions of the world (using the World Bank regional classification). Secondly,

Granger causality tests were performed for panel data for the total sample and for those regions.

The results of the panel data analysis are in line with the theoretical perspective and indicate that the greater the freedom, the greater the degree of nations' prosperity. Among several components of freedom, legal freedom stands out for its statistical significance and the magnitude of its estimated coefficient. It is noteworthy that the magnitudes and statistical significance of the coefficients related to freedom differ between regions.

In turn, the results of Granger causality tests point, in almost all cases, to a bi-causal relationship between freedom and prosperity. In other words, freedom precedes prosperity and prosperity precedes freedom. This concurrency suggests an element of symbiosis between freedom and prosperity, leading to self-reinforcing cycles, both virtuous (higher levels of freedom and prosperity lead to more freedom and prosperity) and vicious (lower levels of freedom and prosperity lead to less freedom and prosperity).

It is also worth noting that these results were obtained from a short time span of data. Neo-institutionalist literature points out that institutional changes occur gradually, exerting more sensitive effects on the prosperity of a nation in longer terms. This reinforces the merits of the Atlantic Council's initiative to develop broader indexes of freedom and prosperity and the importance of maintaining them over time. Thus, future studies can benefit from a greater temporal amplitude, producing increasingly robust results.

The causal relationship between economic freedom and prosperity

Jamie Bologna Pavlik
Benjamin Powell
Andrew Young

THE FULL TITLE OF ADAM SMITH'S 1776 magnum opus is *An Inquiry into the Nature and Causes of the Wealth of Nations* and economists have been asking about the sources of long-run economic growth ever since. Even Robert Lucas, a Nobel Laureate who won the prize in economics for work on short-run business cycles, eventually turned his research efforts toward the long-run questions. In doing so he frankly stated: "The consequences for human welfare involved in questions like these are simply staggering. Once one starts to think about them, it is hard to think about anything else."¹ Despite nearly 250 years of economic thinking on the topic since *The Wealth of Nations* was published, we think Adam Smith had much of the story right when he observed that "Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable

Jamie Bologna Pavlik is a research fellow at the Free Market Institute at Texas Tech University.

Benjamin Powell is the executive director of the Free Market Institute at Texas Tech University.

Andrew Young is the director of graduate students and a research fellow at the Free Market Institute at Texas Tech University.

administration of justice; all the rest being brought about by the natural course of things.”² In other words, little else is required than to provide individuals with *economic freedom*.

Over the last thirty years multiple indexes have been created that measure economic freedom in a way that approximates the ideal outlined by Adam Smith. During that time, hundreds of studies have been published linking economic freedom to higher income levels and growth, as well as many other desirable outcomes (e.g., life expectancy).³

The Atlantic Council has now constructed a new country-level index of economic freedom. In this chapter, we explain how theory suggests that greater economic freedom will make a country more prosperous. We then use the Atlantic Council’s Index to illustrate, first, a positive correlation between economic freedom and prosperity. Then, second, we use a modern empirical technique to further illustrate that the relationship is causal. This is precisely what Adam Smith and subsequent economic theory indicates we should expect.

Theory: Why economic freedom promotes prosperity

All societies confront the same fundamental economic problem: how to organize their scarce resources to satisfy individuals’ most important desires out of the infinite array of possibilities. Societies that solve this problem well, and repeatedly re-solve the problem as circumstances evolve, are prosperous and grow. Those that do not are poor and stagnant.

A market economy solves the economic problem by allowing decentralized competition between entrepreneurs to discover, and continually rediscover, the solution. But the quality of the institutional and policy environment is crucial for how well entrepreneurs perform this task. The institutional and policy

environment provides entrepreneurs with the incentives and information that guide their actions. When that environment provides more economic freedom, it channels their efforts in ways that promote prosperity.⁴

Economic freedom is characterized by: well-defined and enforced *property rights*; the ability of those holding property rights to *freely trade* them with others, including individuals from other countries; and, lastly, the ability of individuals to *invest* their property in ways they find most profitable. Why do we expect economic freedom, as here characterized, to be important for prosperity?

To begin with, *property rights are the bedrock of any market economy*. Without rights of ownership, individuals cannot engage in market exchange that moves resources from less- to more-valued uses. And in thinking about this, we must note that property rights can be more or less complete; also more or less secure. In general, any property right can be defined in terms of (a) the right to *use* something, (b) the right to *exclude* others from using that something, and/or (c) the right to *transfer* that property to someone else. A more complete property right is defined to a greater extent in terms of (a), (b), and (c); a more secure property right is one where there is a greater expectation that definitions in terms of (a), (b), or (c) will be enforced.

The definition and enforcement of property rights are complementary. (The former without the latter is moot; the latter without the former is trivial.) The greater the extent to which you have both together, the more that owners can use their property—and profit from using it—themselves or via exchange with others. As such, well-defined and enforced property rights provide incentives to use that property in ways that are most valuable to society (within the hands of the owner *or* by the owner knowing when it is better to transfer the property into the use of others).

Alternatively, if property rights are incomplete or insecure, it will decrease the incentive to use them efficiently. For example, in the United States, we have property rights in our own bodies, but these property rights are incomplete. For example, we can *use* our kidneys; we can certainly *exclude* others from using them; but our rights to *transfer* them are severely proscribed. We can give (donate) them away, but we are not allowed to sell them. In this case, the property right to our kidneys is incomplete. An implication is that individuals with two good kidneys are not incentivized to trade one of them to someone else who values it more highly. This fact is evidenced by people who wait for years on (donor-based) transplant lists or—tragically—die while they had the means to bid a competitive price.

Similarly, even if one does have complete property rights, if those rights are not secure, owners may not have the incentive to put the property to its highest valued use. Imagine being given formal legal title to a factory in Haiti. If you do not believe your property will be secure from criminal gangs or future government nationalization, you would have no incentive to invest for the long run.

When property rights are relatively complete and secure, they provide incentives for entrepreneurs to channel resources to their highest-valued uses. Of course, the process still requires entrepreneurs to be able to know what the highest-valued uses are. Furthermore, the process requires that they know how the highest-valued uses are changing over time (with, for example, technological changes or the changing preferences of individuals). That is where prices come in. Market prices provide the information about the relative scarcity of resources in alternative uses. When the price of any resource increases, it signals that the resource is now valued more highly somewhere else in the economy. Owners of the resource then have an incentive to sell it off into the hands of others. (Importantly, those sellers do not need

to know where or why the resource is more urgently needed elsewhere. They need only see the price change.)

As the Nobel Laureate Friedrich Hayek notes: “The marvel is that in a case like [this], without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people . . . are made to use the material or its products more sparingly; *i.e.*, they move in the right direction.”⁵ Changes in market prices give entrepreneurs incentives to move resources towards more highly valued uses, doing so by conveying the minimum of information necessary for them to do so. In a world where knowledge of market conditions and people’s preferences are in continual flux, the price system’s economization of information is invaluable.

All of the above requires that entrepreneurs are able to *freely trade their property with others*. Those others not only include individuals within their own country, but also individuals across the globe. For domestic entrepreneurs, exports can greatly increase the scope of the demand for their product, allowing them to increase production. Similarly, imports serve as important components and raw materials in their production process. Shutting off international trade would deny entrepreneurs many mutually beneficial opportunities for exchange. Put differently, restrictions on international trade mean that individuals in any given country have severely circumscribed property rights.

Furthermore, part of being able to exercise one’s property rights is to be forward-looking in terms of how one employs resources (or decides to transfer those resources). Indeed, the world is dynamic and decisions involving capital—that is, resources which are devoted now in search of future profits—are critical as to whether countries experience long-run growth. Therefore, whether the institutional and policy environment allows entrepreneurs to *invest their capital both within their country and across its borders* is key. When their capital is restricted

from seeking the best opportunities for future profits, property rights are, again, circumscribed in ways that are detrimental to prosperity.

Measurement: The Atlantic Council's Economic Freedom Index

The Atlantic Council publishes an overall index of freedom, which accounts for legal, political, and economic dimensions. While these different dimensions are not mutually exclusive, they can meaningfully be considered separately. Here we are concerned with the Atlantic Council's Economic Freedom sub-index. This sub-index reflects many aspects of what we have just described. In particular, it is constructed based on four separate indicators: (a) property rights, (b) trade freedom, (c) investment freedom, and (d) women's economic freedom.

The property rights indicator is perhaps the most straightforward. It measures "the extent to which a country's legal framework allows individuals to acquire, hold, and utilize private property, secured by clear laws that the government enforces. Its component parts are protection of property rights and risk of expropriation."⁶ It is clearly a measure indicative of both the completeness and security of property rights, as we have described above.

The trade freedom indicator measures "a wide variety of trade restrictions: tariffs, quotas, hidden administrative restraints, and controls on exchange rates and the movement of capital."⁷ In terms of our description above, this can be interpreted as a measure of how well prices reflect real international scarcities. In countries that score higher on this measure their prices better reflect the availability of resources around the globe because entrepreneurs have more complete property rights to exchange to a greater extent with foreigners.

The investment freedom indicator measures “the ability of individuals and firms to move capital within and across a country’s border without restrictions.”⁸ This indicator can be thought of as a proxy for how freely the entrepreneurial process can move capital in response to the incentives and information provided by property rights and prices. If entrepreneurs have better access to capital, they can more quickly and efficiently reallocate resources to promote prosperity.

Finally, the women’s economic freedom indicator measures “inequality in legislation between men and women as it relates to economic activity.”⁹ This was not something that was explicitly discussed in the “Theory” section above. However, roughly half of the global population consists of women. As such, any country is circumscribing the property rights of roughly half of its citizens if it discriminates against women. In other words, roughly half of the market’s discovery process is impeded if women do not have the same economic rights as men. There is no evidence to suggest that the inherent entrepreneurial potential of women is less than that of men. And even if it was less by any plausible amount, it remains clear that circumscribing the rights of the entire female population is detrimental to a country’s overall prospects for prosperity. Thus, this measure helps to capture how widespread the formal property rights and economic freedoms are within a country.

Existing empirical research using the Atlantic Council’s measure of economic freedom shows statistical correlation between freedom and measures of prosperity. As every introductory statistics student is taught, correlation is not causation. However, even absent more compelling statistical techniques, we believe that economic theory, as briefly summarized above, gives us good reason to believe that these statistical correlations are illustrating an underlying causal relationship. Below we examine this empirical relationship with greater scrutiny.

Empirical analysis: Does economic freedom cause prosperity?

Data and approach

The Atlantic Council's Freedom Index is a valuable tool that can be used to study the relationship between freedom and prosperity. However, there are some limitations with this data that dictate our empirical approach to examining the relationship. This section first reviews this new index and describes our empirical approach before proceeding with our empirical analysis.

The new Freedom Index is composed of three main indicator areas: economic freedom, political freedom, and legal freedom. The Index was released with 2021 data as well as data for three earlier years, each five years apart: 2016, 2011, and 2006. We believe each of these areas of freedom are important but focus our analysis on the relationship between the economic freedom indicator and prosperity. This is in part driven by our need to observe changes in Index values to study causal relationships. Political and legal freedoms tend to change too gradually for a short fifteen-year time span to be useful in our analysis. Also, the theoretical causal link between freedom and prosperity is stronger for economic freedom than for the other two areas.

We first focus on economic freedom's effect on a simple measure of prosperity: GDP per capita. This is a standard measure of the average standard of living within a country and has expansive country/time coverage. Our measure of GDP per capita is derived from the Penn World Tables (PWT), Version 10.0.¹⁰ A difficulty with the GDP per capita data is that it is not (yet) available past 2019 in the PWT. Though, given the economic consequences of the COVID-19 pandemic, 2020 data may yield a misleading impression of world prosperity.

We also use a separate index constructed by the Atlantic Council as an alternative measure of prosperity: the Prosperity Index. This Index is a broader measure of prosperity than simple

GDP per capita but this broader scope also limits its usefulness in empirical analyses over a relatively short time period. The Prosperity Index is an equally weighted index of: income, measured as gross national income (GNI) per capita; health, measured by life expectancy; the environment, as measured by water quality; minority rights, as measured by acceptance of religious minorities; and happiness (subjectively evaluated well-being), as measured by survey data in the UN World Happiness Report. Although these measures are important for understanding long-run prosperity, and although most are highly correlated with the level of GDP per capita, by their very nature, most change very slowly. Larger changes in the growth rates of GDP per capita can be observed over shorter periods and it is thus better suited for our empirical analysis that is confined to fifteen years of data availability.

Our empirical strategy is to first illustrate that levels of economic freedom are highly correlated with both the Prosperity Index and GDP per capita using a simple regression analysis. (When using GDP per capita we take the natural logarithm of the measure, which allows us to interpret a change in that measure as a percentage change.) Then, when we move on to studying the causal relationship, which requires us to examine how five-year changes in economic freedom impact subsequent five-year changes in outcomes, we restrict our analysis to the relationship between economic freedom and GDP per capita. In this latter approach, we identify countries that experienced meaningful increases in economic freedom and then *match* them to *similar* countries that did not experience such reform. We then compare subsequent changes in prosperity across the two groups.

Countries differ across many important dimensions. While political systems are slow to change, they are drastically different across countries. Some of these differences are important to consider when estimating the effect of economic freedom or changes in economic freedom on prosperity. For example, it may well be the case that authoritarian-run countries are less willing

to implement economic reforms conducive to freedom. These authoritarian countries are also likely to be less prosperous in general. If we compare prosperity levels (or growth outcomes) of these countries with those of more democratic countries, which tend to have more economic freedom, we are unlikely to get a reliable estimate of economic freedom's effect on prosperity.

A better juxtaposition would be to compare prosperity in countries with similar political structures, but different levels of economic freedom. In a regression analysis, this is done by including control variables for political institutions, along with other factors that could correlate with both economic freedom and prosperity. For matching, this is done by pairing countries that experienced meaningful increases in economic freedom with countries that are similar *except for not having experienced the economic freedom increase*. (Assume, for example, that in 2011 countries A and B are both democracies; they have similar income levels; they also start from similar levels of economic freedom. But A experiences a subsequent increase in economic freedom while B does not. We want to use countries like B to create a “counterfactual” by which to evaluate the effect of increased economic freedom on A's prosperity.) In other words, we want to compare prosperity (in regression) or changes in prosperity (in matching) across countries that differ in economic freedom but are otherwise similar.

Our analysis considers a set of indicators that is standard in the literature—an index of human capital, investment share of GDP, government expenditure share of GDP, export share of GDP, an index of democracy, and inflation. More specifically, we follow the recent analysis of Grier and Grier,¹¹ who analyzed the impact on growth of economic freedom reform as measured by the Economic Freedom of the World Index.¹² These indicators are intended to capture many of the important characteristics of a country that may influence both economic freedom and prosperity. Summary statistics and sources for these variables, and our outcomes of interest, are given in Table 1.

Table 1. Basic summary statistics and sources

Indicator	Definition	Obs.	Mean	St. dev.	Source
Levels					
Economic Freedom	Economic Freedom (EF) Index	696	64.05	17.13	Atlantic Council ^a
Prosperity Index	Prosperity Index (PI)	696	50.57	19.06	Atlantic Council
GDP per capita	Real GDP per capita	495	19,273	21,511	Penn World Tables (PWT) 10. ^b
Changes					
Economic Freedom	EF Index T - EF Index T-5	522	1.533	3.903	Atlantic Council
Prosperity Index	Change in the PI from T through T+5	522	0.431	2.384	Atlantic Council
Growth PWT	% Change in GDP per capita T through T+5	330	0.112	0.259	PWT
Controls					
Standard set from Grier and Grier^c					
Human Capital	Human Capital (HC) Index	420	2.543	0.694	PWT
Investment	Investment share of GDP	495	0.231	0.088	PWT
Government	Government expenditure share of GDP	495	0.183	0.077	PWT
Exports	Exports share of GDP	495	0.281	0.242	PWT
Polity	Polity 2 Index	470	4.026	6.212	Polity V Project ^d
Inflation	% change in GDP deflator	677	8.435	16.634	World Bank ^e

Notes: ^a Dan Negrea and Matthew Kroenig, "Do Countries Need Freedom to Achieve Prosperity? Introducing the Atlantic Council Freedom and Prosperity Indexes," Atlantic Council, <https://www.atlanticcouncil.org/in-depth-research-reports/report/do-countries-need-freedom-to-achieve-prosperity>.

^b University of Groningen, <https://www.rug.nl/ggdc>. ^cKevin B. Grier and Robin M. Grier, "The Washington Consensus Works: Causal Effects of Reform, 1970-2015," *Journal of Comparative Economics* 49, no. 1 (March 2021), 59-72. ^dMonty G. Marshall, Ted Robert Gurr, and Keith Jagers, *Polity IV Project: Political Regime Characteristics and Transitions, 1800-2015. Dataset Users' Manual*, Center for Systemic Peace, 2017. ^ewww.worldbank.org/data.

Regression

We first present simple regression results, showing the contemporaneous relationship between the Atlantic Council's Economic Freedom Index and prosperity (as measured by the Prosperity Index or GDP per capita). Recall the Economic Freedom Index is only available in five-year increments from 2006 through 2021. We also include all control variables discussed above, however these controls are included as five-year lags. Ideally, we want to compare the effect of economic freedom in two countries that *begin* with similar characteristics. Controlling for the initial levels for each control variable allows us to focus on this comparison. Lastly, we include control variables for each year (i.e., 2011, 2016, and 2021). These control variables help capture events that are common across countries in any given year (e.g., the effects of the COVID-19 pandemic).

The simple regression results are summarized in Table 2. Column (1) reports the relationship between economic freedom and the Atlantic Council's Prosperity Index; column (2) presents the results with GDP per capita as the measure of prosperity. In both cases, economic freedom is strongly related to prosperity, with statistical significance at the 99 percent confidence level. These effects are also large in magnitude. As shown in Table 1, the Economic Freedom Index varies drastically across countries, with a standard deviation change of approximately 17 points in the Index. A 17-point increase in economic freedom would increase a country's GDP per capita by 17×1.9 percent, or approximately 32 percent. This is an enormous increase in a country's standard of living. Of course, a 17-point change in economic freedom for any given country is improbable over a short time frame. As also shown in Table 1, the average five-year change in economic freedom within any given country is 1.53. Even with this more modest increase, economic freedom reform is associated with a nearly 3 percent increase in GDP per capita.

Table 2. Simple regression of economic freedom on prosperity

	Prosperity Index (1)	GDP per capita (2)
Economic Freedom Index	0.439*** (0.069)	0.019*** (0.005)
Human capital (lagged)	14.476*** (1.280)	1.074*** (0.102)
Investment (lagged)	17.450** (8.339)	2.401*** (0.765)
Government (lagged)	-45.495*** (12.224)	-0.713 (0.836)
Exports (lagged)	9.575*** (2.998)	0.781*** (0.235)
Polity Index (lagged)	0.225* (0.131)	-0.043*** (0.014)
Inflation (lagged)	-0.056 (0.038)	-0.000 (0.002)
Year = 2016	-1.960*** (0.412)	-0.102*** (0.037)
Year = 2021	-2.381*** (0.670)	
Observations	396	265
R-squared	0.823	0.767

Statistical significance: * 10 percent; ** 5 percent; *** 1 percent.

Although we control for many important characteristics, linear regression does not establish a causal relationship between the variables without additional, and often unwarranted, assumptions. Regressions include *all* countries of the world in their estimates. This can result in extreme extrapolation and yield comparisons that are not intuitive. For example, the United States may be compared to the Republic of the Congo. A related concern with the linearity assumption is that a regression treats a change in the Economic Freedom Index from 0 to 10 the same as a change from 90 to 100,

even though the former is likely more influential. We address these concerns with a matching analysis in the following section.

Matching analysis

In this section, we focus on how five-year *changes* in economic freedom influence subsequent *changes* in prosperity in the five years that follow. By focusing on *changes* in prosperity—that is, growth—we are analyzing *within*-country changes in our outcome of interest. GDP per capita substantially varies over a five-year time span with an average growth of 11 percent. In comparison, the Prosperity Index only increased by approximately 0.43 points, on average. A 0.431 increase is extremely small, given that the Index is constructed on a 0–100 scale. In addition, and as discussed above, given the components of this Index, we do not expect the Prosperity Index measure to vary much through short time periods. Our focus here is therefore on GDP per capita alone.

We also focus only on significant changes in economic freedom. By “significant,” we mean an increase in the Economic Freedom Index of at least 3.5 points. On average, economic freedom increases by 1.53 points within a five-year period, with a nearly 4-point standard deviation. An increase of 3.5 points, then, is larger than the average but not quite an outlier. This yields 91 potential instances of economic freedom reform of this magnitude to study. We also double this cutoff to 7 points, although the number of instances in which countries experience such drastic change is small, with only 29 potential cases.

To analyze the effect of these increases in economic freedom on changes in subsequent prosperity, we utilize a matching method called Mahalanobis Distance Matching (MDM). Essentially, this matching procedure minimizes the difference in relevant characteristics of the country that increased economic freedom and otherwise similar countries that did not experience positive

reforms in economic freedom. The relevant characteristics in our case are the same (lagged) controls as in our regression analysis.

Take our measure of democracy (the Polity 2 Index) as an illustrative example.¹³ Suppose a reforming country has a Polity score of 8, implying it is highly democratic. MDM will match this country to other countries with similar levels of democracy but not the same large improvement in economic freedom. Given that we have a range of characteristics we are concerned about and that we try to best match against all of them, and that these characteristics themselves are highly variable, our matches will not be perfect across all margins. However, focusing only on these best matches minimizes the need to extrapolate and reduces the risk of making poor comparisons as happens in regressions. We consider comparing each reforming country to its closest match on all these other characteristics and then subsequently compare it to an average of its two, three, and four closest matches. For simplicity, we refer to these matches as their “nearest neighbor” (or “two neighbors,” etc.).

Similar to the regression analysis, we match each of the characteristics using their value prior to the change in economic freedom. This allows us to compare the effect of changes in economic freedom across two countries (and averages of two, three, and four countries) that were otherwise identical *prior* to this change in freedom. In this same spirit, then, we also include lagged economic freedom scores and lagged GDP per capita as additional characteristics to match upon to better estimate the effect of a change in economic freedom.

Our matching results are presented in Table 3 for the 3.5-point threshold and Table 4 for the 7-point threshold. In both cases, economic freedom reform is associated with higher GDP per capita growth over the subsequent five years. These numbers are comparable to our regression estimates. A 3.5-point increase in economic freedom is associated with an increase in GDP over five years

of approximately 6 to 8 percentage points. A 7-point increase in economic freedom corresponds to even larger increases in GDP over five years: nearly 10 to nearly 15 percentage points. Both represent considerable increases in the average income of a country's citizenry.

Table 3. The effect of economic reform, defined as an increase in the Economic Freedom (EF) Index of at least 3.5 points, on GDP per capita growth

Nearest neighbors	1	2	3	4
GDP per capita growth	0.038 [0.303]	0.059* [0.074]	0.084** [0.010]	0.085** [0.012]

Statistical significance: * 10 percent; ** 5 percent; *** 1 percent.

Note: Matching covariates include: lags of economic freedom, investment, government spending, exports, Polity score, and inflation at time T-5. The lag of the dependent variable (at T-5) is also included in each specification.

Table 4. The effect of economic reform, defined as an increase in the Economic Freedom (EF) Index of at least 7 points, on GDP per capita growth

Nearest neighbors	1	2	3	4
GDP per capita growth	0.086 [0.206]	0.102*** [0.004]	0.138*** [0.000]	0.146*** [0.001]

Statistical significance: * 10 percent; ** 5 percent; *** 1 percent.

Note: Matching covariates include: lags of economic freedom, investment, government spending, exports, Polity score, and inflation. The lag of the dependent variable is also included in each specification.

Conclusion

Back in 1776, Adam Smith recognized that the wealth of nations is rooted in the economic freedom of their citizens. Without discounting the nearly two-and-a-half subsequent centuries

of scholarship, Smith's fundamental insight remains consistent with both theory and evidence.

In line with its mission to engage international affairs and advance them toward meeting global challenges, the Atlantic Council has constructed a country-level index of economic freedom that covers the last decade and a half. This paper has reviewed the theory suggesting that economic freedom should be associated with prosperity; second, it has provided evidence, based on the Atlantic Council Index, that economic freedom not only correlates with prosperity but, indeed, is an important *cause* of prosperity.

Regarding the latter aim, we have analyzed the Economic Freedom Index in relation to both the Atlantic Council's Prosperity Index, as well as the straightforward measure of country-level GDP per capita. Our evidence suggests that economic freedom remains an important correlate of both GDP per capita and the Atlantic Council's broader measure of prosperity, while controlling for a number of other factors. Furthermore, GDP data changes enough over the fifteen-year period covered by the Atlantic Council's Economic Freedom Index for us to employ "matching methods," a more sophisticated approach to establishing causal statistical relationships. Based on this approach, we find that a meaningful increase in economic freedom leads to large increases in GDP per capita over a five-year time horizon. For example, a 3.5-point increase in a country's economic freedom score is associated with a five-year increase in GDP per capita between 6 and 8 percentage points.

This chapter indicates that both theory and evidence support Adam Smith's prescription of "peace, easy taxes, and a tolerable administration of justice." The recipe for greater prosperity across the globe is increased economic freedom.

The role of elites in driving towards long-term prosperity: The case of Kenya in Sub-Saharan Africa

Luis Ravina Bohórquez

A COUNTRY'S PROSPERITY AND DEVELOPMENT DEPEND on the state's strength, and the efficiency of the services it provides. Therefore, it is crucial to have strong institutions that, together with government policies, guarantee and defend society's basic needs, such as freedom, education, security, or the rule of law. The role of elites with power is, therefore, fundamental to ensuring the country's sovereignty and development; it is the duty of elites to empower society with the necessary tools to question nepotism and corruption. Moreover, for efficient state services, public policies that favor the welfare of its citizens, and strong institutions that guarantee the functioning of democracy and fundamental rights, a country's elites must support these initiatives and use their power and influence to steer the country toward a path of prosperity. Elites have a responsibility to make decisions and draw up plans for development because they are the ones who have the capacity to make things change.

When we refer to the elites, we are not only talking about people in charge of managing the government and politics of the country but also civil and economic elites and, in general, the people with real influence in decision making. These can

Luis Ravina Bohórquez is a professor of economics at the University of Navarra (Spain).

be civil society leaders, businesspeople, cultural leaders, or politicians. In this essay, when I speak about elites in general, I'm referring to all of these people: those with power and influence.

Through their actions, these leaders determine whether a state will develop strong institutions or instead be captured by powerful elites that hinder socioeconomic growth. For executive, legislative, and democratic institutions to function well and benefit the pathways to freedom and prosperity, elites must first act in favor of these objectives. As we will explain later, this happens when a development bargain exists. The participants in this bargain must acknowledge the primacy of the institutions themselves—recognizing that the institutions sit above the people who hold any political, public, or regular office. The elites are the ones with the power to make the necessary changes, but they also have the force to prevent change from happening at all, allowing corruption, civil conflict, or any other brake on a country's development to continue.

As Acemoglu and Robinson detail in their book *The Narrow Corridor: States, Societies and the Fate of Liberty*, the role of the elites is decisive:

Achieving liberty is a process; you have to travel a long way in the corridor before violence is brought under control, laws are written and enforced, and the state starts providing services to its citizens. It is a process because the state and its elites must learn to live with the shackles society puts on them, and different segments of society have to learn to work together despite their differences.¹

In this essay, I highlight the ways in which elites in power can be decisive for stable development in Sub-Saharan Africa. Of all world regions, Sub-Saharan Africa has the biggest age gap between leaders and their populations, as well as with the

world's longest-serving head of state, President Paul Biya of Cameroon—eighty-nine years old at the time of writing, and in power since 1982. Acemoglu and Robinson point to Malawi as an example where leadership traditionally has been shortsighted and corrupt.² Still, in 2020 Malawi's judiciary annulled an incumbent's electoral victory, and the country now ranks eighth (of thirty-three) in the region in respect of the rule of law.³ However, despite leadership goodwill, change doesn't happen overnight: President Lazarus Chakwera had to dissolve his cabinet in 2022 due to corruption allegations, and the country remains one of the world's poorest.⁴

Some countries have managed to develop a functioning plan for stability. Kenya and Zambia, for example, show that despite some obstacles, steps toward freedom can be taken by empowering institutions that constrain elites' power. In contrast, others persist in failure because their governments have not prioritized economic and political progress as the main objectives. Therefore, to explain and analyze the decisive role of the elites in achieving developed, democratic societies, we will need various illustrative examples of how their actions can favor or harm their people.

Historically, each country has had different approaches to dealing with violence, corruption, or poverty. Carrying out a plan to improve, even a little, the labor conditions or fundamental rights of an underdeveloped nation is a very complex matter. There is no single formula or recipe; each country has achieved prosperity to a greater or lesser extent with different policies and types of government. Each nation has its conditions, history, time, culture, and way of thinking. That is why the route to prosperity depends on the case and it is impossible to speak of "formulas for development" that work in any context. Many attempts by international organizations and powerful foreign governments to help underdeveloped countries have failed. The plan must be drawn up and led by the elites: they are the only people overseeing the

country and have the most significant capacity for real influence for change.

Good results flourish when elites in power assume the responsibility of leading their people to paths of prosperity and freedom. And when the elites in question do not seek a way toward prosperity, freedoms remain minimal, and the population is at the mercy of their mismanagement; this does not help the country's development.

For this analysis I will focus on Sub-Saharan Africa, specifically the case of Kenya. Kenya's recent good performance—it is a regional leader on measures such as separation of powers, stability, and democracy—has set it on the road to freedom and prosperity. Specifically, I will talk about how advances and improvements in education (thanks to the bargain that emerged from previous governments and their policies) have helped Kenya along this road.

Policies for improving access to regular, good-quality schooling in Kenya have been a perfect example of how political elites can contribute to developing prosperity and freedom, since education is a central factor in both. This analysis will focus on the elites' contribution to these changes. Despite endemic corruption and ethnic conflict undermining its development progress in the past, the country's leadership has, in recent years, stood out for favoring long-term progress through independence of its institutions, and for favoring stability. As a result, Kenya shows evident improvement in education, indicating that paths to prosperity are underway.

In his book *Gambling on Development: Why Some Countries Win and Others Lose*, Stefan Dercon points out that what matters most for success is a “development bargain”: a shared commitment among those with the power to shape politics, economy, and society to strive for growth and development. The elites' willingness

to take advice and learn from mistakes is essential. Dercon also explores how these bargains come to be:

Why aren't the [Democratic Republic of the Congo] or other countries that haven't succeeded practising better economic policy-making focused on growth and development? My simple answer: if success requires an elite bargain that favours growth and development, then failure suggests the lack of this bargain. What is it about these countries? How does a development bargain emerge in some places and not others?⁵

This essay seeks to answer Dercon's questions, framed as "Why have a development bargain and good policy emerged in Kenya and not in Uganda?" First, through a case study, I will decipher what has caused Kenya to take steps toward freedom, showing it to be an example of a job well done by the country's decision makers. Then, focusing on education as a fundamental indicator to measure development, I will assess why policies targeting prosperity have succeeded in countries like Kenya, while elsewhere in the region, such policies have failed to progress and stagnation persists.

Kenya: Long-term vision

There are specific moments when a society hits rock bottom and faces a decisive point that could split the country or unite it toward a common goal. In Kenya, that moment was 2008, when 1,133 people died and 650,000 people were displaced from their homes due to major post-election ethnic clashes, according to the final Report of the Truth, Justice and Reconciliation Commission, published five years after the events.⁶

Many felt the country might fall into a full-blown civil war and turn into yet another failed state, as had Kenya's neighbors Somalia and Sudan (later South Sudan). However, when the country was at its worst, elites showed the traits that everyone expected of them: seriousness and professionalism, to leave differences aside and work together towards healing existing differences.

Mwai Kibaki and Raila Odinga entered into a power-sharing agreement in 2008 that ended the immediate violence, although it would face problems later on. They set the path for future long-term agreements that have driven Kenya to become a regional example of stability, democracy, and growth. The proven commitment of Kenya's political elites to accepting court rulings in political disputes, and their willingness to seek compromise with opponents at difficult moments, have seen them become vital continental peace brokers. For example, former president Uhuru Kenyatta played a vital mediating role in peace negotiations in South Sudan, Ethiopia, and the Democratic Republic of the Congo.

All of that wouldn't have been possible without the political will in 2008 to invest in the country's future. Leaders in liberal democracies tend to prioritize short-term, quantifiable, and achievable goals which the electorate will recognize as theirs and spur their vote in the upcoming polls, rather than long-term structural changes that won't be recognized and whose success depends on their successors upholding such policies.

In his 1919 essay *Democratic Ideals and Reality*, British political geographer Halford J. Mackinder wrote: "Democracy refuses to think strategically unless and until compelled to do so for purposes of defense."⁷ The conclusion Mackinder reached a century ago is today increasingly felt across a globalized world where breaking events complicate long-term goals. A decade after the 2008 financial crisis, the COVID-19 pandemic struck the entire globe. Once the economy started to regrow, the Russian invasion of Ukraine altered supply chains and immediate priorities.

Despite such phenomenal world events, to which Kenya has been not a stranger, the country has followed a comprehensive plan to spur its growth into a “newly industrializing, middle-income country providing a high quality of life to all its citizens . . .” That is the main goal set in the Kenya Vision 2030,⁸ agreed upon in June 2008, only four months after the power-sharing agreement.

The post-election violence was the turning point that forced leaders to step up and deliver wide-ranging policies. Vision 2030 was not a mere document, but a strategic plan to swiftly overhaul the institutions of all levels of Kenyan society and upend a divisive path. More important than the document itself is that all leaders have committed to it as a national program; Kenya now has its third president since the Vision was launched.

Vision 2030 has helped to evolve all pillars of Kenya’s society. Kenya has invested heavily in infrastructure to reap the benefits of regional integration through the African Continental Free Trade Area and become a continental powerhouse. The country is already seeing the results, shipping batteries and tea to Ghana⁹ and becoming a key route for exports in East Africa. Kenya has made its lack of natural resources a strength by diversifying its economy, sustaining annual growth of over 3 percent for every year since 2009 (except 2020).¹⁰ Despite failing to achieve the probably unrealistic 10 percent annual target that was initially set, the country became in 2020 Sub-Saharan Africa’s third-largest economy, surpassing commodity-dependent Angola.¹¹

Leaders’ commitment to change is also visible in the political sphere. In 2010, leaders agreed to reform the constitution, making changes that some had sought for decades. For instance, amongst the amendments was a new provision for contested elections in the judiciary, which reduced the possibility of violence. The country’s institutional strength and separation of powers were shown in 2017, when the Supreme Court annulled the elections won by incumbent president Uhuru Kenyatta, becoming the first

country in Africa to do so. However, this would mean nothing if elites refused to accept or abide by the court ruling. After three election cycles, those who lost electoral court cases always accepted the final verdict, showing democratic maturity.

In an effort to spur public spending toward peripheral areas, improve service delivery, and reduce ethnic tensions, the country also devolved powers to 47 newly created counties. The country's decentralisation has been the most significant commitment of Kenyan national elites to the country's long-term sustainability, as it meant them relinquishing some political power by transferring competences and funding to counties.

Education: An elite decision toward prosperity

Investing in good-quality education is the best decision democratic leaders can take to make a country grow in the long term. Over the years, several studies have directly linked economic growth and investing in educating a country's human capital. The Organisation for Economic Co-operation and Development (OECD) calculated the cost of not investing in education. Its 2010 paper titled *The High Cost of Low Educational Performance* estimated that a 25-point increase in the Programme for International Student Assessment (PISA) scores achieved through twenty years yields consistent economic growth through human capital value addition: "By the end of expected life in 2090 for the person born in 2010, GDP per capita would be expected to be about 25% above the 'education as usual' level."¹²

However, it is essential to commit to education in the right ways. Development economist Lant Pritchett has been investigating for many years how to improve students' learning foundations, including through the Research on Improving Systems of Education (RISE) program. Overall, the evidence from RISE and

elsewhere has shown that focusing on a one-size-fits-all model imposed through a top-down bureaucratic system does not benefit learning. Some governments have tried to modernize their curricula by standardizing them for all in the name of equality, but as Pritchett proves, this only generates weak learning environments.¹³ Excessive public control of what is taught and how it should be taught only sets a barrier to each student's uniqueness and curtails their freedom.

Instead, governments should set a foundational basis after which schools and teachers can have their own freedom to set their values and foster tailored learning for their students. Ignoring societal differences and trying to assign the same pace of learning to all students will only leave behind those from the most unfavored backgrounds.¹⁴ To ensure good-quality learning, governments must first dedicate time and resources to teacher training to ensure they attend the workplace and are committed to their students' education.

Kenya's Vision 2030 set the country's educational reforms for the upcoming decades in terms of both quality and quantity. As a priority, leaders sought to bring education centers to arid and semi-arid land areas, especially in the north and east of the country, by constructing new schools, reforming primary education centers, and hiring more teachers. Without school buildings, teaching is impossible.

Then, government officials decided to renew its curricula to focus on students' qualities. By 2017, the country had developed a competency-based curriculum focused on learning practical competencies that could serve them for a future in the labor market, such as critical thinking and problem-solving, self-efficacy, and communication, amongst others. Pritchett's investigation found that "re-centering teaching on students' skills and abilities has enormous pay-offs," and is a "low-cost solution to improving learning."¹⁵

This curriculum's implementation has had its problems, for example in teacher training, resources and equipment, and public participation.¹⁶ Yet despite these shortcomings the reforms have helped Kenya to leapfrog its neighbors on several indicators of education; it is now a leader across east and southern Africa, both in attendance and performance. Primary completion is universal for female and male students; and lower secondary completion reaches 79 percent, 30 points higher than the regional average and above its income group, according to the World Bank's latest Human Capital Index.¹⁷ Students also now get better grades and excel in mathematics and languages.

Pritchett and the RISE program identify five actions that will allow an education system to flourish.¹⁸ Kenya has already implemented three of these: commit to universal, early foundational learning; align systems around learning commitments; and support teaching. Now, to ensure the success of the reforms and prove their commitment, elites must follow up with the last two measures: measure learning; and adapt the new curricula to what the data shows as time passes.

These results were only possible with enough budget to implement the reforms. As of 2020, total government expenditure on education in Kenya as a share of GDP was 5.1 percent, higher than the 3.4 percent average across Sub-Saharan Africa, according to World Bank data.¹⁹

Reacting to unexpected events: Leadership in times of crisis

Kenya's educational leadership has also proven itself in its responses and plans for unexpected events. Kenya's government, like most around the world, closed schools when the COVID-19 pandemic struck in March 2020. Four months later, the government decided to cancel classes and declare the school year invalid.

The decision was controversial and understandably criticized, not only due to learning losses, but also due to the wider, known effects of school closures and restriction of movement. Calls to one phonenumber to report violence against women and girls rose by a staggering 301 percent in the first two weeks of lockdown, and reports of gender-based violence increased by 87.7 percent during April–June 2020, according to data from the National Crime and Research Centre.²⁰

The government defended its decision, arguing that the deep inequalities between students who could afford to learn from home and those without the technology and space to do so would generate a knowledge gap.

Despite this being a difficult decision to take—and one which, in retrospect, could have been enacted better—leaders invested their energies in planning to catch up with lost time. In October 2020, some classes came back and in January 2021, nine months after the lockdowns began, schools fully reopened with a new interim calendar and a plan to return to the pre-COVID school calendar within two years. The Ministry of Education decided to add one more term per year, making it four instead of three each year, meaning students would get taught one full year and an additional period the following year. To incentivize the return to classes, and to ease the economic burden of extra school fees on top of the pandemic, the government reduced school fees by 16 percent. As of 2023, students have already recovered the lost school year and will soon be back on the original school calendar.

As with any other country, Kenya was not ready for such a disruption and made errors in its initial decisions. However, the effort taken in planning toward a regular return to classes shows the importance of having committed leaders with a long-term vision toward prosperity.

The path of Kenya's education sector through the pandemic compares favorably to neighboring Uganda, where leadership

has failed to find creative solutions to short-term crises. Schools remained closed for two years due to COVID-19, only restarting in 2022. At that point, 10 percent of students did not report back to school²¹ and empirical studies predict that those who did would carry a learning deficit of 2.8 years.²² Furthermore, instead of working toward alternative plans to avoid further closures during health emergencies, in November 2022, the government of Uganda closed schools again for several weeks due to an outbreak of Ebola. The repeated use of school closures as a control mechanism hinders children's education and shows a lack of leadership and care for a country's prosperity.

In low- and middle-income countries (LMICs), the elites' decisions, or lack thereof, are crucial for the well-being of a country. Kenya's case—of leadership focused on a long-term vision while still providing solutions for short-term shocks—is an example in the context of Sub-Saharan Africa.

Conclusion

The work of the elites in political power is essential, and the role of institutions as the basis for controlling and sustaining the path toward development is an unquestionable pillar. In the case of Kenya, mainly focusing on the country's education system, we have seen how the role of elites has been decisive in the country's progress in prosperity and freedom. The route to development is, as Acemoglu and Robinson put it, a "narrow corridor": a complex process that does not happen overnight. However, Kenya continues to walk that corridor for development. What is exciting and positive for the country is that the elites intend to learn to live with the shackles society puts on them.

Stefan Dercon points out the importance of political elites being willing to take advice and learn from mistakes. We have been

able to appreciate how this has been happening in Kenya. Thanks to elites in power favoring the will of society, a power-sharing agreement ended the terrible violence of 2008, beginning a new journey toward political and social stability. Moreover, accepting court rulings in political disputes and agreeing with the opposition in tense moments have turned Kenya's elites into vital continental peace brokers. The year 2008 was a critical turning point. The elites, despite their differences, have been able to sustain a long-term vision that has helped it become a reference in the region, take a clear path toward prosperity, and overcome setbacks.

Education is a crucial example of elite commitment to freedom and prosperity. American economist Theodore Schultz believed that investing in human capital is the most significant investment a country can make. The wealth of nations depends on their capacity to grow their human resources rather than their physical resources or particular policies.

There is no recipe or formula, but situations can improve when things start pointing in the right direction, seeking liberty and growth. Kenya is a striking example that it is possible to move forward and improve the quality of life of its inhabitants. Of course, Kenya is not an "ideal" country; it continues to grapple with severe problems, above all, rampant corruption. But, notwithstanding that, its long path toward being the stable country it is today shows that when elites are committed, structural changes can happen through long-term planning and taking little steps towards a great common goal.

Informality as an anti-measure of prosperity

Elakiya Ananthakrishnan

IN DEVELOPING ECONOMIES, THE INFORMAL sector can account for upwards of 60 percent of GDP and over 90 percent of employment. Understanding the role of a country's informal economy in its path to prosperity is a task made difficult by the sheer amount of goods and service provision occurring outside the remit of government regulation and oversight. For those engaged in informal employment, the informal sector is a source of livelihood but also a precarious work situation lacking in the social protections afforded by formal employment.¹

This chapter presents three data sources on informal economy size from the World Bank's Prospects Group, World Economics, and International Labour Organization's ILOSTAT. It highlights cross-country trends in informal economy size over the past quarter century. The datasets presented in this chapter show wide disparity in informal economy size by geographical region and income group, with significant variation among different countries within these categories. Countries in South Asia, Latin America and the Caribbean, and Sub-Saharan Africa show

Elakiya Ananthakrishnan is research staff at the London School of Economics. She works on "Women's Empowerment, Economic Freedom, and the Role of Law in Driving Prosperity," a research project funded by the John Templeton Foundation. She wishes to thank Dr Simeon Djankov of the Financial Markets Group for his valuable comments and guidance.

on average around a 20-percentage point larger share of informality in GDP than middle-income countries.

Disparities in informal employment by gender, with most countries showing higher shares of informal employment for women as compared to men, point to the need to study the impact of the informal economy on development through a gender lens. In contexts with larger informal economies, women tend to be even more highly represented as a proportion of the informal workforce. The correlation is weak, but it suggests there are additional determinants specifically of *women's* involvement in informal work—over and above the determinants of overall informality.

Definition and measurement

Inherently difficult to measure, a large part of the early literature on informality debated the definition of the informal sector. The productive view classified firms as informal based on characteristics like low productivity or small size. The legalistic view, which classifies firms and workers as informal when they operate at the margin of the state's legal guidelines on production and employment, has now emerged as the most widely accepted definition.² For the purpose of this chapter and the data sets presented, the informal economy refers to the collection of firms, workers, and productive activities that operate outside the state's legal and regulatory frameworks, and are hidden from official authorities.³

Informal activity at the firm level can occur at the “extensive” margin, where firms do not formally register with the state or at the “intensive” margin, where formally registered firms supplement their labor force by employing workers informally. It is important to note that informal employment is not limited to the informal sector: informal employment can occur within the formal sector as well, with enterprises structuring employment in

ways that avoid legal regulations like the minimum wage or commitments to providing employment benefits.

With the informal economy existing outside the realm of government regulation and hence outside many formal measurement practices that capture output and employment in the economy, it remains a nebulous concept that resists precise measurement. New forms of digital work and technological developments have also led to the creation of jobs and output that are not yet recognized in existing formal guidelines of economic activity measurement, causing further difficulties.⁴ The need for a uniform comprehensive statistical framework for measuring the informal economy is imperative to aid cross-country comparisons and empirical analysis.⁵

The multiple accepted measures and proxies for informal economy size can be broadly divided into two categories: indirect model-based methods, and direct survey-based methods. Indirect measures such as the Multiple Indicators Multiple Causes (MIMIC) method or the dynamic general equilibrium (DGE) are derived from model specifications that incorporate more readily observable input variables like GDP per capita, or the share of direct taxation in overall taxation, or model parameters like capital labor stock or private consumption. They also often require assumptions to be made about base year values upon which the remaining time series of estimates are constructed. Conversely, direct measures tend to be survey-based and often labor-focused, looking at self-employment percentages in total employment, the percentage of employment outside the formal sector, or the percentage of informal employment. While free of specific model assumptions, these estimates are often difficult to compile and require intensive surveys to be conducted. A drawback of self-employment or informal employment data as a measure of informality is the data paucity for advanced economies, which hampers cross-country time-series analysis.

Other measures of informal economy size in the literature—although not available in as rich a panel data set as described below, and often only present in single-country contexts—include indirect measures such as the discrepancy between national expenditure and income statistics, the discrepancy between official and actual labor force, the use of electricity over and above the use suggested by formal-sector production, and computationally challenging measures such as estimation of the consumption-income gap of households.⁶

For the purposes of this chapter we use the simplest available methods, which also have the widest country coverage.

Data description

World Bank Prospects Group data

The World Bank's Prospects Group holds a comprehensive database of informal economic activity. The database focuses on measures that have strong cross-country and temporal coverage: it includes the twelve most used model-based and survey-based measures of informality and covers up to 196 economies (across various indicators) over the period 1990–2018.

The most complete data exist for DGE estimates (1991–2018), which present the size of a country's informal economy as a percentage of GDP. The DGE model considers how households trying to maximize utility will allocate labor between formal and informal economies, mapping the change in these allocations over time. Unlike survey data, due to the potential for calculating informal economy size using a clear theoretical basis and more readily available parameters, this method provides comprehensive country and year coverage. It is also useful due to applicability to policy experiments and projections.⁷

Some criticisms of the DGE framework remain, however, including:

- The DGE framework requires specific model assumptions about the form of production functions and household preferences in the economy, as well as assumptions about the relationship between formal and informal sector productivity.
- Estimates of the informal economy size are calculated with respect to base year estimates of informal economy size that must be obtained from an independent study. This risks sensitivity to the estimate of informal economy size found in the independent study.⁸
- Data availability, especially in the case of emerging markets and developing economies (EMDEs) may restrict the extent to which a DGE model maps all features of the informal economy. Often only a few stylized facts can be matched by the model.

It should be noted that in 2018, the last year for which any Prospects Group data are available, data are present for only 116 countries, with missing values concentrated in lower- and middle-income countries in Asia and Africa.

World Economics Quarterly Informal Economy Survey

World Economics (WE) conducts a Quarterly Informal Economy Survey, which combines the latest estimates of country-level informality from economists globally. Estimates for each country are combined into a simple average, with outliers removed from the data. Data are present for 155 countries (with the informal economy given as a percentage of GDP) on a yearly basis for the years 2000–21.

ILOSTAT estimates by gender

It is also important to think about the gender aspect of informality and its relation to prosperity. A hierarchical segmentation is observed in the interaction between different types of informal work, levels of earnings, and poverty risk. Chen et al. place informal employers at the top of the ladder, with the highest earnings and lowest poverty risk, followed by own-account workers, employees, other informal wage workers, industrial outworkers/home-based workers, and—at the bottom—unpaid contributing family workers.⁹ When considered alongside evidence that across most regions, women are more likely to work in the most vulnerable sections of the informal economy (e.g., as domestic workers or at the lowest tiers of global supply chains) and in contexts where the most serious deficits of decent work can be found,¹⁰ the need to study informality with a gender lens becomes clear.

ILOSTAT provides data for the period 1999–2021 for 104 countries (mainly EMDEs), with informal employment as a percentage of total employment presented by gender. There is a significant overrepresentation of data from the regions of Latin America and the Caribbean, Sub-Saharan Africa, and Europe and Central Asia—regions that tend to show higher levels of informality as compared to the global average. There is also a significant skew toward the later years, with the median observation in 2015. Some regions (Middle East and North Africa, South Asia, OECD, East Asia and Pacific) have no observations prior to the mid-2000s and hence presenting global trends in this period would be misinformative, reflecting only regions with significantly higher than average levels of informality. This data set is spliced with data from WIEGO for the year 2016, in order to incorporate estimates for OECD countries for at least one year. It is worth noting that there were some significant discrepancies between WIEGO estimates and ILOSTAT estimates for the year 2016, where both data sets included estimates for a particular

country. This highlights the previous observation, that a more unified statistical framework for measuring informal economy size must be established.

Observed trends in informality

Both the World Bank DGE estimates and the WE data show a declining trend in informality over the past few decades.

DGE informality trends

The highest levels of informality are observed in Sub-Saharan Africa and Latin America and the Caribbean, in consensus with other studies and the broader literature. We see a decline across regions, with the most significant reduction in informality observed in the South Asia and East Asia and Pacific regions. Cross-country rankings of informal output and employment, as calculated from the DGE estimates, are typically consistent with other indicators presented in the World Bank data set. Global average informality—the proportion of the economy comprised of informal work—dropped 6 percentage points, from 34.7 percent in 1990 to 28.7 percent in 2017.

The declining global trend in informality between 1990 and 2018 is driven by sharp declines in the size of the informal economy in several regions: South Asia (12 percentage point reduction, from 39.7 percent to 27.7 percent); East Asia and Pacific (11.7 percentage point reduction, from 35.4 percent to 23.7 percent); Latin America and Caribbean (8.6 percentage point reduction, from 41.2 percent to 32.6 percent); and Sub-Saharan Africa (6.3 percentage point reduction, from 42.2 percent to 35.9 percent). In OECD countries or the Middle East and North Africa, the reductions in informality were more modest, at 3–4 percentage points over the same period.

Very few countries showed the opposite trend (i.e., a growing informal sector). Zimbabwe (5 percentage point increase), Tajikistan (14 percentage point increase), Central African Republic (3.4 percentage point increase), Comoros (5.7 percentage point increase), and Democratic Republic of the Congo (4.5 percentage point increase) are notable exceptions. All these countries have experienced significant negative GDP fluctuations over the period of interest, caused by either serious political instability or civil wars—events that would lead to the erosion of the formal economy, potentially explaining why informality has increased in contrast to the global trend.¹¹

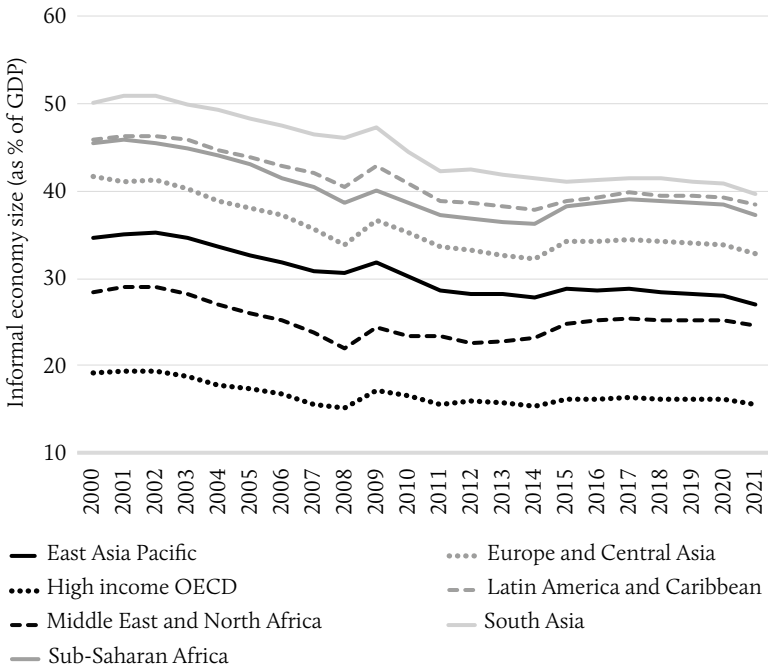
Legal “families”—groups of countries categorized according to their legal origins: the basis from which their laws and institutions originate—often exhibit significantly different legal rules and approaches, which then have a significant influence on economic outcomes.¹² This could potentially be due to the colonial influence of some Western nations in lower- to middle-income countries.¹³ For instance, countries that were colonized have tended to remain low- or middle-income—though it is not possible to draw a causal link—and there is a correlation between legal origin (a result of colonization) and subsequent economic development. Relevant to our purposes, there is a similar correlation between colonization/legal origin and the size of a country’s informal economy. Higher levels of dispersion in informal economy size are seen in Latin America, Europe and Central Asia, and Sub-Saharan Africa, with the significant positive skew in Latin America and Central Asia likely driven by countries like Bolivia (62.9 percent) and Georgia (61 percent), which exhibit the highest values for informality in the data set.

World Economics’ Quarterly Informal Economy Survey trends

World Economics’ estimates of the size of informal economies show a global average decline of around 7 percentage points

(reduction from 37 percent to 30.3 percent) between 2000 and 2021 (Figure 1).¹⁴ A pronounced spike in informal economy size is observed around 2009 with the global average increasing almost 2 percentage points in one year (potentially due to the global effects of the 2008 financial crisis, which may have pushed many into informal employment after job losses).¹⁵ The DGE estimates do not reflect this shock, perhaps due to modeling assumptions. However, the World Bank MIMIC estimates do reflect this spike more closely.

Figure 1. The informal sector was declining before COVID-19



Source: World Economics, “Informal Economy Sizes: Informal Economy Size as a Percentage of GDP,” <https://www.worldeconomics.com/Informal-Economy>.

The highest levels of informality are observed in (from higher to lower) South Asia, Latin America and the Caribbean, Sub-Saharan Africa, and Europe and Central Asia. Note that there is a difference in regional ordering of average informal economy size observed between the World Bank and World Economics data sets (the World Bank estimates order the regions as follows: Sub-Saharan Africa, Latin America and the Caribbean, Europe and Central Asia, and South Asia). The World Economics estimates show a higher informality rate for South Asia, Latin America and the Caribbean, and Sub-Saharan Africa at the beginning of the twenty-first century as compared to the World Bank DGE estimates, along with a more gradual decline over the two decades following.

Similar to the World Bank DGE estimates, the global decline in informality in the World Economics data seems to be driven by declines in South Asia (10.5 percentage point reduction, from 50.1 percent to 39.6 percent), Latin America (7.2 percentage point reduction, from 45.7 percent to 38.5 percent), Sub-Saharan Africa (8.3 percentage point reduction, from 45.5 percent to 37.2 percent) and Central Asia (8.9 percentage point reduction, from 41.7 percent to 32.8 percent) as opposed to OECD countries and the Middle East and North Africa, which show moderate declines of around 4 percentage points. Almost no instances of increasing country-level informality are observed in this data set, with Libya, the Bahamas, and Gabon being exceptions with very moderate increases in the 2 percentage point range. This difference with the World Bank DGE estimates could be due to the fact the countries experiencing increases in informality in the previous data set experienced their periods of political instability largely in the nineties, prior to the time period for which data are available in the World Economics survey.

The World Economics data show similar trends as the DGE data when ordering countries by legal origin, with French and English legal-origin countries exhibiting the highest levels of informality.

Grouping by income across regions, lower-middle-income countries show the greatest decline in informality at 9.1 percentage points (46.2 percent to 37.1 percent), low-income countries show an 8 percentage point decline (45.7 percent to 37.7 percent), upper-middle-income countries show a 6.9 percentage point decline (40.4 percent to 33.5 percent) and high-income countries show around a 4.2 percentage point decline (22.5 percent to 18.3 percent). This result matches documentation in the literature of a strong correlation between per capita GDP and informal economy size.¹⁶

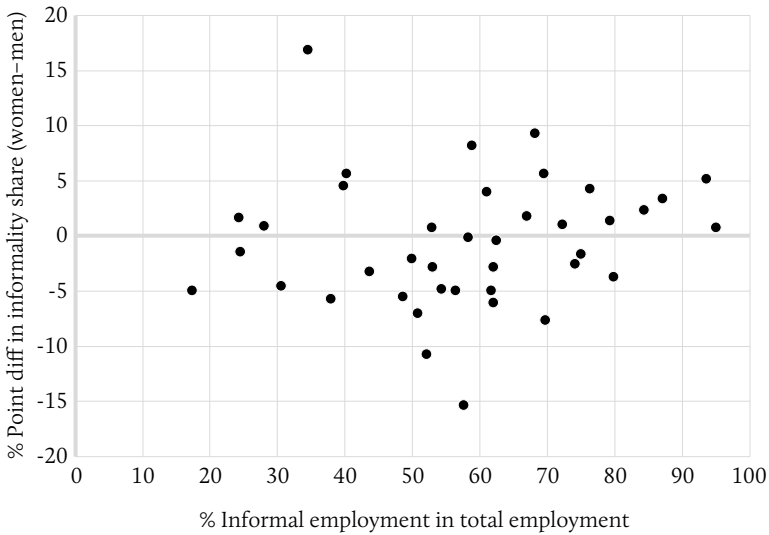
ILOSTAT estimates by gender trends

We see higher levels of female informal employment in Sub-Saharan Africa throughout the 2000–20 period, with both male and female informal employment increasing slightly over the course of the sample. This is particularly relevant as the data for this region are relatively rich. Conversely, Latin American and Caribbean countries show little to no difference in informal employment rates by gender. Europe and Central Asia show a rapid convergence between female and male informal employment rates, with very little difference by gender, after 2015. It is difficult to comment on trends observed for South Asia, OECD countries, and Middle East and North Africa due to data paucity—the aggregate estimates tend to be dominated by a few countries in each category. For example, in eight of fourteen years the estimates for Middle East and North Africa are driven only by Egypt and the West Bank (Gaza Strip); some countries (e.g., Bolivia, South Africa) have more data available whereas some countries only present once over the entirety of the time period.

Nordic countries, which represent the Scandinavian legal origin group, are absent from this data set. Convergence observed in the French legal origin category is likely driven by countries in Europe and Central Asia (seventy-eight of ninety-one countries

in the latter group are of French legal origin), with the other major category being Latin American countries, which show a consistent lack of difference in informality rates by gender. German legal origin countries show higher rates of male informal employment as compared to women, an unusual observation in this data set. Countries with German legal origin are all based in East Asia and Europe and Central Asia.¹⁷

Figure 2. Women’s informality has its own determinants



Sources: “Women, Business and the Law,” World Bank, <https://wbl.worldbank.org/en/wbl>; “Statistics on the Informal Economy,” ILOSTAT, <https://ilostat.ilo.org/topics/informality>.

A weak positive correlation was observed for 2016 (including the spliced data) between higher level of overall informality and a higher level of informality in women’s employment as compared to men (Figure 2). When it comes to legal barriers to work, it might be assumed that if these are higher for women as compared

to men (or conversely, if there is a lack of legal protections for women) then a greater percentage of women might work in the informal sector, outside these legal constraints. For example, if there are laws preventing night-work for women, then night shifts in legal enterprises will be unavailable to them; so we might expect to find women moving to work in informal enterprises, beyond those laws. Or, another example: if there is no maternity leave provision in law, more women will need to drop out of formal employment; we would expect to see them increasingly involved in “family labor” or in informal part-time work instead.

However, in a somewhat surprising finding, minimal or zero correlation was observed between the rate of female informal-sector employment¹⁸ and the WBL (World Bank Women, Business and the Law) index,¹⁹ which captures each country’s legal rights that affect people’s access to work, and ranks countries on how equal these are for men and women.²⁰ This unexpected finding can perhaps be explained by turning the issue on its head and viewing the laws (or lack thereof) in the formal sector as proxies of social standards in the informal sector. For instance, referring back to the example above: just because there are no rules against night work in the informal sector, this does not mean that you are going to see large numbers of women working night shifts in the informal economy—because societal norms already restrict women’s movement at night.

Informality and prosperity

A large body of evidence documents the presence of larger informal sectors in countries with lower GDP per capita, weaker GDP growth, lower investment and productivity levels, less financial sector development and innovation, and higher poverty. In 2020, EMDEs with above-median informality (using World Bank DGE

estimates), on average, ranked around 110 out of 166 in their achievement of the UN Sustainable Development Goals (SDGs), around twenty places lower than EMDEs with below-median informality. A close to 20-percentage point differential in the proportion of the population living in extreme poverty was also observed between the two groups.²¹ These findings beg the question of whether the informal sector serves as a barrier to growth or is a symptom of underdevelopment.

An important potential channel of underdevelopment is the lower productivity of the informal sector. A large literature attests to the fact that informal firms tend to be smaller in terms of labor employed and revenue generated, and that they are less efficient. Estimates of the productivity differential between informal- and formal-sector firms range from 30 to 216 percent.²² Amaral and Quintin formulate a model where in the presence of a contract enforcement gap between sectors, employers with higher optimal scales of production choose to operate within the formal sector to gain access to formal financing.²³ They suggest that managers only choose to enter the formal sector when they perceive returns to financial access and the scaling opportunities it provides as exceeding additional tax and regulatory costs. Consequently, formal-sector firms are found to operate at higher physical capital-to-employment ratios. Other explanations for the sectoral productivity differential include a greater informal-sector reliance on unskilled labor²⁴ and the backward technologies employed by informal firms.²⁵

These observations provide some support for the Dualist school of thought, which sees the informal and formal economies as separate entities, operating almost tangentially.²⁶ By this theory, informal enterprises do not compete with formal enterprises and have not only separate production processes and inputs but separate consumer bases. This view predicts a slow movement towards formality as a country develops and that a population

growth rate that outstrips the creation of new economic opportunities will not result in the reallocation of labor from informal to formal sectors. When population growth outstrips growth in per capita income, the absorption of the labor force is undertaken by the informal economy, and the share of formal employment will decline. Human capital growth has the opposite effect, expanding the formal sector and improving its ability to absorb labor.²⁷

This view posits that the formal sector holds the key to economic growth and as this growth picks up, it absorbs new generations of workers into the formal sector, shrinking the informal sector. A potential explanation for the duality view is that informality is a survival strategy for low-skilled entrepreneurs who could not bear the additional cost of formality.²⁸

A pushback against the duality view is presented by Maloney in the Mexican context²⁹ and by Ulyssea in the Brazilian context.³⁰ They provide evidence to show an overlap in productivity distributions for firms in both the informal and formal sectors and a lack of a threshold firm size at which formality becomes more likely. That is, there is a lack of evidence of a “missing middle” in firm-size distribution between the formal and informal sectors. This evidence of a productivity continuum among formal- and informal-sector firms conflicts with the dualist claim of the two sectors catering to separate and non-competing markets.

The widely documented formal/informal-sector wage gap—which persists even when observable differences in worker profiles are controlled for—is another potential indicator of lower informal-sector productivity or even exploitation of workers.³¹ Ulyssea, however, finds that when controlling for firm characteristics in Brazil (assuming there is positive assortative matching between firms and workers, which would control for selection based on worker quality as well) this wage differential vanishes.³² These results suggest that (a) self-selection is one of the main drivers of the wage gap between observably equivalent workers, and

(b) conditional on skills, formal and informal workers perform the same tasks within the firm.

Another view of the informal sector, popularized by de Soto, presents the informal sector as a source of potential productivity that needs to be unleashed by reducing entry barriers and high costs to formal registration.³³ This view connects the rise of informality to bad governance, which manifests as excessive and unnecessary regulation and deficient provision of public services. In this view, microentrepreneurs try to shirk the excessive costs of formal registration—that a small enterprise may not have the capacity to bear—by remaining in the informal sector. Informal-sector firms are viewed as competing with those in the formal sector, with some work finding a reduction in profitability for formal firms facing informal competition. The World Bank's nationally representative survey of registered firms in 135 countries over the period 2008–18 found that around 55 percent of formal-sector firms reported competing with informal firms. The share of formal firms facing informal competition was 13 percentage points higher in EMDEs as compared to advanced economies, with smaller formal firms more likely to face competition. The literature documents that potential channels of reduced profitability for formal firms facing informal competition may include higher credit constraints.³⁴

A final school of thought characterizes informal firms as deliberately sidestepping regulation in order to earn higher profits, and not pay taxes.³⁵ Ulyssea proposes a taxonomy of informal-sector firms in Brazil based on the above framework and finds that the proportion of firms fitting de Soto's view of pent-up productivity that could contribute to formal-sector growth is a meagre 9.3 percent.³⁶ Rather than viewing the above schools of thought as competing frameworks, he proposes that they simply represent different outcomes resulting from heterogeneous firms optimizing profits and survival chances given their specific circumstances.

Public finance capabilities and informality

Government revenues in EMDEs with above-median levels of informality are 5–12 percentage points of GDP below those with below-median informality.³⁷ The literature also points to the formation of a vicious cycle in which informality and subsequent tax avoidance make the provision of public goods—crucial to the effective functioning of markets—even harder for governments to provide (especially those in emerging markets and transition economies). These public goods include law and order/policing, the running of effective regulation and taxation institutions, and uncorrupted public administration. This results in convergence to a low-level equilibrium that affects growth in transition economies.³⁸ The low-level equilibrium is suboptimal because firms in the unofficial sector are said to be less productive than those in the official sector and have lower incentives to formalize due to low public goods provision. Johnson, Kaufman, and Shleifer also emphasize that market-supporting public goods are among the first to have funding cut when public finances are low, particularly where governments have weaker spending power and are increasingly influenced by specific industrial lobbies.³⁹

The cyclical nature of informal economy size and informal-sector employment have important implications for employment policy and for interventions targeting the informal economy. The reasoning behind a proposed countercyclical nature of informal economy size is that when the formal economy experiences downturns, the lack of formal opportunities leads to movement into the informal sector, which is more flexible due to lack of regulation. The evidence on this is mixed and few cross-country studies exist that identify causal effects. One such study, by Ceyhan Elgin, finds evidence for the countercyclical nature of informal economy size from a 152-country panel data set (from the 1999 to 2007 estimates of Schneider, Buehn and Montenegro⁴⁰ on whose calculations the

World Bank indirect model estimates are based) and uses this to suggest that informal economy size amplifies business cycles.⁴¹ Further, Elgin argues that the fluctuation of informal-sector size during downturns has spillover effects for the rest of the economy through the fluctuation of the tax base, which informal-sector participants do not contribute to. Çiçek and Elgin posit that consequently, developing countries' ability to follow countercyclical fiscal policy may be hampered due to their large informal economies.⁴² Conversely, Bosch and Maloney look at employment flow data from Brazil and Mexico and find that separation rates are actually higher in the informal sector during downturns and that flows of labor from formal to informal sectors are procyclical rather than countercyclical, throwing doubt on the view of the informal economy as absorbing excess labor or as a form of disguised unemployment during downturns.⁴³

Tackling informality

It is difficult to establish whether informality causes low productivity among informal firms or whether informal firms select into informality due to their low productivity. The question of policy measures to reduce informal economy size is one that must be treated with care due to this identification issue arising from the endogeneity of a firm's decision to operate in the informal sector.⁴⁴ Djankov et al., among others, document that higher levels of entry regulation are observed in countries with larger informal sectors,⁴⁵ although the literature finds little conclusive evidence that reducing regulatory requirements pushes firms to formalize. La Porta and Shleifer argue that government regulations are not the binding constraint on informal firms' decision to operate outside the formal sector.⁴⁶ Fewer than 10 percent of formal or informal firms in their cross-country data set cited business

licensing, permits or the legal system as their greatest obstacle, citing financial constraints and land access instead. De Andrade et al. report no increase in firm registration when firms are given more information about registration, or when costs for doing so are waived, from a randomized control trial conducted in Brazil.⁴⁷ These findings, in conjunction with La Porta and Shleifer's observation that most firms that are formal start out that way,⁴⁸ points to evidence that most informal firms never make the transition to formality. La Porta and Shleifer suggest that this phenomenon reinforces the dual view of informality: informal firms choose not to go formal as they would not survive the additional cost of regulation.⁴⁹

Generally, the literature finds that formalization has little to no statistically significant effect on firm performance measured in sales, profits, and employee cohort. Even when positive effects are observed they tend to be driven by outliers, indicating that the perceived benefits to formalization for the vast majority of small informal firms are quite low.⁵⁰ However, aggregate productivity effects of enforcing formality may manifest through channels like elimination of low-productivity informal firms and subsequent reallocation of resources,⁵¹ reducing self-selection into low-productivity informal jobs or informal entrepreneurship,⁵² or influencing decisions relating to human capital accumulation prior to job-market entry due to lower informal-sector job availability.⁵³

A key trade-off to be noted when increasing enforcement of formality is the potential for negative welfare effects from at least temporary unemployment due to reduction of opportunities in the informal sector. While in the literature enforcement on the extensive margin (at firm level) shows positive effects on output and wages,⁵⁴ enforcement on the intensive margin often leads to unemployment and can amplify the adverse effects of a negative labor market shock.⁵⁵ These negative welfare effects are likely to be borne by the most vulnerable workers—those with fewer

options—necessitating caution in policy making when targeting the intensive margin of informality.

Informality constitutes a complex phenomenon that is difficult to explain with any one mechanism or driver. It is a key issue in the quest for prosperity as it implies a lack of access to appropriate social protections for workers, less ability to finance public services, and a failure to adopt appropriate technologies that could boost economic growth. It may also be a crucial buffer between society's most vulnerable and extreme poverty, making it imperative that policy interventions targeting the informal sector are implemented with care.

The data sets presented in this chapter show a declining trend in informality at the global, regional and country levels, with the few exceptions being in states experiencing significant political instability. A marked difference in levels of informal employment by gender emphasizes the need to address the gender dimension of informality in further research.

How prepared are conflicting world orders for the next wave of technological innovation?

Julio C. Amador Díaz López

INCREASING GEOPOLITICAL TENSIONS FROM THE end of the 2010s gave rise to a technological Cold War. In all likelihood, whichever world order—liberalism or authoritarianism—achieves technological supremacy will be able to fend off its challenger. This chapter aims to understand which world order is better suited for driving and maintaining innovation. To do so, we take historical factors that have shaped past waves of innovation and review these alongside data from the Atlantic Council’s Freedom and Prosperity Indexes. This chapter finds that, even though the liberal order seems better positioned to foster technological innovation, there are ways in which authoritarian regimes can elbow their way into innovation.

Introduction

As different worldviews have become increasingly wary of each other, the basic geopolitical fabric of the last few decades has been remade. Throughout the 2000s, the Western worldview appeared to run out of steam, particularly after the 2007 and 2008

Julio Amador Díaz López is a lecturer at Imperial College London.

financial crises ravaged the welfare of citizens in the West. Increasingly, Western leadership fell out of touch with everyday citizens by burdening them with failed policies aimed at generating economic prosperity. And citizens seemed to regard their leaders as hypocritical elites that did not care for the general welfare of the population. Meanwhile, nationalistic movements, such as the Brexit campaign and referendum in the United Kingdom and the Make America Great Again movement, seemed appealing to voters in the Western world—even if, or precisely because, these movements appeared to break with the status quo.

As events in the Western world appeared to be dismembering the liberal order, authoritarian leaders seemed encouraged and determined to out-compete the West. Vladimir Putin, for example, moved to break the “rules-based world order” by invading Georgia in 2008 and annexing Crimea in 2014. In China, Xi Jinping broke with his country’s political norms by extending his period as premier, accelerating the “integration” of Hong Kong, and increasing the threat of annexation of the territory of Taiwan. Even the COVID-19 pandemic, in the beginning, appeared to be making the case for authoritarian regimes, as President Xi seemed to have controlled the spread by implementing a draconian “zero-COVID” policy; and both Russia and China seemed to be able to produce vaccines within the first months of the pandemic and mandate inoculation of their populations, bypassing the bureaucracy that appeared to stifle the West.

Even if, in retrospect, both China’s COVID pandemic blunders and failed imperialistic exercises like Putin’s invasion of Ukraine have removed some of the bravado from authoritarian leaders, it is still unclear how the events of 1990–2020 will remake the geopolitical fabric. What appears increasingly clear is that scientific and technological tools, such as the ones used to create a vaccine in record time or monitor public compliance with draconian

How prepared are conflicting world orders for the next wave
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measures like “zero COVID,” will become extremely important in shaping the new geopolitical order.

Emerging technologies, such as online social media and its “rabbit hole” of recommendation algorithms, allowed anti-liberal movements to occur. For example, machine learning and artificial intelligence technologies allow the Communist Party in China to keep track of its citizens and enable the diffusion of misinformation and propaganda. Moreover, this technological revolution powered the development of know-how to harness existing chipsets, new chip architectures, and investment into new technologies like artificial intelligence and machine learning. Thus, a “new arms race” between world superpowers has emerged as theoretical research has shown these new technologies—like quantum computing—could upend our current encryption technologies and supercharge machine learning development.

However, it is precisely the development of these technologies that is enabling the discovery of new, lifesaving drugs, improving the efficiency all sorts of manufacturing techniques, and allowing more people access to all kinds of information; they will also allow humanity to simulate and explore the farthest reaches of space and look into unimaginable places like black holes. Furthermore, emerging challenges, such as the climate crisis or the new space race, have allowed technologies such as nuclear fusion and reusable rockets to emerge. But, once again, the question will be whether countries use these innovations to bolster prosperity or curtail freedom; this will be the choice that remakes the geopolitical fabric of the days to come. In short, technology and the way it is used will tilt the balance of power in this new era.

Because of its importance in shaping the new world order, the question “Which order—liberalism or authoritarianism—is better prepared to foster technological innovation?” deserves some consideration. Below, we compare factors that social scientists

deem relevant to innovation. By reviewing these factors through a historical lens, this chapter aims to help readers form an opinion of which worldview is better positioned to foster innovation. In addition, this chapter informs policy recommendations by taking a data-driven view of the positions of the different orders, and outlining factors that might help technological innovation.

To be clear, this author does not believe there is a clear path to technological innovation. Because the liberal order of the nineties itself aimed at spreading freedom and democracy through the free market and flow of information, much of the world we still live in now is connected; a large portion of the products we use in the West are manufactured in China, with processes developed in the West, coupled with locally grown know-how. As much as talks of “decoupling” and “reshoring” are happening now, disentangling manufacturing, value chains, and knowledge networks created during the “golden age of liberalism” will be difficult, if not impossible. Because the information has flowed freely during the last decades (at least from West to East), it is nearly impossible to know which world order will harness this information in the best possible way. But the exercise within this chapter aims to understand which is the most fertile ground for innovation in an era of decoupling.

Determinants of invention and innovation

Innovation is social by its very nature. Social factors are the ones that will ultimately determine which societies nurture or discourage innovation. As Joel Mokyr puts it, summarizing Joseph Schumpeter’s argument: “The enemies of technological progress were not the lack of useful new ideas but social forces that for one reason or another tried to preserve the status quo.”¹

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Conditions conducive to invention and innovation can be broken into the individual component and, for lack of a better term, the environmental component. However, the individual part is probably the most difficult to quantify, as doing so requires measuring the ingenuity required for invention. As such, this chapter will turn its attention away from this component.

On the other hand, even if not entirely quantifiable, environmental features *can* be assessed to a certain degree. To further our analysis, we will divide such environmental issues into two elements: one related to aspects of societies that may affect the individual or their behavior, and a second related to the “structure” of the society in which he or she lives. The former includes values, willingness to accept risk, attitudes toward science, and resistance to innovation. The latter involves demographics, labor costs, politics and the state, and path dependency.

Factors related to innovation

Demographics. Adam Smith, in *The Wealth of Nations*, observed that the demographics of a specific population were essential determinants of technological innovation.² Smith’s concept of innovation referred to the generation of know-how in production. Smith argued that the larger the population, the more specialization in labor; and the more specialized the labor force, the more know-how the workforce would develop. In sum, Smith argued that large populations tend to be more innovative.

Labor. Another factor—closely related, yet contrary to Smith’s demographic argument—is the size of the labor force. It can be said that the larger the labor force, the cheaper this factor of production (labor) will be. Because this production factor is cheap, there will be fewer incentives to complement or substitute work with technology. In this manner, the argument contradicts Smith: the larger the population, the less innovative it will be.

Risk. The argument related to risk also has different shades. First, societies more averse to risk can develop innovation through constant, incremental steps. However, societies more prone to taking considerable risks could reap the rewards of larger innovation bets, possibly resulting in paradigm-shifting innovations. As such, Mokyr argues that it is precisely societies that are less averse to riskier, long-term projects that are more conducive to innovation.³

Science and technology. Closely related to risks are attitudes towards science and technology. Societies like Germany and France have a long-established tradition of producing theoretical research.⁴ Such practices might be more conducive to incremental innovations. On the other hand, societies like the United Kingdom and United States, although they have now developed and become established in their theoretical research capabilities, have been better positioned to create innovations through engineering: a more hands-on approach to innovation. Such a *modus operandi* might allow these societies to innovate by “thinking out of the box.”

Values. Attitudes toward risk and science and technology are part of a multidimensional set of values, which might also include “aspirations.” Graduates from Western universities might aspire to work in the tech sector, for example. Another critical value is the appreciation of diversity. For example, Mokyr argues that more inclusive, diverse societies have historically tended to incorporate and improve upon innovations coming from outside, thus providing a potential boost to innovation.⁵ The corollary is that more inward-looking communities tend to overlook innovations from outside, potentially curtailing their potential applicability.

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Even if not exhaustive, this list of behavioral factors allows us to, if not understand, at least sketch a society's attitudes toward innovation. Behavioral factors and individual ingenuity shape a society's attitudes toward innovation. However, this is only one part of the picture. A society's structural factors, those affecting an individual's system of incentives, make for the other part.

Institutions and property rights. The mechanism through which property rights incentivize innovation is simple. By protecting property rights, the innovator can exploit the rights to their creation. Simply put, it incentivizes innovation by creating a monopoly over the invention. This rationale assumes the inventor knows how to exploit their innovation, which is only sometimes true. Together with property rights come institutional strength. Among the different roles institutions play in society, one is the protection of such property rights by ensuring the law is observed. Other roles include creating a level playing field through regulation, or supporting promising innovations to make it to the market through financing. Most relevant, good institutional strength will ensure markets operate as well as possible, thus incentivizing the innovator by creating conditions for their inventions to be commercialized. In sum, a healthy institutional environment will protect the innovator and create the right conditions to make their creation reach its full potential.

Politics and the state. Closely related to institutions is the way in which politics and the state operate. It is usually the political process that slowly but surely impacts the operation of institutions. A political process separated from institutions will allow the latter to function in as frictionless a way as possible. If, on the other hand, politics interferes with the dynamics of institutions, their operation will become distorted. Such distortions will indeed modify the incentive structure, thus stifling innovation.

Path dependency. Even if not frequently discussed, path dependency is likely one of the essential factors in determining innovation. Path dependency refers to the ways in which decisions made in the past impact and constrain current and future decisions. As such, countries that enjoy higher levels of innovation because of higher institutional strength, leaner political processes, or the right amount of state intervention are more likely to continue enjoying such high levels of innovation. On the contrary, countries where institutions are weak, or where the political process and state regularly interfere with institutions, are likely to follow their path and continue experiencing low levels of innovation. It is worth noting, however, that path dependency is not a “law,” and structural changes may allow a country to set a new course. But alas, this is rarely the case.

Our brief review shows that most behavioral and structural factors conducive to innovations are closely entangled. It is often the case that unique behavioral characteristics, such as an appetite for risk, affect structural elements such as institutions. And because of path dependence, the relationship between factors is circular, making it extremely difficult to point towards a single factor conducive to innovation. Because of this, we need to clarify which worldview might be better prepared to foster the next wave of technological innovation. Our aim in the following section will be to review, rather than evaluate, the differences between liberal and authoritarian regimes to paint a picture of the current state of factors conducive to innovation in these two different worldviews.

The road to technological domination

Historically, the factors discussed above interact in complex ways to determine technological innovation. It is worth noting that

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no single factor can predict which worldview might dominate over the following decades. However, a simple survey of several prerequisites for innovation will allow us to understand which worldview is better positioned to develop technology in the years ahead.

As an illustrative exercise, we will use components from the Freedom and Prosperity Indexes to generate a single composite indicator of factors conducive to innovation, which will allow us to understand which countries, with their regimes, are better positioned to sustain innovation. The exercise will not be entirely rigorous and will necessarily lack some important indicators of technological progress. As such, the reader should take this exercise with a grain of salt. Nevertheless, it will still prove helpful for building a quantitative understanding of the different worldviews' standing and approaches.

Specifically, this exercise will use the following components as imperfect proxies for the abovementioned features. But, again, this experiment intends to illustrate rather than provide definitive answers.

- **Investment.** Among other things, investment flows can indicate the existence of potential innovation projects—whether privately or state led. As such, they can be an important (if highly imperfect) measure of risk, as every project will have a risk profile, and some certainly involve a science and technology aspect.
- **Productivity.** This exercise uses a constant total factor productivity measure. Labor and capital are both measured, and one of the factors includes technology. Because of this, productivity can be considered a proxy for both labor and science and technology.
- **Education.** The intention of including education in our exercise is to use it as a proxy for science and technology and, even if tangentially, to help assess specific attitudes and

values; for example, it would be expected that societies that value education more highly might have greater chances of producing innovations.

- **Property rights.** The measurement of property rights is the most straightforward. Protecting property allows the inventor/innovator to safeguard and exploit its creation. The greater the protection of such rights, the larger the incentives for innovation.
- **Trade freedom.** Trade allows for the free exchange of goods and, alongside, ideas that might be relevant for innovation. Moreover, it provides access to different markets, thus creating incentives for inventors/innovators.
- **Minority rights.** In our exercise, this indicator serves as a proxy for attitudes toward the inclusion of minorities. As discussed above, the inclusion of minorities might help innovation by enabling the exchange of different ideas.
- **Political freedom.** This indicator is used in this exercise as a proxy for the state and the degree to which it intervenes in markets and institutions.
- **Legal freedom.** This indicator is a proxy for the functioning of a country's institutions, and how their interaction with political freedom will affect the incentives inventors will face.

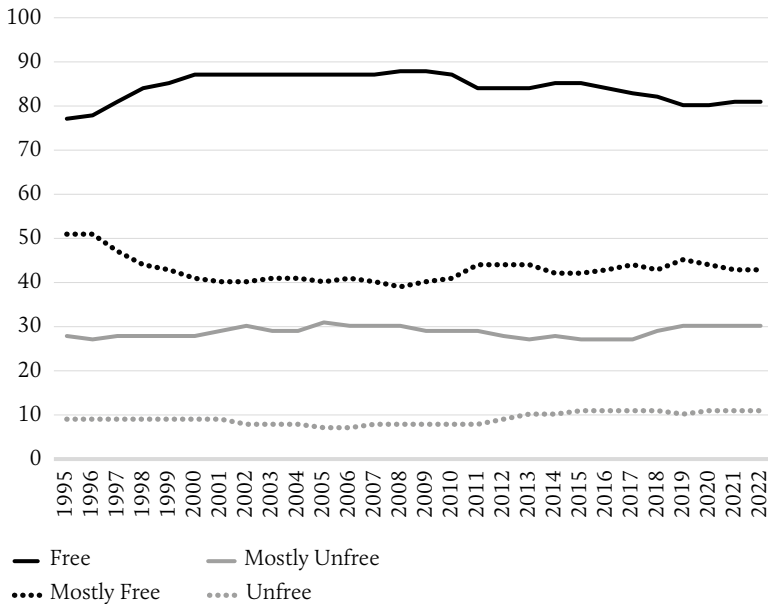
Because this is only an exploratory exercise, it must be understood that: (a) Many previously discussed factors still need to be included. (b) Many of the chosen variables have overlapping factors. And (c) many of the factors are heavily correlated among themselves. For these reasons, our indicator will only take the average of these components to show where we can expect a fertile ground for innovation in the years to come.

At the outset, we use the scores from the Political Freedom sub-index (of the Atlantic Council's Freedom Index) to group the countries into four categories: Free, Mostly Free, Mostly

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Unfree, and Unfree. For any given year, a country that scores more than 75 in Political Freedom would be classified as Free. A score between 50 and 75 will be Mostly Free. A country that scores between 25 and 50 will be categorised as Mostly Unfree. And finally a score below 25 will be classified as Unfree. In addition to the abovementioned caveats, it is essential to underscore that cutoffs between categories leave countries that might reasonably belong to another category. However, once again, the aim is to provide a picture rather than explicitly and irrevocably offer a causal explanation.

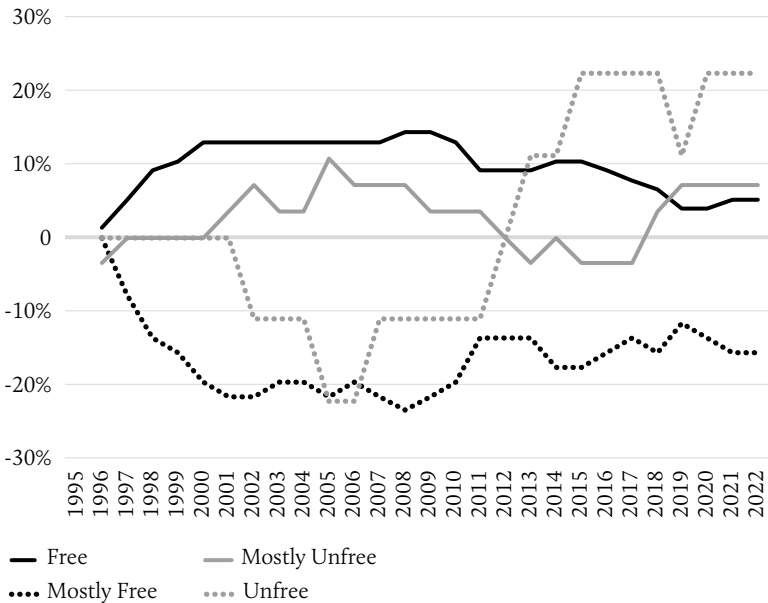
Figure 1. Number of Free, Mostly Free, Mostly Unfree, and Unfree countries, based on Political Freedom scores



Source for all figures: The 2023 Freedom and Prosperity Indexes (forthcoming, 2023).

Figure 1 shows the number of countries in each of the four categories. Because of nuances in the methodology used by different sources to produce the Index, most of the countries in the sample are categorized as Free. Also, because of the temporality of the Index, changes in the number belonging to each category cannot be fully appreciated. Because of this, the more informative graphic in Figure 2 tracks the *changes* in the number of countries of every type. Figure 2 shows that the number of Free countries plateaued in the early 2000s. Interestingly, in the first decade of the 2000s, the number of Unfree countries decreased as the number of Mostly Unfree countries rose. However, looking further into the decade of the 2010s, a wave of undemocratic movements begins to make gains.

Figure 2. Percentage change in the number of Free, Mostly Free, Mostly Unfree, and Unfree countries, in relation to 1995



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When looking into the average of factors conducive to innovation (investment, productivity, education, property rights, trade freedom, minority rights, political freedom, and legal freedom), Figure 3 shows that Free countries are ahead of any other classification. Moreover, these trends appear not to change over time. However, when looking at percentage changes using 1995 as an initial base, as in Figure 4, the Unfree world appears to be making gains after 2007. This trend is fed by the increased number of countries in the Unfree category but also coincides with the backlash against the liberal order caused by the 2007 and 2008 financial crises.

Figure 3. Average of scores of factors conducive to innovation, for Free, Mostly Free, Mostly Unfree, and Unfree countries

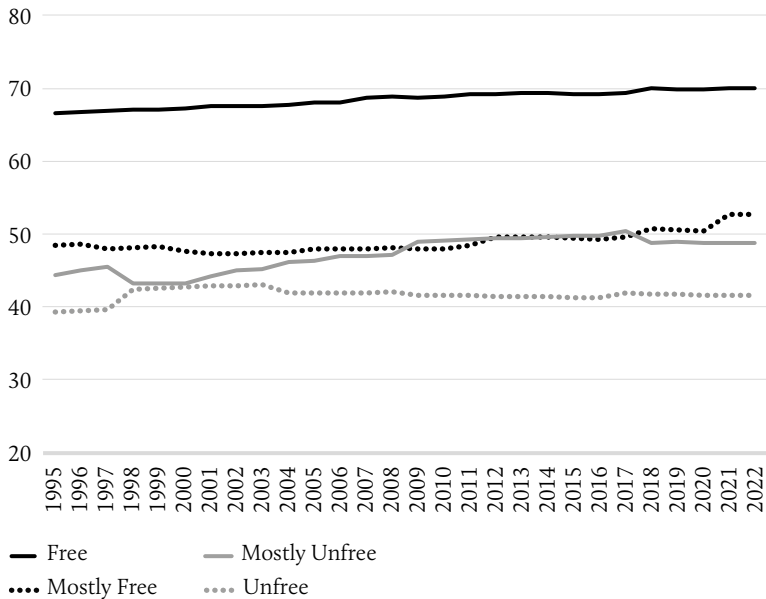
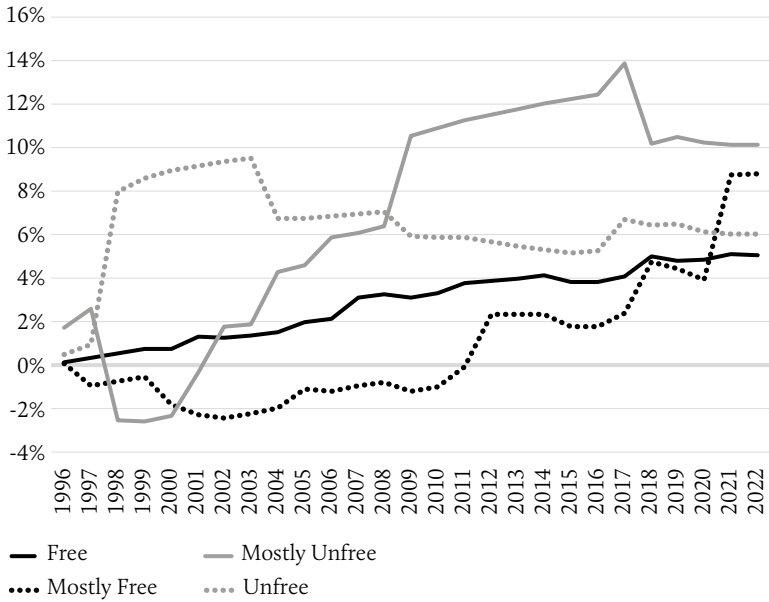


Figure 4. Percentage change in the average scores for factors conducive to innovation of Free, Mostly Free, Mostly Unfree, and Unfree countries, in relation to 1995



A possible explanation for this change might be that one component dominates or distorts our composite indicator. For example, when we look at one factor alone—investment (shown in Figures 5 and 6)—the investment score in Unfree countries increased by almost 20 percent compared to the beginning of the financial crisis.

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Figure 5. Average of the investment scores for Free, Mostly Free, Mostly Unfree, and Unfree countries

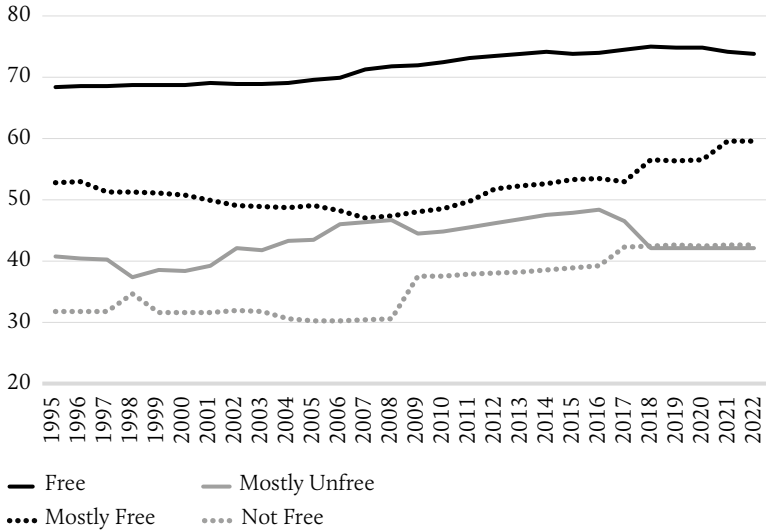
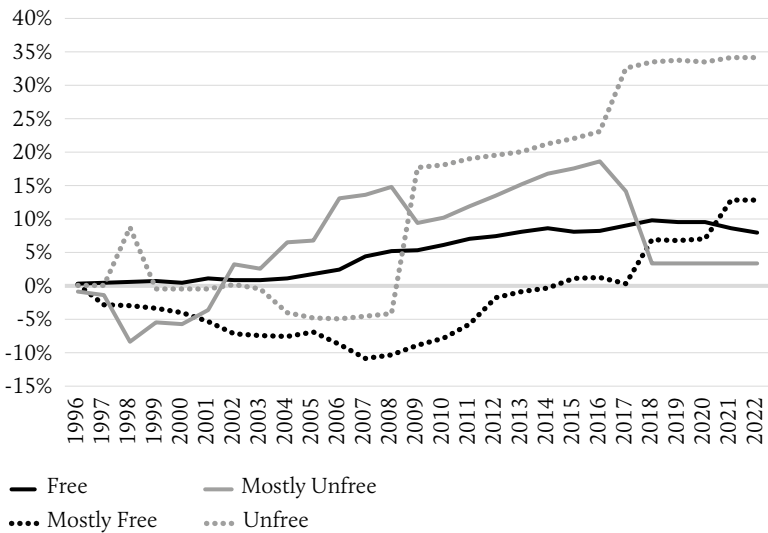


Figure 6. Percentage change in the average of the investment scores of Free, Mostly Free, Mostly Unfree, and Unfree countries, in relation to 1995



The trends presented in this exercise reveal that the Free world still holds an enormous advantage in some factors conducive to innovation. They also show that whatever shortcomings different worldviews might have, these can be compensated to a great extent by effective policies, including investment. Below, we discuss the factors and potential advantages that each worldview might have.

Discussion

A quick look into the factors mentioned above clarifies that societies with different political organizations, liberal or authoritarian, also have other features that might allow them to take the lead vis-à-vis technological innovation. For example, some authoritarian or not entirely free regimes enjoy large, young populations that they can exploit to copy and develop know-how. Authoritarian regimes can also “mandate” innovation by investment, streamlining the development of specific technologies, and often avoiding ethical concerns. The threat to Western technological dominance has been so significant that Western powers, including the United States and the European Union, have directed tremendous investments to develop strategic competencies in artificial intelligence, quantum computing, and green energies. However, upon closer reexamination of the components outlined above, it becomes clear that the Western order might still hold an edge in technological innovation.

Demographics. In the two decades prior to 2010, China’s population explosion led to a bonanza in terms of productivity. Outsourcing from the West allowed Chinese manufacturers to employ their large workforce and develop specialized production in many industries. Assisted by lax regulation in terms of intellectual property

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protection, China was able to build know-how in different industrial sectors. These shortcuts also allowed China to quickly catch up to the West in technological terms, and by the end of the 2010s, China had created good technological capabilities. For instance, the Chinese could harness the data produced by their large population to develop and train complex artificial intelligence systems. However, as China's authoritarian regime became increasingly assertive and the Western countries decided to begin severing China from their technological supply chains, it became increasingly clear that China had yet to reach the West's level of development. One of the possible explanations is that China had always been able to rely on its large workforce to cheaply produce everything in its factories, thus reducing the need for technological innovation. Contrast this with the case of Germany and its aging population. As its workforce became smaller, Germany needed to fulfill the need for factors of production. This phenomenon led to an explosion in the development and adoption of automation technologies that complemented human labor and helped keep German factories afloat and running.

Labor. China's population is aging and its birth rate is decreasing. These two factors will eventually build pressure on the labor market as China's workforce "ages out." Because it is not being replaced at the same rate, this factor is likely to become problematic.

At the time of writing, the population of India, the largest democracy on Earth, is about to exceed that of China, thus creating more competition for Chinese manufacturers, as regards labor costs. These pressures might increase China's incentives to innovate by adopting automation technologies like Germany. On the other hand, Western countries have been facing the problem of a shrinking labor force for two decades now. In fact, not only are manufacturers in Germany developing new automation technologies but also, manufacturers in the United States and

Europe are rethinking the whole concept of work. From automation technologies to efficiency tools such as remote work, these economies must deal with new labor-related challenges that have pushed them to innovate.

Risks. Another labor-related challenge—addressed in diametrically different ways by the two worldviews—was how to respond to the COVID pandemic. On the one hand, democratic societies adopted riskier attitudes toward the pandemic, from using unproven technologies to reopen societies, such as mRNA vaccines, to organizational innovations, such as furlough, the four-day work week, or work-from-home policies. These riskier attitudes allowed most Western countries to return to pre-pandemic production levels. By contrast, risk-averse policies in authoritarian regimes, with China being the most evident example, adopted very conservative policies like “zero COVID.” Even though these approaches created the impression of public protection, in the end they stifled growth and innovation. These measures had such an impact on production and services that many firms began redrawing their supply chains, and if Chinese producers are removed from supply chains, this might deprive them of the know-how required to expand their own technological innovation.

Science and technology. In all likelihood, the feature where both liberal and authoritarian regimes are most similar is in their approach to science. Both worldviews have realized the outsized importance of science and technology in generating prosperity. As such, they have both sought to finance significant scientific endeavors. For example, until the outbreak of the nationwide war in Ukraine in 2022, there was still cooperation in space exploration between Russia and the West. European and US astronauts used to travel to the International Space Station (ISS) in Russian-made rockets launched from Russian launchpads.

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Similarly, the Chinese regime developed its space programme by building a space station like the ISS. Liberal and autocratic regimes have followed similar, state-led approaches in developing chips, quantum computing, and artificial intelligence. These efforts exemplify similarities between state-led worldviews. However, their differences become clear when deploying scientific insights into technological innovations. Because of the nature of authoritarian regimes, these tend to use industrial policy to deploy their technologies and grow their prosperity. Even if liberal societies have made use of industrial policies for the very same reason, Western societies have tended to rely on “the invisible hand” of the market to allow their innovations to percolate through society. Liberal societies have developed vibrant venture capital investment industries and a “startup engineering” culture that has successfully taken some scientific developments—begun in government laboratories—and deployed them throughout the market. The most notable example is the internet and the many innovations it set in motion, such as social media, online financial services, e-commerce, and so on. But, most recently, there has been a marked movement from government-led research to private industry in liberal societies, noticeable in space exploration, quantum computing, and green energies. Even if Western venture capital has sought to replicate this model in authoritarian regimes, these have resisted the push through institutional intervention. Because of this intervention, the percolation of technological innovation in these societies has frequently lagged.

Values. Value sets and systems are markedly different between authoritarian and liberal worldviews, and these differences are both consequence and cause of the behavioral aspects above. While graduates from top universities in democratic societies might look for jobs they consider attractive, well-paid, and prestigious in the technology sector, graduates in authoritarian societies look

for jobs they consider secure and prestigious in the public sector. A second dimension within the value systems is their tolerance of different opinions and appreciation of minorities. While recent nationalistic movements in democratic countries such as France, the United Kingdom, and the United States have tarnished the West's reputation for openness and tolerance, these countries still have an extensive tradition of opening themselves to views and ideas from different parts of the world. Universities in the West receive students and academics from all nationalities, making them, in all likelihood, the most diverse in the world. By contrast, authoritarian regimes tend to be more inward-looking and appreciative of everything produced within their boundaries.

Leaving aside human ingenuity, a more risk-loving society, willing to listen to different ideas, has a greater chance of creating new technologies, even if they only stumble upon them by chance. This brief discussion suggests that the Western worldview is better aligned with this behavior, even if only marginally. However, the attentive reader can notice that organizational and institutional factors play a prominent role in shaping attitudes and outcomes. Therefore, our attention now moves on to discuss these factors.

Most important is the difference in how both worldviews regard the individual. Whereas liberal societies tend to view the individual as the main component of society, authoritarian societies tend to view the individual as part of a collective. This difference is essential as policies and incentives will be “tuned” to benefit the individual or the society, depending on the worldview.

Institutions and property rights. As values help to define institutions, we move on to discuss institutional design. Liberal countries design their institutions to protect and uphold individual property rights. By doing so, countries like the United States or the United Kingdom incentivize technological innovation by allowing the inventor or innovator to extract fully the potential exploits of her

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creation. By contrast, institutions in countries like China or Russia are tuned to serve the state. By adjusting institutions and property rights to help the state, individual incentives for innovation are absent. As such, innovation in these countries must be driven or pushed by different forces.

Politics and the state. The political process in free societies is driven by democratic competition. In theory, political competition will allow diversity and incentivize politicians and society to adopt the best ideas and practices. In practice, such competition is always constrained by different factors beyond this chapter's scope. Nevertheless, allowing competition and the flow of ideas might ensure the best or better-positioned actors arrive at the institutions. It also constrains bad actors from staying in positions of power for an extended period. By contrast, politics in authoritarian societies are captured by an elite that controls the state and its institutions. Such capture allows elites to perpetuate themselves in power and discourages other actors from challenging them.

Path dependency. As our brief comparison shows, most of the elements discussed are closely related; for example, values affect institutions, which are impacted by the political process. Furthermore, this dependency is not only among the factors discussed but also through time. Processes—like the fall into authoritarianism—tend to reinforce themselves, even if marginally, over time. As such, the factors discussed above that impact innovation for both worldviews tend to strengthen themselves. This rationale is not to say that change is impossible but to underscore the inertia of social processes in determining outcomes.

Conclusion

Our brief discussion of the factors determining innovation suggests the liberal order is better prepared to incubate and develop the next wave of technological innovations. Just after the “end of history” decade, and with the turn of the new millennium, pundits on both sides of the ideological worldview began to predict the decline of the West. Factors like the financial crises at the end of the 2000s and the rise of nationalism during the mid-2010s seemed to suggest that the liberal order could be waning, with rising powers led by authoritarian regimes in China and Russia positioned to upend the status quo.

Technologically, a quote from futurist, technologist, and investor Peter Thiel reflects the declining status of the free world. Thiel stated in 2013: “We wanted flying cars, but all we got is 140 characters,” contrasting the vision of a future that was to be radically different against a reality in which the only difference was the rise of social media.⁶ However, the landscape had turned on its head by the end of the 2010s and the beginning of the 2020s. Innovations in almost every field—from chip design to artificial intelligence to new, seemingly unattainable developments such as those in nuclear fusion, or CRISPR and mRNA technologies—all developed in free societies, painting a radically different picture.

It is essential to underscore that, regardless of the apparent edge liberal societies have in technological innovation, “Cardwell’s law” predicts that the technological dominance of the West will eventually end.⁷ This view is based on historical precedents: both the Arab world and China once held the edge regarding technology. And the dominance of both civilisations eventually came to an end.

This raises the question: Is there an avenue to delay, if not avoid, such an outcome? We conclude with a short discussion of policy recommendations to sustain technological innovation.

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Policy recommendations

The most straightforward recommendation is to reinforce institutions and property rights. The former precludes power-hungry elites from taking control of the state and distorting incentives. The latter protects the innovator's rights to enjoy and exploit their innovation. Put together, these two elements cover the incentives for innovation.

There might be other avenues to generate incentives for innovators. For example, the state might provide incentives for highly risky bets. However, fully exploiting such innovations requires a free market whose forces will find the right fit for a specific product and reward the inventor accordingly. In this way, policies promoting scientific innovation for risky bets and protecting the early stages of innovations, such as patent systems, are fundamental. However, a careful balance is required to avoid interfering with a free market, as competition in the later stages of creation develops a beneficial incentive ecosystem for innovators. This balancing act—protection of the initial stages of the market, and state intervention to incentivize risky bets versus avoiding interference with free markets—is no easy task. However, it is a task more easily undertaken in liberal societies, where elites are unable to interfere in institutions to extract rents, than in authoritarian ones. Thus, protecting the liberal order itself might be the best way to achieve innovation.

PART II

National and regional reflections
on freedom and prosperity

The quest for freedom and prosperity in the Middle East and North Africa

Khémaies Jhinaoui

DESPITE THEIR DIFFERENT TRAJECTORIES, EVERY country in the Middle East and North Africa (MENA) has faced successive cycles of instability and upheaval throughout their post-independence years. Hardly a year has passed since the 1950s without major crises or episodes of sub-regional turbulence. Throughout these years, the longing for freedom and the quest for economic well-being have been the twin drivers of protest movements.

The most recent wave of unrest, which occurred after 2010, was not properly addressed nor well understood by the region's ruling regimes. Home-grown uprisings shook these authoritarian systems to the core and ultimately ushered in processes which were supposed to lead to the overhaul of the old order in the Arab world. In other countries, no uprisings took place and the status quo was maintained against all odds. All in all, aspirations for change evolved differently from one country to another, depending on local conditions and their level of progress—in terms of institution building and social advancement—since independence.

More than sixty years after gaining their independence, most Arab countries found themselves lagging behind the rest

Khémaies Jhinaoui is a diplomat and former minister of foreign affairs of Tunisia. He is president of the Tunisian Council for International Relations.

of the world in terms of political openness, public freedoms, good governance practices, and the rule of law.

Divergent visions of the Arab Spring

For years, two divergent visions as to the best way to improve the lives of the majority competed for the hearts and minds of the region's elites: authoritarianism and liberal democracy.

Autocrats in power since the 1960s, some of whom are still at the helm of Arab governments, have repeatedly faced off with various contending groups, including liberal activists, who had long struggled in opposition or at the political periphery, with very few assuming any real power.

Authoritarians have always favored strong government as the best way to project "national sovereignty," impose their self-serving notion of security, and promote an economic growth model that often involved nepotism and clientelist networks. Their narrative was that centralized authority did not hamper liberty and that once the countries reached a sufficient level of development, including a "middle-class threshold" and an adequate ratio of literacy, a smooth transition to democracy could begin. But there was no illusion about their countries ever reaching this elusive level of development or about the authoritarians' intent to allow any other scenario but their indefinite stay in power. Liberals, on the other hand, argued that economic openness combined with effective rule of law and political participation are fundamental prerequisites for a vibrant economy and shared prosperity. They maintained that democracy could better ensure checks and balances, free media, and rule of law. Experience, they pointed out, has proven that there is no durable prosperity without accountability, unfettered initiative, and willingness to dismantle inhibitive restrictions.

When Tunisian protesters took to the streets in 2010–11, clamoring for change, their slogan “jobs, freedom, and dignity” enunciated the hopes of many people across the region.¹ However, strong aspirations for a better life and rule of law ended up, in most cases, in chaotic transitions that ensured neither.

Countries such as Libya and Yemen, which suffered from the absence of solid institutional legacies, were not able to sustain political and economic transitions. The sudden fall of old regimes left both countries with a complete institutional vacuum that led to chaotic situations. Alongside Syria, they fell into endless spirals of civil strife—and civil war—while their populations struggled for mere survival. Gripped by these violent cycles, Libya and Yemen sought the support of the international community to help them craft a new system that would enable them to settle their disputes and achieve stability. International goodwill notwithstanding, forms of foreign interference, added to the lack of peaceful dispute settlement tradition, made the objective of peace and rebuilding impossible to achieve.

Regime change in Tunisia and Egypt

In the cases of Tunisia and Egypt, though both quite different from a historical perspective, the early phase of transitions after 2011 proceeded in a more orderly fashion. Both countries opted for regime change based on transitional processes aimed at installing new representative governments and anchoring democratic institutions. Both countries adopted new constitutional frameworks, elected new governments immediately after the demise of old regimes, and set in motion new reform processes.

Tunisia, which had enjoyed a period of relative economic growth until 2010 and which boasted a solid civil-service tradition

since independence, was in a better position to address most of the challenges it faced after the fall of the Ben Ali regime. It elected a constitutive assembly and adopted a new, broadly based constitution in 2014, which despite some loopholes and politically self-interested interpretations, set up functioning institutions premised on the principle of checks-and-balances.

The new legal frameworks, coupled with internal dialogue between actors, created the conditions for three general elections and a peaceful transfer of power. The Quartet of groups that supervised the national dialogue through this period even won a Nobel Peace Prize in 2015.² However, the lack of a deeply entrenched democratic culture, and the neglect by the new political system of the urgently needed social and economic reforms, planted the seeds of economic and political crises, and frustrated the people's aspirations for sustainable prosperity and better living conditions. The resulting deterioration of the socioeconomic situation ultimately jeopardized the gains in terms of freedom and democracy building.

Lack of economic reforms stunted growth and led to increased poverty and unemployment. Tunisia's GDP per capita decreased from US\$4,355.62 in 2010 to US\$3,688 in 2017.³ Socioeconomic decline eventually planted the seeds for neo-authoritarian and populist trends, which played on fears of the lower classes that plain liberalism and disengagement of the state from economic production could lead to further deterioration of their living conditions. In this context, populist narratives, which included disdain for political parties and "the elite," gained favor with the population. Liberal economic reform became synonymous with painful and unacceptable pressures on the poor and with subservience to foreign diktats.

The experience of Tunisia shows that democratic transitions that do not meet the social and economic needs of the population, and where politicians are disconnected from the country's realities,

can lead the public to lose confidence in the democratic process altogether—even if the people remain strongly attached to their freedoms. A curious contradiction can even emerge between attachment to freedom and scorn for democratic processes. Labeling Tunisia a “free country” (scoring 78 out of 100 in the 2017 Freedom House report) did not, in fact, translate into better standards of living or more prosperity for the Tunisian population.⁴

Unsurprisingly, growing distrust and disillusionment lent growing support to populist movements and neo-authoritarian trends while liberal elites were sidelined and electoral choices blurred, with the whole process jeopardizing the future of democracy.

As far as Egypt is concerned, the election of a new ideologically driven Islamist government, that aimed to reshape Egypt’s society and politics based on its partisan agenda, sparked fears within the population and much of the elite. This accelerated the collapse of the nascent democratic process and stirred up a strong reaction from the army, which found the moment propitious to seize power. In a net reversal of the political process, authoritarianism was restored, with the army controlling and distorting much of the economic production process. Once again, state interventionists used the social argument to guarantee a continued role of the state in the economy, enacting or keeping in place restrictions that inhibited free enterprise. It came as no surprise when the new leadership introduced measures that fettered freedom of thought and expression.

Avoiding reforms

In the face of the popular push for freedom and political participation across the region, monarchies and oil-rich countries were able to resist the wave of change and preserve the old autocratic system, with minor adjustments. While some had to introduce

dozens of political and economic reforms to appease their young populations, others such as Qatar, with majorities of expatriate populations (primarily migrant workers) and ample financial resources, had an easier task preserving the status quo.

For many countries in the region, oil and gas revenues have been useful for replenishing state coffers. But in most cases this fossil-fuel income has not been used to institute new systems that ensure equitable distribution of wealth and consolidation of freedom and good governance practices.

Wealthy stakeholders acted preemptively outside their borders to shore up neo-authoritarian power structures and prevent the emergence of a new mode of government that could have better met the hopes of the populations for more freedom and economic opportunity. In certain cases, as in Tunisia and Egypt, they were helped by domestic actors—mainly politicians and media representatives—who opportunistically sought dividends from outside interference at the expense of their own democratic processes and sound governance.

Nowadays, the Middle East and North Africa seems perhaps even more alarmingly fractious and divided than in 2011. Most countries went through major structural and political transformations but regrettably none can claim today to have built a new representative system driven by good government practices and free market principles.

Following the 2011 uprisings, politicians were tempted by two models: One sought a radical break from the status quo ante by dismantling old institutions and political systems, and launching a process aimed at establishing a different mode of government based on transparency, the rule of law, and judicial independence. The second model was more gradualist in nature, opting for a pragmatic approach to accommodate people's aspirations for greater political participation while upholding the basic structures of old regimes.

Twelve years after the Arab Spring, neither model has helped any country in the region to achieve political, economic, and legal freedom levels described by the Atlantic Council Freedom and Prosperity Indexes.⁵ Lack of realism or inexperience—if not both—combined with score-settling and zero-sum-game mindsets, undermined the processes.

The quest for freedom doesn't have to be radical

Radical movements from the left and the right of the political spectrum pulled together their forces in order to transform what was a legitimate peaceful longing for freedom and dignity into counterproductive and sometimes violent processes of change with vindictive agendas against old regimes. They insisted on scrapping constitutions and electoral laws, embarking on rapid and comprehensive structural overhauls, and revamping entire governmental and institutional frameworks.

In most cases, the countries that chose to totally and suddenly break with the old systems failed. Abrupt change led either to the collapse of state institutions and descent into civil war, as was the case in Libya, Syria, and Yemen, or to a situation where the whole transitional process stalled, such as in Tunisia. In the case of Egypt, the brief democratic experience collapsed after a showdown between dogmatic Islamism and military authoritarianism, pushing the country to a status quo ante situation.

In Tunisia, hard-earned political freedoms (including freedom of expression and freedom of conscience) were enshrined in the constitution. But liberalization did not extend to investment and free enterprise laws and practices, which could have helped ensure the creation of wealth and improve the standard of living of the population. Unsurprisingly, political reforms were not

matched by economic achievements during the past decade; and most people felt disconnected from the whole democratic process.

In Tunisia, successive governments were handicapped, to varying degrees, by political instability as well as by their own lack of vision as they averted structural reforms. The economy remained mired in a permanent slowdown while endless strikes and social unrest caused a drastic drop in economic productivity, not to mention the inhibitive impact that the turmoil had on political leaders.

In Libya and Yemen, the uprisings accelerated total collapse of the already shaky and weak institutions. Led for years by autocratic leaders, both countries' regimes—long built around tribal structures—were not able to withstand the fallout of the uprisings and adequately channel the yearning for freedom and change among the population toward constructive projects. Interference by regional and international powers further complicated matters.

In Libya, the dictatorship of Muammar al-Qaddafi was forcefully removed by outside military intervention with no exit strategy, leaving the country prey to unrest, social strife, and growing chaos. Governmental instability and political division within Libyan society, combined with the proliferation of armed militias, did not promote political progress or economic revival.

Despite government efforts to continue the regular payment of salaries to civil servants, overall living conditions in Libya deteriorated and the country faced sporadic shortages of consumer goods and failure of public services, as well as cyclical collapse of the security situation. The country's already fragile state institutions became weaker still and oil revenues, instead of being put to use in rebuilding the state, became part of a spoils-driven struggle for power.

Developments in Libya in fact showed how instability and violent strife can endanger freedoms and human rights, while making economic stagnation worse. They also showed how

oil production, when hostage to internal feuds, could become a source of corruption and further violence, and encourage retreat from the rule of law and freedom.

Yemen, on its part, has been through successive cycles of civil war through the past decade. The country, which was already in complete shambles before 2011, is today simply a failed state. UN and international mediation efforts did not succeed in bridging the wide schism between Yemeni factions and could not help forge a permanent ceasefire that could pave the way for calm and stability in the country. No effort to improve good governance, expand freedom or revitalize the economy is possible in a fragmented society and a divided state subjected to endless foreign interference and regional meddling.

In the case of Syria, where a civil war has been raging for more than a decade, state institutions continued to operate within the confines of the old political and economic system, despite the ongoing hostilities and the devastating effects of extremist attacks. Isolated and no longer in control of large parts of its national territory, the Syrian regime was able to survive with aid from Russia and Iran. All traditional prosperity parameters are in decline and political freedom is obviously in regression. Any hope for the restoration of stability, democratization of the system, and resumption of economic growth will require a new political process that does away with the old anti-democratic practices, and allows for the disengagement of foreign troops, the reunification of the country, and the normalization of relations with its neighbors.

Egypt is a case study in its own right. The country, which followed the path of Tunisia in 2011, opted for radical change: removal of the old regime, adoption of a new legal and constitutional framework, and the appointment of a new government. The election of an Islamist president—Mohamed Morsi—and the appointment of a conservative government accelerated the collapse of this burgeoning, if flawed, democracy and ignited

widespread popular protests in 2013. After a brief, tumultuous transition, a military coup that same year reversed Egypt's course, effectively reverting the country to the pre-revolution system.

Efforts to streamline Egypt's economy through the adoption of a new investment law in 2017—offering new incentives, guarantees to foreign investors, and implementation of major infrastructure projects—did draw important inflows of hard currency. Investment came mainly from the Gulf countries, keen to back a like-minded authoritarian regime, but this did not translate into a substantial increase of per capita income or the betterment of the daily lives of Egyptians. Prosperity remained elusive and according to the World Bank's annual *Doing Business* report, Egypt ranked 114 out of 190 in “ease of doing business.”⁶

According to Freedom House's annual study of political rights and civil liberties worldwide, Egypt is considered “not free.”⁷ Political parties are legal, but in practice they do not constitute a meaningful opposition to existing power structures. On the legal front, the president, as head of state, has exclusive powers in hiring and firing most of the senior civil service hierarchy, as well as government, military, and judicial personnel.

Gradual reform as the best route to freedom and prosperity

A number of countries opted for a more pragmatic and gradualist approach to address people's grievances and respond to the wave of protests that followed the Arab Spring uprisings. Such an approach yielded better results when applied preemptively, that is, before local protests could swell to full-scale revolution.

Countries like Morocco and Jordan were swift to act, before and immediately after the uprisings started in Tunisia and Egypt. Spurred by domestic protest, and spiraling events abroad, they moved to accommodate people's demands for political and

economic reforms. Salaries were also raised, food and consumer goods prices lowered, and new laws were adopted to improve governance, restrain monarchical powers, and introduce transparency in managing public funds.

However, no major institutional shake-up occurred in either country. The two monarchies broadly maintained the status quo, while introducing a set of reforms to liberalize the political system and enlarge participation in public life.

Oil-rich Gulf countries also made preemptive concessions. They improved the standards of living of their populations, developed first-rate infrastructure, and further opened up their economies to foreign investment. The result was relative stability and economic growth in these states (to varying degrees), as well as enhanced influence at regional and international levels. However, the overall impact was limited as these measures did not lead to systemic changes in governance, nor to increased accountability, nor to greater participation of the local population in political life.

The ongoing war in Ukraine is also having its own effect on the region, giving more clout to energy-producing countries and adversely affecting the standards of living of the populations in non-oil-rich nations. In these countries, soaring prices, lack of opportunities, and increasing poverty are boosting populist movements and curtailing liberties.

In Morocco, political and economic reforms have proceeded relatively smoothly. Following a televised speech by King Mohammed VI in June 2011, a referendum was organized to amend the constitution. The new text included a chapter on “Fundamental Rights and Freedoms,” which considered the opposition an “essential component” of the parliament and specified that “the King appoints the Head of Government from within the political party arriving ahead in the elections.”⁸

But the International Commission of Jurists (ICJ) considered that the structures and mechanisms established by the 2011

constitution would increase the control of the executive branch over judicial matters, erode public confidence in the system, and compromise the effective administration of justice.

On the economic level, Morocco introduced a number of reforms which improved the attractiveness of the country to foreign investment. Foreign direct investment into Morocco reached a record level in 2018 (US\$3.6 billion) and although it had fallen back to US\$1.7 billion in 2020, it remained high compared to that of neighboring countries.⁹

Located in a very volatile region, Jordan remained dependent for its stability on relations with its neighbors, namely Iraq, Syria, Saudi Arabia, Palestinian territory, and Israel. Like Morocco, Jordan refrained from a radical overhaul of the old system, but it did set up an independent electoral commission to supervise the parliamentary electoral process and to administer and supervise all other elections. But reforms intended to bolster the independence of the judiciary fell short of international standards: there were no explicit provisions guaranteeing total independence of the High Judicial Council from the executive branch or granting this body control over the administrative and financial management of the judiciary.

Jordan's economic growth has been adversely affected by exogenous factors, namely the dwindling of foreign aid, especially from the Gulf region, the temporary closure of the country's borders with Iraq and Syria, the end of Iraqi oil supplies at preferential prices, and the interruption of energy imports from Saudi Arabia. Furthermore, the economic burden of accommodating large numbers of Syrian and Palestinian refugees continued to exert heavy pressure on the economy.

Despite some encouraging experiences in the co-management of water resources, closer relations with Israel did not impact positively on people's daily lives in Jordan. Nor did they generate the expected prosperity heralded by the Jordan-Israel peace treaty,

signed in October 1994. The current hard-right shift in Israeli politics could jeopardize existing agreements.

Jordan's economic concerns were also compounded by domestic factors. High energy prices triggered strikes and protests in southern cities at the end of 2022. Tribal discontent and feuds within the royal family added to the instability, as did rumors of widespread corruption, which reverberated throughout the kingdom.

Foreign influence impacts the quest for freedom and prosperity

Transitional processes in the Middle East and North Africa since the Arab Spring have been shaped equally by domestic and foreign factors.

Regional and international powers remained attentive to the course of events in the countries affected by the uprisings. Some, genuinely encouraged by the magnitude of change, wanted to support popular aspirations and contribute to the emergence of democratic systems in North Africa and the Middle East. They provided financial and technical support to help government authorities draft new constitutions, enact new laws, and proceed with major political and economic reforms to address people's demands for better participative political life and improved standards of living. Others, animated by ideological or geopolitical goals, tried to shape the outcome of the transitions in a way that met their own national interests.

In some cases, foreign interference exacerbated domestic schisms among feuding factions and made it even more difficult to reach peaceful solutions to violent conflicts. In Libya, while the UN was trying, through its representatives, to help find a political settlement to the complex conflict, foreign powers—especially those from the MENA region—were engaged in fierce competition

for influence in order to maintain their foothold in the country or secure their share of reconstruction projects. In some instances this competition evolved into proxy showdowns, using local warring factions to expand their economic and geopolitical influence and consolidate their presence in the country.

Syria and Yemen are two other cases where foreign regional interventions complicated the crises and exacerbated the suffering of local populations.

In the case of Tunisia, foreign partners pledged financial support and provided technical and logistical assistance to meet immediate economic needs and improve security readiness in the fight against terrorism. US assistance was substantial and decisive in enhancing the operational capabilities of the security forces. The EU, Tunisia's primary trading partner, expressed from the outset its strong support for the democratic transition; but practical assistance did not go beyond the existing provisions of the European Neighbourhood Policy. The assistance equated Tunisia's needs with those of other southern Mediterranean partners, without giving specific consideration to the potential impact that a successful Tunisian democracy, and a thriving economy, could have on the whole region. Indeed, Tunisia already possessed many of the ingredients to succeed in building a democratic system as well as anchoring a vibrant and open economy: a large middle class, established rights for women, a relatively high level of education, and abundant human resources.

Although it provided relatively important financial support, the EU never acquiesced to Tunisian demands for trade advantages and access to European structural funds similar to those granted to Eastern and Central European countries before their accession to EU membership. The EU had acted then as a driving force for its European neighbors when they emerged from the Soviet era, a kind of a regional locomotive that pulled these countries out from old autocratic regimes, economic despair, and institutional

weaknesses. The European Commission secured financial support and helped these nations implement political and economic reforms, while NATO membership provided a security umbrella for the concerned countries. None of this occurred with Tunisia, which found itself going through democratic apprenticeship, fighting terrorism, and facing the social and political aftermath of its revolution almost alone. The impasse was just waiting to happen.

Freedom, prosperity, and human development in Egypt: Why does freedom matter?

Mohamed M. Farid

Throughout history orators and poets have extolled liberty, but no one has told us why liberty is so important. Our attitude toward such matters should depend on whether we consider civilization as fixed or as advancing. In a fixed society there ought to be best methods of doing things. Experts should be more capable of finding these methods than ordinary people, and, for the good of all the people, these methods should be put into effect by collective action. In such a society the practical problem is to obtain the best rulers; there is no need for individual liberty.

In an advancing society, however, any restriction on liberty reduces the number of things tried and so reduces the rate of progress. In such a society freedom of action is granted to the individual, not because it gives him greater satisfaction but because if allowed to go his own way, he will on the average serve the rest of us better than under any orders we know how to give.

—H. B. PHILLIPS¹

Mohamed Farid is a member of the Egyptian Senate and the deputy chair of its Committee on Human Rights and Social Solidarity. He is also a founding member of the Liberal Club in Cairo.

THE 2022 ATLANTIC COUNCIL REPORT, *Do Countries Need Freedom to Achieve Prosperity?*, showed that prosperity and freedom are highly correlated: the correlation coefficient between the indexes is 0.81. High scores for freedom are associated with high scores for prosperity, and low scores for freedom with low scores for prosperity.²

We can focus our analysis of these results on the lower-middle-income countries in the Middle East and North Africa (MENA) region. Despite their differences—these countries have diverse demographic, political, and socioeconomic conditions—most are categorized as Mostly Unfree with the exceptions of Tunisia and Morocco (Mostly Free). On the prosperity index, except for Lebanon which is Mostly Prosperous with a score of 52.3, the rest of countries in the region are considered Mostly Unprosperous.

The UN Human Development Index (HDI) allows us to further examine the relationship between freedom and prosperity. The HDI is a summary measure of average achievement on three key dimensions of human development: a long and healthy life, being knowledgeable, and having a decent standard of living. The HDI is the geometric mean of normalized indices for each of these dimensions. The health dimension is assessed by life expectancy at birth. The education dimension is the mean of years of schooling for adults aged twenty-five and above, and expected years of schooling for children of school entering age. The standard of living dimension is measured by gross national income (GNI) per capita.³

All countries in the region have a low HDI rank. Algeria performs best, ranking 91 out of 183; Mauritania ranks last in the region at 158 (Table 1).⁴

Table 1. Freedom, prosperity, and human development rankings for countries in the MENA region

Country	Freedom rank	Prosperity rank	HDI rank
Tunisia	78	92	97
Morocco	102	112	123
Lebanon	117	74	112
Algeria	138	107	91
Mauritania	142	166	158
Egypt	145	126	97

Sources: Freedom and prosperity rankings: Dan Negrea and Matthew Kroenig, “Do Countries Need Freedom to Achieve Prosperity? Introducing the Atlantic Council Freedom and Prosperity Indexes,” Atlantic Council, <https://www.atlanticcouncil.org/in-depth-research-reports/report/do-countries-need-freedom-to-achieve-prosperity>; HDI ranking: United Nations Development Programme (UNDP), *Uncertain Times, Unsettled Lives: Shaping Our Future in a Transforming World*, Human Development Report 2021/22, UNDP, 2022, <https://report.hdr.undp.org>.

This confirms the correlation between the freedom and prosperity indexes. Despite all the differences between these countries, lack of a high degree of freedom is consistently linked to lower prosperity.

Over the period covered by the Freedom and Prosperity Indexes (2006–21), Egypt consistently remained in the Mostly Unfree and Mostly Unprosperous categories. Its freedom score peaked at 46.6 in 2011, but then gradually decreased over the years, reaching 35.8, before slightly improving to 37 in 2021. Despite this, Egypt made progress on the HDI, rising from 0.65 to 0.73 over the same period.⁵

Challenges facing Egypt

Between 2011 and 2022, Egypt faced unprecedented challenges both at national and regional levels. At the national level, Egypt experienced staggering population growth, with over 20 million births in this period. The population reached over 104 million in 2022, one-third of whom are under the age of fourteen. This is particularly problematic given the urban concentration on the Nile Delta and along the length of the Nile River, which together account for just 6.8 percent of Egypt's one million square kilometers. Deteriorating infrastructure and high rates of poverty, with almost one in every three Egyptians living below the poverty line, present additional major challenges.⁶

These and other factors led to political turmoil: millions of young Egyptians took to the streets in 2011 in a massive uprising demanding better standards of living, eradication of corruption, and more democratic reforms. The protests sparked a revolution, but the turmoil continued, characterized by terrorist attacks targeting civilians, particularly Christian minorities, foreigners, and tourists. This resulted in a decline in tourism activity, one of Egypt's main sources of revenue and foreign currency.

At the regional level, instability in neighboring countries such as Syria and Libya caused an influx of Egyptian workers returning home, increasing the already high unemployment rate. The turbulence in these countries also led to security issues, including illegal migration, human trafficking, and border infiltration by Islamic terrorist groups and the illegal trade of military weapons. To address these issues, the government implemented expensive and prolonged security and military measures, which were successful in restoring stability, but required ongoing resources to maintain.

As the decade came to an end the world was hit by the COVID-19 pandemic. Egypt was no exception and is still suffering from its repercussions.

To address these challenges, the government began implementing economic reforms in 2014, including reducing fuel subsidies and redirecting those funds toward targeted cash assistance programs for the most vulnerable members of society. This program was launched in 2015 under the name of Takaful and Karama: two connected schemes providing conditional cash transfers to support poor families with children under eighteen.

In 2016 the Egyptian government sought support from the International Monetary Fund (IMF), which resulted in a loan of US\$12 billion. The loan was accompanied by a socioeconomic program aimed at achieving macroeconomic stability and improving the quality of life for Egyptians. As part of this program, the government was required to implement several measures, including allowing the value of the Egyptian pound to float freely on the currency market, and making changes to the taxation system.

The government intensified investment in infrastructure projects, as well as social expenditure, implementing major development projects and initiatives in education, health, housing, and utilities. It also expanded social protection programs to mitigate the impact of several monetary and fiscal reforms that were imposed as conditions of the IMF loan (which included cutting energy and fuel subsidies, currency devaluation, and replacing the existing sales tax with higher value-added tax, VAT), and to improve Egyptians' quality of life. The result of these changes was that Egypt improved its ranking on the HDI. In 2006, Egypt ranked 111 out of 177 countries. Progress stalled in 2011, and the country's ranking fell to 113 (of 187). In 2016, Egypt ranked 111 (of 188) and by 2021 it had further improved to 97 (Table 2).⁷

Table 2. Progress made by Egypt on the HDI and other key metrics (2011–21)

Indicator	2011	2021	Change %
Population	84,529,251	104,258,327	+23.3%
GDP (current US\$)	235.99 bn	404.14 bn	+71.2%
GNI per capita, Atlas method (current US\$)	2,560	3,510	+37.1%
Human Development Index value	0.679	0.731	+7.65%
Life expectancy at birth	69.9	70.2	+0.14%
Expected years of schooling	12	13.8	+15%
Mean years of schooling	7.6	9.6	+26%
School enrollment, primary (% gross)	99	106*	+7 percentage point
Inequality adjusted HDI	0.478	0.519	+8.5%

* Latest enrollment data are from 2019. Gross enrollment is the ratio of total primary-school enrollment, regardless of age, to the actual population of primary-school-aged children. The 106% ratio here indicates that a number of older children are enrolled in primary education.

Sources: Population, GDP, GNI, and school enrollment: World Bank Open Data;⁸ HDI, life expectancy, expected years of schooling, mean years of schooling, and inequality adjusted HDI: UNDP Human Development Report 2021–22.⁹

The Egyptian government celebrated the launch of the UNDP 2021 HDI report as evidence of its success in improving citizens' lives. However, the question arises as to whether freedom is also necessary for progress in human development. To answer this, we must examine the macroeconomic environment and its impact

on human development, education, healthcare, and poverty in Egypt.

Egypt's macroeconomic environment

The government's economic reforms, supported by the US\$12 billion loan from the IMF, have helped stabilize the country's economy in recent years and led to a budget primary surplus. The reform of energy subsidies, in particular, played a large part in this. However, tax revenues remain insufficient and are heavily dependent on indirect taxes, specifically VAT. This resulted in a tax revenue of 12 percent of GDP in fiscal year (FY) 2020/2021. The government financed its spending by increasing its debt, which reached 87.5 percent of GDP in 2020/2021,¹⁰ with external debt at 34.2 percent of GDP. This affected the budget allocation, with interest payments alone accounting for 33 percent of total spending in the 2021/2022 budget.¹¹

Although the central bank devalued the Egyptian pound in 2016, it did not take the necessary measures to keep the Egyptian pound floating, which resulted in a pegged rate and created an unrealistic exchange rate. This led the government to accumulate more debt. And because of the structural issues in the Egyptian economy—characterized by low productivity and a reliance on non-tradable, less sophisticated activities like wholesale, transportation, and construction—this has had a negative impact on the trade balance and reduced the competitiveness of Egyptian exports. The ratio of external debt to exports of goods and services reached 308.6 percent in FY 2020/2021.¹²

This was accompanied, throughout 2016–22, by the expansion in the activities of state-owned enterprises and public economic authorities, both of which are generally economically inefficient entities. As a result, these entities have a negative impact on the

Treasury, as the sum of the transfers they received (subsidies, loans, and contributions) is greater than the taxes and dividends paid to the Treasury. To put this in perspective, in FY 2022/2023 the shortfall between Treasury disbursements and revenues from these bodies was EGP 169.7 billion.¹³ This is equivalent to almost 120 percent of the allocations for food subsidy, fuel subsidy, cash transfer programs, and baby formula and children's medicine subsidy *combined* for the 2022/2023 budget.¹⁴

The implementation of these policies resulted in the private sector, particularly non-oil sectors, experiencing contraction. This is evident in the average of Egypt's Purchasing Managers' Index (PMI), which was 48.8 during July 2021–February 2022,¹⁵ making its share of investments 21.4 percent in FY 2022/2023.¹⁶ And despite reforms taken, the government still couldn't attract foreign direct investment (FDI). The highest annual FDI inflow during this decade was US\$9.01 billion in 2019, well below the 2008 figure of US\$9.49 billion.

This macroeconomic environment has made the Egyptian economy more susceptible to exogenous shocks, due to its high dependency on imports for raw materials, intermediate goods, and investment goods, as well as its reliance on tourism, expats' remittances, and revenue from the Suez Canal as the main sources of foreign currency. By July 2021, the situation had become so dire that the net foreign assets position of banks had turned negative to keep up with the demand for foreign currency.

In early 2022, Egypt faced a major challenge when the United States Federal Reserve tightened monetary policy in response to Russia's invasion of Ukraine. This led to a large exodus of portfolio investments, estimated at around US\$21 billion. The government of Egypt had to take drastic measures to prevent further deterioration of foreign currency reserves, including restrictions on imports to reduce the outflow of foreign currency. However, these measures had unintended consequences: they created

a supply shock that disrupted production and caused a backlog of goods worth US\$14 billion at ports. This ultimately led to an increase in inflation.

The import restrictions caused a decline in exports as well (especially because three-quarters of imports are raw materials, intermediate, and investment goods). This was reflected in the data from Egypt's PMI for November 2022, which showed that business optimism among non-oil firms had dropped to its lowest level in over a decade, with only 4 percent of firms reporting a positive outlook for the next 12 months.¹⁷ Rising prices, supply problems, and weak global demand also served to drive business activity even lower.

In March 2022 the Central Bank of Egypt devalued the Egyptian pound by almost 16 percent. In order to mitigate such inflationary hikes while maintaining a tight grip on foreign reserves, the government launched a social aid package including the expansion of Takaful and Karama, the cash transfer program, by increasing the tax exemption threshold.

As inflation kept rising, due to the ongoing war in Ukraine and the supply shock created by import restrictions, another social mitigation package was announced in July 2022. It included a raise of the minimum wage for government employees, a second expansion of cash transfers, and a six-month temporary pension for nine million households.

In October 2022 the government announced a third package, expanding the Takaful and Karama program once again so that it now reached 20 million individuals, and extending the temporary pension announced in the previous package for another six months.¹⁸ This package marked an important structural shift, as it involved civil society organizations both in delivery and outreach efforts.

In parallel, the government of Egypt turned to the IMF to seek help and negotiate a new deal under the Extended Fund

Facility (EFF). The government also launched a dialogue on state ownership and its role in the economy, and held a conference to discuss the economic crisis, involving experts, private sector executives, and politicians.

The government announced a gradual easing of import restrictions to alleviate supply problems, and released goods that were stuck at ports. In addition, they issued the State Ownership Policy Document, a set of guidelines clarifying the state's role in the economy.¹⁹

At the end of October 2022, Egypt and the IMF agreed an additional loan of US\$3.1 billion. As part of the agreement the government agreed to implement a durable flexible exchange rate. In November, the Central Bank of Egypt implemented a third devaluation of the Egyptian pound, causing a sharp decline in its value. This has led to a growing black market for foreign exchange, as people seek to buy and sell currencies at rates more favorable than the official exchange rate.

Reviewing government efforts on the Human Development Index (HDI)

Education

Egypt's pre-university education system is the largest in the MENA region, in terms of number of students and teachers. In 2019/2020, about 23.6 million students were enrolled in the system, with about 1,019,000 teachers. Despite achieving high enrollment rates in primary schools and a low dropout rate, Egypt is performing poorly on one of the most important indicators of educational quality: class size. The primary level class size increased from an average of 43.8 students in 2011 to 53.4 students in 2020, suggesting a decline in quality.²⁰

It is worth mentioning that in the year 2019/2020 the average class size across all education levels at public schools, responsible for almost 90 percent of enrollment, was 48.3 students. In private schools, it was 33.8 students.

The World Bank's Learning Poverty Brief for Egypt estimates that 70 percent of students are not able to read and understand an age-appropriate text at age ten.²¹ The results of the Trends in International Mathematics and Science (TIMSS) assessment for Egyptian students in 2019 showed some progress compared to those achieved in 2015. The average score in mathematics increased from 392 to 413,²² and in science from 371 to 389.²³ TIMSS is a nationally representative international assessment for 4th and 8th graders in mathematics and science.

Despite the progress made, Egypt still ranks in the bottom decile of countries based on the percentage of students reaching the "Low International Benchmark" set by the TIMSS scoring scale. Nearly a half of students reach the Low International Benchmark in mathematics and science, and about a quarter reach the Intermediate Benchmark.

Healthcare

Maintaining and improving the health of a population of over 104 million is a tremendous task, especially considering the population growth rate of 2.1 percent per year between 2010 and 2020, higher than the 1.8 percent rate of the previous decade. The Egyptian government succeeded in increasing life expectancy at birth over the past decade, from 69.9 in 2011 to 71.8 in 2018. The repercussions of the COVID-19 pandemic drove it down to 70.2 in 2021, but even with the worldwide decline in the HDI, Egypt is still below the global average.²⁴

In addition, there was significant progress in reducing the child mortality rate. For children under five this has fallen from 28.8 deaths per 1,000 live births in 2010 to 20.3 deaths in 2019.

Malnutrition and stunting in children remain big challenges for the government but there have been significant improvements. In 2008, almost one in three Egyptian children under the age of five were stunted, but in 2021 the percentage went down to 12.8 percent. Similarly, child wasting came down from 7 percent in 2008 to 3 percent in 2021. Yet prevalence of anemia among children under five has increased from 27.2 percent in 2014 to reach 43 percent in 2021.²⁵

On accessibility, the ratio of doctors per ten thousand inhabitants increased from 11.7 in 2011 to 12.1 in 2020.²⁶ Despite the increase in the ratio of doctors to inhabitants, there has been a decline in the number of doctors working in the public sector in recent years, falling from over 103,000 in 2016 to around 91,000 in 2020. The number of doctors working in the private sector over the same period rose from around 22,000 to around 30,000.²⁷

A similar trend took place in the number of hospital beds. Over the past decade, there has been a 9.8 percent decline in the number of hospital beds in the public sector, from 98,319 in 2011 to 88,597 in 2020. On the other hand, the private sector has seen a 30 percent increase in the number of hospital beds, from 25,287 in 2011 to 33,020 in 2020. This represents 27 percent of Egypt's total number of hospital beds.²⁸

Private clinics and pharmacies are the preferred choice as service providers for chronic and acute medical conditions; 53 percent of individuals with chronic conditions seek care at private clinics that offer specialist outpatient care, while 18.5 percent seek medical advice at pharmacies, and 11.5 percent receive care at government hospitals. For acute conditions, about 38 percent of individuals seek medical advice at pharmacies. There are serious concerns about the quality of these services, as pharmacists and pharmacy clerks have no medical training, let alone medical licenses.

Out-of-pocket expenditure is another important issue for access to healthcare. Over the past decade, out-of-pocket payments remained almost constant at 60 percent of current health spending, with a slight decrease in 2020 to 59 percent.²⁹

Poverty

Poverty in Egypt has been increasing since the start of the twenty-first century. In FY 1999/2000 the poverty rate was 16.7 percent. By FY 2010/2011 it had risen to 25.2 percent. It continued to increase, reaching a peak of 32.5 percent in FY 2017/2018 due to the devaluation of the Egyptian pound in 2016. For the first time in the decade, the poverty rate dropped, to 29.7 percent in FY 2019/2020. The official poverty rate is surveyed and calculated by the Central Agency for Public Mobilization and Statistics (CAPMAS) and a new poverty line is set each survey year. The value at which the line is set changes over time to reflect the most recent consumption patterns of the population.

The small decrease in 2019/2020 meant that around four million people were no longer living in poverty. This was due to a couple of policy reforms, including the increase of the tax exemption threshold and the extended coverage of the cash transfer programs (Takaful and Karama), as well as market absorption of the inflationary wave caused by devaluation.

The Gini index, which measures inequality in distribution of per capita consumption, has barely changed since 2010. In the most recent year for which we have data, FY 2019/2020, Egypt's Gini index stood at 29.0.³⁰ This means there was almost no change in wealth distribution, whether through government interventions or through market or labor changes. The composition of household income can shed some light on this, as it comprises a significant share of "transfers": income received by households in several forms (e.g., charity, gifts, remittance, government aid, and subsidy, whether in cash or in kind).

The latest Household Income Expenditure and Consumption Survey (HIECS) gives a clearer view of the living conditions of the poor in Egypt.³¹ Transfers, in cash or in kind, represent 23.7 percent of national average household income after wages. However, in rural areas this increases to 24 percent, of which around three-quarters were in cash and one-quarter in kind. The average household spends over one-third of its income on food. This is an indicator that jobs in both rural and urban areas are of low quality and that government interventions and policies are leading to distortions, creating a dependency on transfers for the majority of households. Nationwide, the majority of households rely on food subsidies, with 84 percent of households covered by the program and even higher percentages in rural areas (91.1 percent). These subsidies make up 7.4 percent of total household food consumption, but this figure rises to 11.9 percent for households with the lowest incomes. Though the percentage may appear small, the reliance on subsidized food items is significant. For example, households obtain 77.9 percent of their cooking oil, 78.5 percent of their sugar, and 14.7 percent of their rice from these subsidies, highlighting the distortion caused by the long-standing, inefficient food subsidy program.

Looking at healthcare expenditure, the average household spends 10.4 percent of its income on healthcare services. Of this healthcare spend, 51.2 percent goes to medication and other healthcare products. This increased to almost 58.2 percent in the poorest households. Expenditure on hospital services is 12.2 percent for the poorest and 26.4 percent for the highest-income households. This is another example of the access problem in the healthcare system, as the poor usually go to pharmacies for their diagnoses and prescriptions.

As for education, expenditure reaches 5.7 percent of households' spending. Of this, school fees represent 38.6 percent, private tuition fees 28.3 percent, and transportation to schools 9.6 percent.

In rural areas, the allocation of expenses is different, with 22.1 percent going toward school fees, 36 percent to private tuition, and 10.3 percent towards transportation. The enrollment rate for public schools in rural areas is 89.8 percent and 82.6 percent in urban areas. This allocation reveals disparities and distortions in the education system, and suggests a lack of quality in some areas.

Another indicator of the poor quality of school education is the high average expenditure on private tuition, by even the poorest households. This extra tuition makes up 30.8 percent of total education expenses, compared to school fees, which represent only 17.2. In contrast, the highest-income households allocate only 13.3 percent of their education expenses to private tuition and 67.1 percent to school fees, as they tend to send their children to private schools where tuition standards are higher.

Conclusion

Since 2011, the government of Egypt has faced unprecedented challenges. At the international level, instability and civil wars in neighboring countries, coupled with the ongoing global crises caused by the COVID-19 pandemic and its repercussions, supply chain disruptions, the Russian invasion of Ukraine, and a general tightening of monetary policy have all had an impact. At the national level, Egypt has also experienced two major uprisings—in 2011 and 2013—a war on terror, and a rapid growth in its youth population.

To address these crises, the government has relied heavily on state intervention to drive growth and create jobs by expanding and strengthening public economic authorities and state-owned enterprises. This has led to a restriction of economic freedom and hindered private sector growth, even before the Russian invasion

took place. From July 2021 to February 2022, Egypt's Purchasing Managers' Index (PMI) averaged 48.8.

The government's policies, interventions, and heavy investment in non-tradeable activities and infrastructure have led to some improvements in standards of living and a better ranking on the Human Development Index, as evidenced by the data. Yet, this progress remains modest. Despite these improvements, the quality of services remains poor, and barriers to access still exist. An unfavorable macroeconomic environment has led to a reduction in private sector activity, although it still outperforms the public sector. Furthermore, there are some concerning indicators related to "brain drain" from the public to private sector within Egypt, as well as to other countries.

The ongoing war in Ukraine, high inflation—particularly of food prices—coupled with a significant outflow of approximately US\$21 billion in portfolio investments during FY 2021/22, has led to a sudden drop in reserves and further increased pressure on the budget. As Margaret Thatcher famously stated, "the problem with socialism is that you eventually run out of other people's money," which in the case of Egypt, has become a reality. As a result, it is anticipated that the poverty rate will increase and standards of living deteriorate for millions of Egyptians.

Therefore, eventually improving people's lives and liberating them from poverty will require a vibrant free market where the private sector can thrive and create decent jobs, while also ensuring efficient public investments in human capital. History and research have established that economic and political freedoms are prerequisites for this goal. It is no surprise that countries that are at the top of the Human Development Index are also at the top of the Freedom and Prosperity Indexes.

Therefore, for Egypt to overcome its structural distortions and the tremendous challenges of reducing poverty and improving standards of living, a well-defined role for the state in the

economy, improved governance, and efficient allocation of public resources are needed. This will enable growth led by the private sector, where jobs can be created and more revenue generated, allowing for the development of healthy and skilled workers, and a more stable economic environment that is less vulnerable to external shocks and crises. Expanding social protection for the poor and improving health and education for all will be crucial steps toward achieving this goal.

This cannot be achieved without greater economic, social, and political freedom. It is imperative for the government of Egypt to see the current crisis as an opportunity for further reform and to implement more drastic measures to decrease the state's involvement in the economy and establish a clear framework for the relationship between the state and the private sector through the state ownership policy. Improving competition policies and removing trade barriers are also crucial steps. However, these steps cannot be successful without better governance and more transparency.

Violence against journalists: A tool to restrict press freedom in Mexico

Sergio M. Alcocer
Jeziret S. González

FREEDOM OF EXPRESSION INCLUDES FREEDOM OF THE press and access to information to promote social progress and better standards of life. Without these freedoms, democracies are not complete, and other human rights may be in danger.

Reporters Without Borders (RSF, by its Spanish acronym) defines press freedom as “the ability of journalists, as individuals and collectives, to select, produce and disseminate news in the public interest independent of political, economic, legal and social interference and in the absence of threats to their physical and mental safety.”

Press freedom is included in the Atlantic Council’s Freedom and Prosperity Indexes, as part of the civil liberties indicator in the Political Freedom Index. Mexico, considered Mostly Free, ranks 82nd of 174 countries included in the overall Freedom Index, with a score of 58.2 out of 100. Regarding Political Freedom specifically, it ranked 88th, scoring 60.8 out of 100.

Sergio M. Alcocer is president of the Mexican Council on Foreign Relations (COMEXI); former undersecretary for North America in the Ministry of Foreign Affairs; professor at the National Autonomous University of Mexico (UNAM) and part-time professor at the University of Texas at San Antonio.

Jeziret S. González is a member of COMEXI and columnist with MVS News.

Mexico is very different to its neighbors to the north: the United States had an overall score of 79.2 and Canada 87.8, ranking them at 29th and 11th respectively in the Freedom Index. One southern neighbor, Belize, also outperforms Mexico on this Index, scoring 61.9 in 2021, although Mexico came out slightly ahead of Guatemala, which scored 54.3 in the same year.¹

In this chapter, we analyze press freedom in Mexico, considering the socio-territorial particularities and political landscape of the country. Specifically, our analysis includes the presence of drug cartels and transnational criminal organizations (TCOs) throughout the territory, the levels of marginalization, and the Mexican president's stance on the press.

Another objective of this chapter is to examine the outcomes of the Protection Mechanism for Human Rights Defenders and Journalists that the Mexican government implemented to confront violence against those who seek to uncover the truth and uphold human rights. In addition to the diagnosis made by the Office in Mexico of the United Nations High Commissioner for Human Rights,² an anonymous interview was conducted for this research with a journalist who requested protection under the Mechanism and experienced, first-hand, its advantages and limitations.

According to the UN Educational, Scientific and Cultural Organization (UNESCO), fifty-five journalists were murdered worldwide in 2021, seven of them in Mexico.³ Journalists work to strengthen public interests, including freedom of expression, but unfortunately their integrity is often violated in different countries and under different circumstances. The past decade has revealed new trends. Long ago, murders of journalists occurred mostly in countries experiencing armed conflicts; but now, they are regularly committed in countries at peace, in two regions in particular: Asia-Pacific and Latin America. Most of these murders are committed in countries with large social inequalities and/or high rates of violence and crime.

Article 19 of the Universal Declaration of Human Rights established that everyone has the right to freedom of opinion and expression.⁴ This right includes the freedom to hold opinions without interference and to seek, receive, and impart information and ideas through any media, regardless of frontiers.

In Mexico, press freedom has been recognized by law since 1917 when the current constitution was enacted; nonetheless, censorship comes in the shape of threats and direct attacks from both sides: organized crime and the authorities. Also, new technologies add a different dimension: on one hand, they offer the possibility of a broad and rapid distribution of information, but on the other, journalists are exposed to online threats and harassment—and even to surveillance, making them and their informants more vulnerable. The low cost and high quality of surveillance technology mean these tactics are very easy and cheap to implement.

It is also worth noting that most of the media in Mexico are in the hands of big national companies, which makes it difficult to rely on the quality of the news. But not only that, since the election of President Andrés Manuel López Obrador (AMLO) in 2018, he has started a campaign against journalists, whom he accuses of supporting the political opposition, calling them “biased,” “unfair,” and “the scum of journalism.”

Mexico is considered one of the deadliest and most dangerous countries for journalists; a correlation between levels of organized crime and violence perpetrated against journalists is evident. From 2000 to 2022, 163 journalists were murdered in Mexico, thirty-eight of those during President AMLO’s tenure.⁵ Moreover, most of the killings occurred in states where some of the most prominent drug cartels operate.

To protect journalists and human rights defenders from continued violence, the Mexican government launched a program in 2012 called the Protection Mechanism for Human Rights Defenders and Journalists.⁶ Although the Mechanism was deployed

ten years ago, 2022 became the deadliest year for journalists in that period, proving that it has not been enough to safeguard journalists' lives. In the following section we will describe the context of Mexican journalism, and discuss the Mechanism's impact, ten years after its implementation.

Mexico and its press, in context

Mexico is a country of 126 million people, with 43.9 percent living in conditions of poverty. Twelve of Mexico's thirty-two states have more than 50 percent of their population living in poverty.⁷ Also, Mexico is multicultural, with seventy-one indigenous groups representing more than seven million people who speak an indigenous language. Social, cultural, and economic inequalities are, as expected, concentrated in those indigenous groups, and disproportionate numbers live in states where illegal drugs are either produced or transported. Also, it is well known that corruption is a major problem in the country. Even though the current federal government declared it to be one of its top priorities, results show that actions have been too weak. The Mexican Institute for Competitiveness (IMCO), a non-partisan, nonprofit public policy research center, created its own Corruption Risk Index, focusing on public procurement by analyzing 260 institutions from 2018 to 2021. IMCO's key findings included that federal institutions do not prioritize public bidding processes, that contract documents are often unavailable, and that contracts are frequently awarded to risky suppliers.⁸

Along with poverty and corruption, Mexico has another major problem: transnational criminal organizations (TCOs), commonly referred to as "drug cartels" and "drug trafficking organizations" (DTOs). In 2006 the federal government launched a war against DTOs, fragmenting the larger and more stable organizations and

sparking greater violence. TCOs are not limited to producing and/or transporting drugs; instead, or in addition, they are responsible for kidnappings, extortion, and inflicting terror on communities.

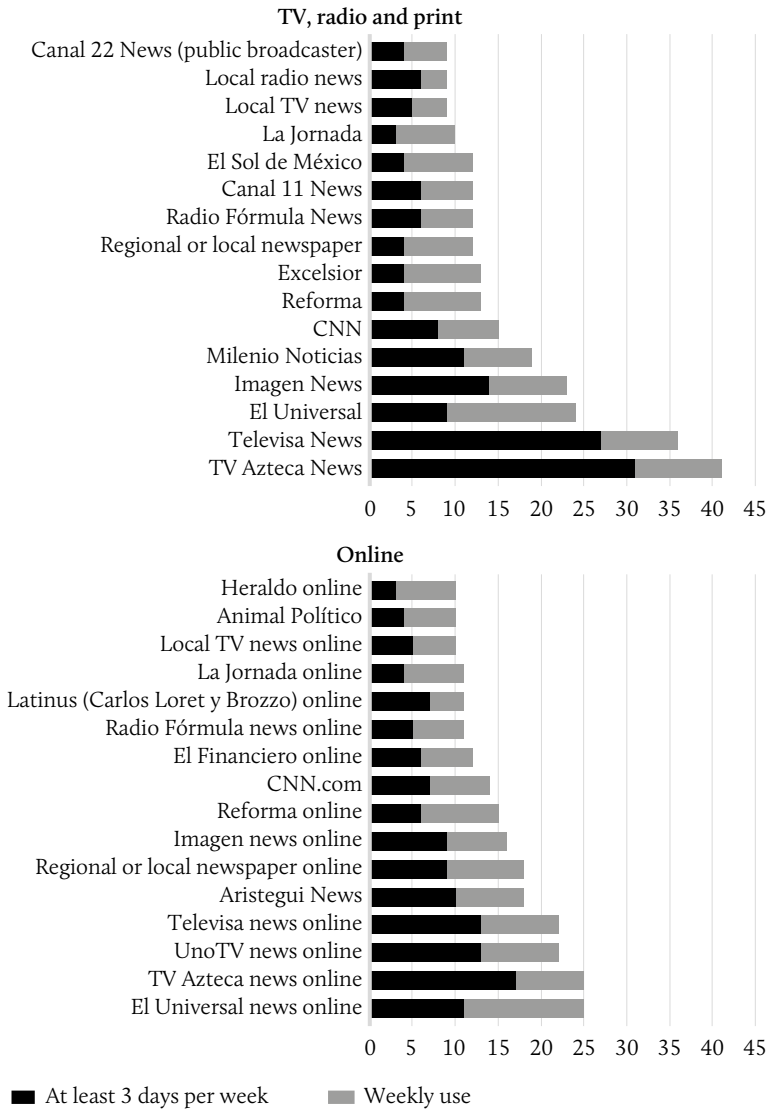
With prevailing poverty, corruption, and organized crime, national, regional, and local governance is poor. The press, thus, plays a central role in bringing relevant information on the most important local and/or national issues to public attention. Whether those issues include corruption in some government office or illegal activities of organized groups in a village, journalists are exposed to a very volatile, highly dangerous environment.

Television is the most important format for news media in Mexico, but there is also radio, journals, magazines, blogs, and social media. There are dozens of national news media outlets, but broadcasting is controlled by Televisa, which in 2021 merged with US-based Spanish-language network Univision. There are seventy daily newspapers, twenty-four radio stations, and forty-four websites, all of them led by the Mexican Editorial Organization.⁹ Grupo Imagen is also an important multimedia conglomerate; other actors include newspapers such as *El Universal*, *Reforma*, and *Milenio*, and the news portal Latinus. There is also Azteca Noticias group.

In Mexico, a privately owned commercial broadcasting system was developed over the years through the concession of a public good to a handful of private individuals—a flawed structure common to most Latin American countries. This concession system permits the federal government to apply pressure and influence over the press, and in some cases dictate what the press is to say.

The relationship between the press and the government in Mexico has changed over the centuries. During the colonial period, the first press publications were conceived as an instrument of propaganda for the Spanish monarchy and ecclesiastical elites. Then, in the post-independence period in the nineteenth century, the press was a weapon that helped impose ideologies

Figure 1. Weekly reach, online and offline



Source: Nic Newman, Richard Fletcher, Craig T. Robertson, Kirsten Eddy, and Rasmus Kleis Nielsen, *Reuters Institute Digital News Report 2022*, (Oxford: Reuters Institute for the Study of Journalism and University of Oxford, 2022).

of groups that contended for power. Different media were controlled through newspaper closures, restricting access to paper, and, of course, censorship. Also, journalists were jailed or tortured. In the twentieth century, government strategies changed—at least on paper—especially after the revolution of the 1910s and the 1917 constitution, when press freedom began to be seen as a synonym for democracy.

While Mexico's constitutions of 1824, 1857, and 1917 showed progress in terms of citizenship and democracy, they also made it clear that the existence of laws did not guarantee citizens access to principles, rights, and freedoms. Undeniably, one of the revolution's main causes and slogans was an electoral demand: "real democracy, no reelection." However, the Mexican political system for many years was far from democratic.

For much of the twentieth century, Mexican politics and public institutions were under the quasi-dictatorship of the Institutional Revolutionary Party (PRI). While the PRI allowed the opposition to participate in elections, they retained control over the media, which helped to ensure that the opposition had no chance of reaching any elected office. The PRI dominated for more than seventy years, from the end of the revolution in 1917 until the 1990s, and it maintained a regime that controlled municipalities, governorships, congress and the presidency. The latter office concentrated many constitutional powers, making the holder the central figure of the political system.

During this period of presidential authoritarianism, the government changed its strategy toward the press and kept journalists close, at least those of them willing to support the regime. Some were even on the payroll of public bodies. As a result, the press became economically dependent on the government, and government influence over the content of the press was very large.

In 1968 the government demonstrated that there was no freedom of the press nor freedom of expression, after former president

Gustavo Díaz Ordaz ordered a brutal repression of the students' movement, whose most urgent demands were freedom for political prisoners, public dialogue, and full freedom of expression.¹⁰ But, instead of negotiating or acceding to these demands, the result was the Tlatelolco Massacre, in which “hundreds of people were killed.”¹¹ The press, subjugated to the will of the government, stigmatized the students' movement from the beginning, labeling them as “strikers,” “agitators,” and “terrorists.”¹²

After this dark episode in Mexican history—and confronted with the anger of the people and the loss of credibility—the national press began a period of professionalization that created space for independent and critical publications. However, it should be understood that professional, autonomous, free, and critical journalism has had to develop despite the media system and its elite owners and not because of them.

The twenty-first century brought major commercial competition and political democratization. New electoral laws stated that political parties must be provided with resources to advertise themselves and the media was obliged to cover campaigns fairly and free of costs. But this just meant that media owners and publishers simply benefited from having a more diverse range of patrons. Social media has also provided cost-free opportunities to be informed, and this has become a challenge for the government-supported press, very often criticized for its bias and lack of objectivity.

Despite some improvements, critical journalism has always had to paddle upstream to sustain its dissident model. Of course, this kind of press tends to face threats and violence, with aggressions coming from two sides: the government and organized crime.

Press freedom and violence

RSF present the annual World Press Freedom Index to compare the level of press freedom enjoyed by journalists and media in 180 countries and territories.¹³ The 2022 index, which comprises the period from January to December 2021, ranks Mexico at 127th with a score of 47.57 out of 100, thus classifying the situation for journalists as “difficult.” This did, however, represent an improvement on the 2021 index, in which Mexico ranked 143rd. Considering the events that took place in 2022, it seems very likely that the country will slide back down the rankings in the 2023 index.

Table 1. Reporters Without Borders’ (RSF) press freedom classification

Points	RSF press freedom classification
85–100	Good
70–85	Satisfactory
55–70	Problematic
40–55	Difficult
0–40	Very serious

Source: “2022 Press Freedom Index,” Reporters Without Borders (RSF), <https://rsf.org/en/index>.

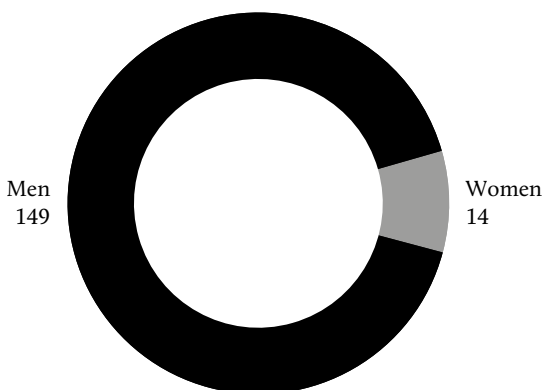
Physical threats and intimidation are the most widespread form of attacks against journalists, followed by physical assaults and kidnappings.¹⁴ Also, among the most recent and alarming challenges are digital attacks against journalists and their sources, harassment through social media, and unmonitored covert surveillance. As the Inter-American Commission on Human Rights says, the most extreme and violent method of curtailing the right to freedom of expression is the murder of journalists. This annuls the victim’s right to life, and entails other consequences besides:

it has an intimidating and silencing effect on journalists' peers; it affects the rights of the victims' families to psychological and moral integrity; and it violates the rights of individuals and societies to seek and receive information.¹⁵

The World Press Freedom Index comprises five indicators: political context, legal framework, economic context, socio-cultural context, and safety. What should be noted is that in the 2022 index, Mexico was ranked 179th out of 180 in the safety index—unsurprising, given that Mexico was the deadliest country for journalists for four consecutive years.¹⁶

From the year 2000 to 2022, 163 journalists have been murdered, most of them men.¹⁷ In addition, twenty-seven journalists are registered missing as of January 2023,¹⁸ including Cándida Cristal Vázquez, who disappeared on July 21, 2022 and who worked as a reporter and radio newscaster in Mazatlán, Sinaloa.¹⁹ Between AMLO becoming president in December 2018 and the end of 2022, thirty-eight murders and five disappearances have been counted; in 2022 alone eighteen journalists were murdered.²⁰

Figure 2. Journalists murdered in Mexico, by gender, 2000–22



Source: Authors' own data; for the full data set, see the digital version of this chapter on the Atlantic Council website.

Also, the Press Emblem Campaign (PEC)—an international, independent nongovernmental organization dedicated to media safety and rights—found in its 2022 annual report that, along with Ukraine, Mexico was the most dangerous country in 2022 for journalists.²¹

In Mexico, as in most parts of the world, no one is held accountable for journalists' murders. The Committee to Protect Journalists (CPJ) in its 2022 Global Impunity Index says that the vast majority of journalists' killers continue to get away with murder. The index ranked Mexico in sixth place for impunity, and it would be even higher but for the index calculation factoring in Mexico's relatively large population. Despite this, the CPJ considers Mexico to be the western hemisphere's most dangerous country for journalists as it has the most unsolved journalist murders in the past ten years with twenty-eight cases.²²

Political violence

It is true that the news media has lost people's confidence and that we live in the era of "fake news." Young people now opt for social media as their main source of news, replacing journalists with influencers. But in Mexico, the connection between journalism and the public has weakened even further with the president's daily attacks.

Every morning, from Monday to Friday at 7 a.m., AMLO gives press briefings known as the *mañaneras* where he speaks about what he considers are some of the most relevant issues concerning Mexico.²³ He includes sections regarding security, impunity, and others, including fake news in a segment called "Who's Who." In this section, the president and the web content coordinator at *La Jornada de Oriente*, Ana Elizabeth García Vilchis, point out journalists and publications that they consider unprofessional and articles they consider untrue.

Some of the journalists who have been name-checked in these briefings have indicated that they have been harassed online after being criticized by the president. In response, they accuse the president of using his briefings as a way to silence the independent press. But the president has his own point of view and classifies the media into two groups: the “good,” the media who cherish his policies; and the “bad,” who he labels as neoliberal, corrupt, and elitist.

President López Obrador has singled out several journalists and media outlets for particular criticism, most frequently the *Reforma* newspaper. He has even labeled foreign press like the *New York Times* and the *Washington Post* as “unethical.”²⁴ Some journalists interviewed by the CPJ in 2019 agreed that AMLO fosters a hostile atmosphere and that his comments seem like aggression or threats. Another freelance journalist said that AMLO, even if “he has always been somewhat authoritarian,” is better than previous governments, especially in terms that “he respects what the media can publish.”²⁵

On December 15, 2022, after the attempted murder of renowned Grupo Imagen journalist Ciro Gómez Leyva, a group of 180 journalists, reporters, editors, and other media professionals signed a letter accusing the president of being “politically responsible” for the crime and demanding an end to the harassment of their profession.²⁶ The journalists that signed the letter are mostly from Grupo Imagen, TV Azteca, Latinus, *El País*, *Reforma*, *El Universal*, ADN, and Foro TV and identify themselves as critical journalists, but some others—including the president—consider them old servants of the PRI regime. So when AMLO responded to their letter during the *mañanera*, he accused the signatories of being “spokespeople for conservatism” who served special interests, and criticized them for their lack of balance regarding AMLO and his regime.²⁷ He even took the chance to point out that there is a fierce campaign against his government, and that the attempted murder may have been a bid to try to destabilize the government.²⁸

He also commented that information should not be left in the hands of journalists, and assured viewers that he was not involved in the attack, and that he does not lead an oppressive state.

Some of what AMLO says is true: the press does sometimes serve the interests of elites and powerful groups. But two days prior to the attempt on Gómez Leyva's life, AMLO said that listening to Gómez Leyva's program was "bad for the health" and that "if you listen to them too much, you may even get a tumor in your brain."²⁹ At the time of writing (January 2023), no arrests have been made relating to this crime but the Attorney General's Office of Justice of Mexico City is working on the case. Anyways, the message for the entire press after this attempt is that prominence does not guarantee security.

Mexican authorities tend to say that the aggressions against journalists are not related to their work. However, President López Obrador launched in 2021 an open attack not just on journalists, but on ARTICLE 19, an international organization created to document censorship, to defeat the censors, and to help the censored. López Obrador said during a *mañanera* that the organization—and other "conservative" groups—was waging a "conservative" campaign against him. ARTICLE 19 responded with an article saying that the attack highlights his "grim record on impunity," with 98 percent of journalist killings going unsolved.³⁰ It should be noted that the term "conservative" is, for AMLO, any person or policy that opposes or differs from his goal of "transformation." It does not relate to any political or economic stance.

Violence and electoral violence related to transnational crime organizations and drug-trafficking organizations

Mexican transnational criminal organizations (TCOs) are present in 70 percent of the country and participate in a wide range of criminal activities beyond drug trafficking.³¹ Before 2006, there were only four dominant drug-trafficking organizations (DTOs),

but after former president Felipe Calderón Hinojosa's war on drugs, they fragmented into nine major groups:

- Beltrán Leyva Organization
- Cartel Jalisco New Generation (CJNG)
- Gulf Cartel
- Juárez/Carrillo Fuentes Organization
- La Familia Michoacana (The Mexican Family)
- Los Rojos (The Reds)
- Los Zetas and Cartel del Noreste
- Sinaloa Cartel
- Tijuana/Arellano Félix Organization

The CJNG is the group with the most presence and fastest growth in the country. It controls various demarcations in the east and west, and is increasing its influence in northern and southern states. The current criminal landscape in Mexico is dominated by the battle between the emerging CJNG, which bases its operations on the trafficking of synthetic drugs, and the Sinaloa Cartel, historically the dominant organization in Mexico.

These groups also act as umbrella organizations for many smaller local criminal groups; counting all of these, the number of TCOs grows into the hundreds. Many of them are involved in extortion, human smuggling, arms trafficking, oil theft, kidnapping, and homicide, among other crimes. These smaller crime groups are part of the big cartels' strategy, dubbed "proxy war," through which the national cartels control the distribution of drugs in various parts of the country.

Organized crime is characterized by the fact that it seeks to neutralize governments and the state through corruption, preventing the investigation, arrest, prosecution, and detention of its members or their profits. For this reason, part of the DTOs' profits is used to coerce public servants, intimidate politicians,

and influence elections; criminal organizations are responsible for most of the political violence at the local level.

During the 2017–18 federal and local electoral process, when more than 3,400 positions at the local and federal level were being contested, including the presidency, a total of 1,203 aggressions against politicians and non-elected officials took place. These resulted in 523 murders: 152 politicians and 371 public employees. This was the most violent electoral process in Mexico's recent history.³²

The second most violent electoral process occurred just a few years later, during the 2020–21 electoral process: 1,066 aggressions resulted in 265 murders, most of them public servants and politicians, and in some cases their colleagues and relatives. It is worth noting that 75 percent of the candidates and contenders attacked were competing for municipal offices, and that 75 percent were candidates of the opposition to the state government. The state of Veracruz experienced the worst aggression of all, with 117 cases.³³

DTOs have sought to influence elections in a number of ways, including violence at polling places, intimidation and coercion of voters, and control of candidate selection—for instance, via campaign financing. This last point is a major problem, and includes issues such as unreported donations and the use of illicit resources to finance political campaigns, to mention just two avenues for corruption. This contributes to Mexico's ranking of 64th in the Perception of Electoral Integrity Index.³⁴ By controlling municipal government DTOs can access privileged information and public resources and obtain protection from the municipal police.

On election day in 2015, ARTICLE 19 registered twenty-seven aggressions against journalists covering the electoral process in different Mexican states.³⁵ These aggressions included equipment theft, reporters being illegitimately asked to delete their photos, threats, physical aggressions, identity theft on social media,

information blackout, arbitrary detentions, and cyber-attacks on news portals. The five states with the most cases were Oaxaca (five), Puebla (five),³⁶ Veracruz (four), Guerrero (three), and Campeche (two).

Also, on the 2016 election day, the same organization documented nineteen aggressions that included harassment, arbitrary detentions, intimidation, threats, and physical assault. The states where the aggressions occurred were Chihuahua (five), Mexico City (four), Sinaloa (four), Aguascalientes (three), Puebla (two), and Veracruz (one). In Veracruz, the day prior to the election, journalist Jorge Sánchez, director of the local newspaper *La Unión de Medellín*, received a call with a death threat. Sánchez is part of the Protection Mechanism for Human Rights Defenders and Journalists and the son of journalist Moisés Sánchez, who was murdered in 2015 in Medellín de Bravo municipality in Veracruz.³⁷

Other media outlets whose staff were attacked during the 2015 and 2016 electoral processes included *La Unión de Medellín* (Veracruz); *El Sol de Puebla*, Status, and e-consulta (Puebla); Yradiamos, Notimex, and *El Heraldo de Aguascalientes* (Aguascalientes); La Revista NCG, *El Diario del Noroeste*, Akronoticias, and Más Noticias (Chihuahua); *Noroeste* (Sinaloa); and *Reforma* (Mexico City).

In the 2015 electoral process, four aggression cases were perpetrated by political party personnel or activists, and in 2016 journalists were harassed and intimidated, also by political party employees or members. On election day 2021 (June 6), sixteen aggressions were registered against journalists and a total of fifty-five since April 19, when ARTICLE 19's hashtag to document such incidents was activated: #RedRompeElMiedo.³⁸ Again, most of the aggressors (50.9 percent) came from political parties, and their actions included harassment, intimidation, threats, physical aggressions, and information blackout.³⁹ This time, the abuses were registered in Baja California (six), Aguascalientes

(five), Jalisco (five), Guanajuato (five), Guerrero (four), Sinaloa (four), and Yucatán (four).

Many local journalists report the crimes of these DTOs, as well as corruption, and the links between politicians and criminals. Thus, it is not surprising that violence against journalists increases during electoral processes, nor that there exists a direct correlation between this violence and the presence of drug cartels in a territory.

Also, we can see that the states with the highest rates of journalist murders are among the poorest in the country. Take the example of Veracruz, which, during Javier Duarte's governorship (December 2010–November 2016), was the most lethal for communicators with eighteen journalists killed.⁴⁰ These are the territories where TCOs tend to settle, due to geostrategic characteristics.

The following table presents the five states in which most murders of journalists took place between 2000 and 2022.

Table 2. The five states with the highest number of journalists killed, 2000–22

State	Number of journalists murdered	Cartels operating in state
Veracruz	34	— Cartel Jalisco New Generation — Zetas
Guerrero	16	— Local group
Oaxaca	15	— Cartel Jalisco New Generation — Local group
Tamaulipas	15	— Zetas — Gulf Cartel
Chihuahua	14	— Sinaloa Cartel — Juarez Cartel

Sources: Cartel information from Congressional Research Service (CRS), *Mexico: Organized Crime and Drug Trafficking Organizations*, CRS, June 7, 2022, <https://sgp.fas.org/crs/row/R41576.pdf>. Deaths data from Article 19, “Periodistas Asesinadas/os en México,”

ARTICLE 19, <https://articulo19.org/periodistasasesinados>; and Committee to Protect Journalists (CPJ), “Las Periodistas Mexicanas Yessenia Mollinedo y Johana García Mueren Asesinadas en Veracruz,” May 17, 2022, <https://cpj.org/es/2022/05/las-periodistas-mexicanas-yessenia-mollinedo-y-johana-garcia-mueren-asesinadas-en-veracruz>.

The Mexican government and Mexican media outlets often tally homicides differently due to restrictions placed on reporting, and crime groups’ attempts to cover up the numbers and identities of their victims (although other times they show off their crimes as a strategy to intimidate or to incriminate another group). Also, there are the so-called “silent zones” that neither the government nor journalists can reach. With impunity being the norm after journalists are killed, the result is silencing and self-censorship of communicators.

At this point, there is something that we should highlight: most of the journalists killed in recent years worked in local news. Similar to the rest of Latin America, 95 percent of journalist killings are committed in small cities, rural areas, transit areas, or border zones.⁴¹ Many of those murdered were covering security and political subjects and were the victims of organized crime. Sometimes journalists receive death threats before being killed, like Lourdes Maldonado López, who was killed in January 2022 and had even used a presidential *mañana* in 2019 to appeal for the government’s help with protection.⁴²

As we can see, there is a fine line between the two “sides” that exercise violence against journalists and communicators. Corruption makes it hard to know what comes first, but what is a fact is that most of the recent murders, disappearances, and kidnappings of journalists are concentrated in states where organized crime has a strong presence. As noted by the Inter-American Commission on Human Rights, the journalists who are targeted most often are those covering local news on corruption, drug trafficking, organized crime, public safety, and related affairs.⁴³

Some of the journalists who are subject to violence and intimidation may opt to align with one powerful interest or another, which sometimes means failing to report or remaining silent. But, for those willing to keep covering sensitive news after receiving threats, the Protection Mechanism for Human Rights Defenders and Journalists was developed. This mechanism is discussed in the following section.

The Protection Mechanism for Human Rights Defenders and Journalists

As the state (i.e., the Mexican federal government) has failed to implement an effective response to criminal organizations, and as it is responsible for protecting, promoting, and guaranteeing human rights, including journalists' rights, in 2012, it created the Protection Mechanism for Human Rights Defenders and Journalists. The Mechanism is a federal agency under the Ministry of the Interior backed by the Law for the Protection of Human Rights Defenders and Journalists, issued in the same year.

Although it protects journalists and human rights defenders, this chapter will focus only on journalists. The Mechanism recognizes a journalist to be:

Individuals, as well as public, community, private, independent, university, experimental, or any other type of communication and dissemination media, whose work consists of collecting, generating, processing, editing, commenting, expressing opinions, disseminating, publishing, or providing information, through any means of dissemination and communication that may be printed, radio, digital or image.⁴⁴

The Mechanism pledges to guarantee the life, safety, and personal integrity of journalists and human rights defenders through three types of measures:

- Urgent Protection Measures: actions and means to immediately safeguard the life, integrity, freedom, and security of people, to be implemented within nine hours of the request.
- Protection Measures: actions to protect from risks and safeguard the life, integrity, freedom, and security of people, but are not required to be implemented in a defined period.
- Preventive Measures: actions and means to prevent the completion of the aggression.

When a journalist reports an aggression or threat, the Mechanism evaluates the risk and designs a protection plan. Until 2019, when the Office in Mexico of the United Nations High Commissioner for Human Rights, at the request of the Undersecretariat for Human Rights of the Ministry of the Interior, published its diagnosis and recommendations to strengthen the Mechanism, 903 people were under its protection.⁴⁵ This number included both human rights defenders and journalists.

In summary, the recommendations from the United Nations High Commissioner for Human Rights included the following:

- The President's Office and the Ministry of the Interior must serve as examples for state governments by fully adopting the recommendations.
- The Mexican state and the state governments must ensure personnel and financial resources for the protection measures and the daily operation of the Mechanism.
- It would be desirable to have an effective system to monitor the correct implementation of the protection plans and

promote relevant sanctions when it detects non-compliance with the corresponding obligations.

As the principal approach of the Mechanism is avoiding the realization of aggression or damage, it is expected that 2,400 people would need protection from the Mechanism by 2024. This number may be untenable and will make the Mechanism more inefficient; there is already insufficient personnel to process the files of those that currently have protection.

Noting that the Mechanism did not address the root causes of risk, the UN High Commissioner also recommended that a new paradigm be adopted: a prevention approach. Also, the report recommended that the causes of risk should be eliminated, as the Mechanism cannot be the sole response to violence against human rights defenders and journalists.

For the development of this chapter, we interviewed a journalist who joined the Protection Mechanism after receiving death threats in 2017 and 2019. This journalist sees the Mechanism as a positive—but small and reactive—response to a complex situation. In his view, it was created by the federal government to serve a privileged few, considering the general state of violence that the whole country lives in.

He says his life changed entirely during the “five years, one month, and four days” that he lived under protection of the Mechanism. He was accompanied by security escorts, although this was “a daily reminder that you are at risk,” and meant that there was no privacy in his life. He added: “Even to go with a lady to the hotel, you go with an escort.”⁴⁶

The interviewee told us that, to protect their lives, some colleagues were transferred from different parts of Mexico to safe houses in Mexico City, under the protection of the Mechanism, although many had lost their jobs as journalists as a result. However, in spite of the Mechanism’s limitations identified by this

interviewee, and despite the difficulties that protection imposes on one's personal and professional life, he is clear that many of his colleagues would be dead without its protection.

Another limitation this interviewee finds in Mexico is that, despite the risky situation in which journalists live, the media sector itself is not prepared to respond. There are no protection protocols or psychological assistance, no courses are provided, and they do not know where to go or what to do in case of imminent danger. He also says that sometimes media organizations promise support, but it never reaches the journalists.

Even if there are many limitations due to lack of funding and other operative deficiencies, the interviewee recognizes the Mechanism as an important measure to protect journalists and human rights defenders. He directs most of his complaints against the prosecuting authorities, specifically the Special Prosecutor's Office for Attention to Crimes Committed against Freedom of Expression, which has not only failed to advance investigations in his own case, but has even attempted to close it. The interviewee says that the Mechanism should not exist and instead, the government should provide access to justice: "It should be legislated so that threats become a serious crime. Without justice, there is no way the Mechanism can protect all human rights defenders and journalists."

It seems ironic that López Obrador's political strategy against DTOs is "hugs, not bullets," which means he would not pursue a war against the TCOs but would instead target the social conditions that allow criminal groups to thrive. But in the first days of 2023, two violent encounters with mafia leaders left more than a dozen dead and the city of Culiacán (Sinaloa) as a war zone for a second time. Even more ironic is that AMLO's morning press conferences are regularly used to single out journalists instead of criminal leaders.

Journalists are victims of violence from both the government and the DTOs. As our interviewee and the United Nations High Commissioner for Human Rights stated, there must be a focus on addressing the root causes of violence and, in the meantime, the Protection Mechanism must be strengthened so that freedom of expression agents can remain alive.

Final thoughts

Mexico is experiencing a grave human rights crisis. Violence faced by human rights defenders and journalists on a daily basis, which takes place in a context of practically absolute impunity that incentivizes its systematic reproduction, is one expression of the critical situation. Violence against journalists and its consequent impact on freedom of the press has been studied primarily as the result of two major underlying problems in Mexico: impunity, and the failed strategy against violence, mainly exerted by TCOs.

A way to put an end to impunity is to build greater capacities—in quantity and quality—in law enforcement agencies, with better investigative capacities. Such capacity development involves political will and capital, large sums of public funds, as well as time and patience. But these kinds of actions are not enough when *active impunity* also exists, that is, a series of actions carried out with the explicit purpose of undermining investigations and not generating results, in which case it can be useful to implement an international mechanism for supervising the administration of justice in Mexico.

Concerning the failed strategy against violence, the security measures adopted by the administration of Andrés Manuel López Obrador, despite the assurances that his strategy was to address the root causes of violence, have been to keep the armed forces as the main tool of public security in the country.

It is necessary to strengthen the local police and leave national security challenges to federal bodies, removing the army from its current function. As long as these issues are not solved, violence against journalists will be a matter of statistics: Which year was worse? Which electoral period was more violent? Strengthening local police corps requires better salaries and social security nets, more—and more modern—equipment and weapons, continuous physical and use-of-force training, among others. Such investment of resources will pay in the long run through more secure communities. Therefore, politicians and decision makers must explain to society at large about the time needed for objective improvements to appear. But, since it seems hard to get to a point where the human rights violations crisis in Mexico—in which violence against journalists is immersed—is fully addressed, or that deep reforms are made to the prosecutorial system, it is necessary to keep and strengthen the Protection Mechanism to prevent greater damage. As the Mechanism is based on voluntary adherence, it cannot realistically cover the entire at-risk population. The Mechanism should have a strategic, proactive component coming from the secretary of the interior: if, through a risk analysis, it is found that a journalist or group is at high risk, the Mechanism would be automatically activated.

But measures also need to become more sensitive so that the people under protection do not lose their jobs, their privacy can be respected, and their mental health is taken care of. Media companies need to be ready to act in case of risk: they must have their own protection protocols and provide training that allows journalists and media workers to develop their roles in safer conditions. And, when things become risky, media companies ought to do whatever is necessary to protect their colleagues and collaborators.

It should be pointed out that a system of concessions and awards has deformed the performance of the media in Mexico. Suffice it to say that many media outlets cover the morning news

briefings, no matter how absurd they may be, and no matter how much their own journalists are singled out in AMLO's "Who's Who" segment; not to do so would risk losing the concession. Journalists and human rights organizations have said that these *mañaneras* by the president and his spokespeople aggravate journalists' situation and heighten their risk.

Indeed, the widespread use of social networks and the constant bombardment of information makes it more difficult to filter content. As we have seen, fake news and disinformation have multiplied during the pandemic, and in similar crises like the 2017 earthquakes. But there are professional tools like *Verificado*—with no ideological bias—for citizens to discriminate real news from fake news.

Freedom of expression is not complete without freedom of the press. As long as journalists and human rights defenders are subject to violence, we can conclude that neither freedom nor prosperity can be fully attained.

Mexico “Mostly Free”? Mexico “Mostly Prosperous”? Uncovering shades of gray in the Freedom and Prosperity Indexes

Vanessa Rubio-Márquez

DEBATE OVER THE RELATIONSHIP BETWEEN economic and political freedom and the prosperity of a society is not new. Scholars and policymakers have long questioned whether prosperity is the fruit or the seed of a free society. Are the two mutually determinant? In the long run can countries attain prosperity without freedom? Can freedom lead to an unprosperous society? In this context, the Atlantic Council’s Freedom and Prosperity Indexes are a powerful empirical tool, allowing us to consider these questions using reliable and comparable data. The Indexes have strengthened debate and interest over the relationship between freedom and prosperity in countries as varied as China, which they currently catalog as Mostly Free in economic terms but Unfree in political terms, and India, which is Mostly Unprosperous despite being Mostly Free in political terms. In these discussions the Indexes serve as key reference points to inform real-life policy debates and policy making.

Still, there are cases in which our understanding of the prevailing conditions in a given country can benefit from additional information. This essay uses the 2022 Freedom and Prosperity

Vanessa Rubio-Márquez is a former senator and deputy minister in the Mexican government.

Indexes (“the Indexes”) to analyse the case of Mexico, a country currently catalogued as Mostly Free and Mostly Prosperous. It attempts to demonstrate how the Indexes do not yet capture certain dimensions of democratic retrenchment and institutional deterioration now being seen in countries across the globe. Some of these dimensions are easy to see, while others are more subtle. The goal of this paper is to demonstrate the benefits of and need for an early warning system that can enable a more accurate analysis of the decline in freedom and prosperity in certain countries. To that end, this paper attempts to provide a qualitative extension to the Index data, drawn from recent developments in Mexican politics, in order to examine essential nuances that lie beyond the country’s current categorization. This exercise is particularly relevant as Mexico has, since 2018, experienced a wave of populism and polarization that has proven detrimental to political and economic freedoms and, ultimately, to democracy itself.

It is important to note that Mexican democracy was far from perfect prior to 2018, the year in which the current government entered office on a single six-year term without the possibility of reelection. The country was facing profound challenges in the form of a culture of privilege, corruption scandals, and brutal inequality. However, it also enjoyed low but sustained economic growth, strong and well-managed public finances, and a clear route to unlocking higher productivity and achieving its full growth potential through sectoral reforms. But despite the expectations of many, Mexico has since 2018 seen a weakening of the rule of law and checks and balances, increased militarization of state functions, a lack of economic growth, and increased poverty levels. These trends in themselves constitute a worrisome backsliding of both freedom and prosperity.¹

By analysing the Mexican case, I will provide support for a better understanding of the correlation between these two factors and

the potential risks to freedom, particularly in many countries that are considered Mostly Free.

The case of Mexico suggests that the Indexes’ methodology is indeed useful in identifying and weighing the elements that make a country free and prosperous, and in providing a sophisticated standard to compare countries around the world. However, it also highlights the need to understand and assess additional relevant trends in order to deepen the analysis beyond the Indexes’ primary results. Qualitative analysis of factors that point to the potential for an erosion of freedoms can enrich the definition of the Freedom Index’s four categories (Free, Mostly Free, Mostly Unfree, Unfree). For example, a Mostly Free country—the most common category among the 174 countries included in the Index—might very well be on the brink of becoming Mostly Unfree due to circumstances that are best understood when the Index is complemented with qualitative information.

Freedom, in the end, is fragile. Moreover, backsliding in democracy and freedom could well lead to a significant reduction in prosperity, whether as a result of a deterioration in the certainty that comes with clearly enforced laws and robust institutions, the diminished state capacity that institutional deterioration implies, or both. A closer look at a country’s particular features at specific moments will help us to better interpret the Indexes and render them even more useful. In sum, this essay aims to shed light on the shades of gray within the classification of Mostly Free countries of the Index and encourage analysts and policymakers to pay closer attention to countries when alarm bells over the future of freedom and prosperity start to sound.

Mexico: Shades of gray in freedom

Mexico ranks 82nd among 174 countries in the freedom component of the Freedom and Prosperity Indexes and is categorized as a Mostly Free country, with 58.2 points. But that aggregate score doesn't tell the whole story about economic, political, and legal freedoms in Mexico today. When broken down by category, the Index ranks Mexico as 52nd in economic freedom (77.3 points), 88th in political freedom (60.8 points) and 122nd in legal freedoms (36.4 points).² A complementary qualitative analysis of recent political developments in Mexico allows us to better understand the processes taking place behind the scenes of the Index's aggregate data. Facts on the ground suggest that freedom in Mexico is at risk due to an overt attack on institutions, checks and balances, and the rule of law. The Mostly Free tag should thus be interpreted with caution. To better understand why, it is necessary to look closely at the change of government in 2018, and what has happened since.

In July 2018, Andrés Manuel López Obrador, widely referred to as AMLO, was elected president after three decades of political activism that turned him into the most well-known social leader in the country. While he was elected on the promise to “end corruption” and deliver well-being, or *bienestar*, he notably did not promise to protect individual freedoms or emphasize the importance of the rule of law. In fact, his view of checks and balances had been revealed years earlier in what became a common refrain in his speeches and at campaign stops, referring to what he called the “abusive and neoliberal” administrations of the past: “To hell with their institutions!”³

As president, López Obrador has also increasingly resorted to a narrative that minimizes the importance of economic growth and instead emphasizes the relevance of “happy people.”⁴ In his binary milieu—characteristic of populist leaders—there are “the

people” on one hand, who he says he represents and defends, and the political and economic elites on the other, who he characterizes as “conservative,” “neoliberal,” “racist,” and “classist.”⁵

It is important to recognise that AMLO came to power in a social environment marked by profound disenchantment with democracy and the political and economic elite that had governed the country for the previous thirty years. The period between 1988—when Mexico’s democratic transition began—and 2018 was driven by a strategic vision shared by successive governments that consisted of integrating the country with the world economy (mainly via North America); allowing privatization in key sectors such as banking and telecoms; developing independent and technical bodies to provide checks and balances; and framing a nascent multi-party and pluralistic democracy based on institutions, laws, and regulations.

Although Mexico did indeed profoundly reform its economic, political, and social landscape for the better, a series of significant failures that excluded large portions of the population from prosperity and allowed ample space for corruption and abuse created both enormous disparities and widespread resentment.

AMLO’s polarizing discourse capitalized on built-up anger and frustration, and he won a landslide victory in the 2018 presidential election. López Obrador gained more than twice as many votes as his closest challenger, with a record-breaking 30 million votes in a country of 130 million inhabitants and 56 million voters.⁶ The scale of the mandate allowed AMLO to deploy an ambitious government plan that has, in many ways, negatively affected the environment for freedom and prosperity.

A first step came before AMLO came to power. On October 29, 2018, the then president-elect announced that he would cancel the ongoing construction of a new airport in Mexico City, a flagship project of the previous administration that, according to López Obrador, embodied the corruption of the “neoliberal”

regime.⁷ To support the cancellation, AMLO's party, MORENA (National Regeneration Movement), organized a public consultation to ask citizens if they agreed with the decision. This marked the beginning of the administration's habit of disregarding existing laws and regulations, and it happened before López Obrador was even sworn in on December 1. For its survey, MORENA decided not to abide by the Federal Law on Public Consultations which, among other things, mandates that public votes be conducted by the National Electoral Institute (INE) in order to be binding. Instead, a "citizen council" was put in charge of the vote, with funding left to "voluntary contributions," mainly from legislators loyal to the president-elect. Despite the fact that less than 1 percent of Mexicans participated in the exercise, the future government proclaimed that "the people" had spoken in favor of canceling the airport.

The political goal of the episode was to send a strong message that previous economic and political elites were no longer in charge, and that even large-scale and well-advanced projects could be canceled at the new regime's whim, without concern for existing laws or market expectations. The cost of canceling the airport—which had been under construction for at least four years by that point—has been estimated at 126.7 billion Mexican pesos (approximately US\$6.3 billion).⁸ That doesn't include the opportunity costs in terms of development potential that such a large-scale project could have delivered for a globally integrated economy such as Mexico's, the fifteenth largest in the world. Before changing any law and prior to assuming power, the new government had already seeded uncertainty and damaged trust among domestic and international private sector actors. This event, on its own, will have lasting and damaging effects on investment decisions for Mexico, a key determinant of present and future prosperity. The cancellation of the airport was likely one of the reasons that in 2019, López Obrador's first year in office, Mexico's long-term trend of low but

constant economic growth was disrupted. The country’s economy contracted by 0.2 percent that year, even before COVID-19 started to affect the situation. Moreover, by throwing away public resources already invested in the airport and demonstrating that contracts could be broken at will, it became clear from the start that the rule of law in Mexico was under serious attack, and that economic uncertainty would be the order of the day. It should come as no surprise that, according to data from INEGI—Mexico’s National Statistics Institute—private investment in the country has stagnated since 2018, as fixed gross investment was 11 percent above its 2013 level in July 2018, and it now stands 12 percent below.⁹ The downward trend started well before the pandemic hit and the country’s investment has not yet recovered.

After the new government took office in 2018, a process to capture or diminish the power of autonomous institutions, the main checks and constraints on presidential power, began. Over the course of Mexico’s democratic evolution, a number of autonomous and technical institutions have been created to serve a wide range of functions and goals: quality statistical and geographical information (National Institute of Statistics and Geography, INEGI); the organization of free and fair elections (Federal Electoral Institute, now INE); safeguarding human rights (National Human Rights Commission, CNDH); ensuring transparency and accountability (National Institute for Transparency, INAI); regulating markets with technical autonomy (Federal Economic Competition Commission, COFECE; Federal Telecommunications Institute, IFETEL; and the Energy Regulatory Commission, CRE, among others); and ensuring purchasing power stability (Central Bank, Banxico, which was granted autonomy in 1994). The new regime well understood that these institutions were put in place to limit power, to create boundaries for government action, and to offer technical considerations for the regulation of markets. To weaken many of these and other autonomous agencies,

López Obrador has used his legislative majorities to appoint unfit loyalists to lead some of them or fill vacancies on their boards, hobbling their institutional and decision-making capacity.

These steps have already had significant effects. For example, a truly independent Human Rights Commission¹⁰ would have scrutinized the creation of a new *Guardia Nacional* (National Guard), under the command of the military, meant to control public safety. This key project of López Obrador's contravenes the civilian nature of the Mexican state and is now being challenged in court as unconstitutional.¹¹ As a further example, López Obrador has de facto eliminated private sector investment in the energy sector, especially in clean energy and oil exploration and extraction partnerships, a move that is being challenged by the United States and Canada within the United States-Mexico-Canada Agreement (USMCA) dispute-settling mechanism.¹² This could have been prevented if COFECE and CRE had been allowed to maintain their autonomy, independence, and respect. Another strategy to prevent the proper functioning of independent agencies has been to leave vacancies open without making new appointments. In fact, in November 2022 the Mexican Supreme Court ruled that the failure to name candidates to lead COFECE was in violation of the constitution.¹³

The administration's efforts to either eliminate or co-opt the sources of control on its power are evident enough,¹⁴ but perhaps too subtle to capture on a quantitative index. Changes in the way institutions are formed and operate affect the way freedom is experienced on a daily basis by both the Mexican people and stakeholders with interests or investments in the country. But these issues are often not reflected in constitutional or legal changes that can be easily identified. Instead, they are part of a series of new practices, and a political environment that favors discretion and personal politics over the predictability of laws and institutions.

Furthermore, the relationship between Mexico’s three branches of government (executive, legislative, and judicial) suggests that checks and balances on presidential power are weakening across the board. AMLO has attacked the autonomy of the Mexican Supreme Court, made questionable appointments to the bench, and even publicly acknowledged that he has exerted pressure on the court on a range of issues in an effort to tip the scales in favor of the government’s interests and vision.¹⁵

Meanwhile, MORENA and its allies, the Labour Party, Green Party, and Social Encounter Party, have enjoyed a comfortable majority since 2018 that allows them to modify laws and regulations and to approve the annual budget without support from the opposition. Mexico’s legislature had actively served as a check on presidential power since 1997, when Ernesto Zedillo became the first president whose party did not have a majority in Congress. Today, it has been relegated nearly to the role of rubber-stamping the administration’s proposals. The most consequential pieces of legislation over the last four years have been drafted by the government and approved by Congress “without changing a comma,” in accordance with López Obrador’s wishes.¹⁶ The only backstop has come in the Senate, where the president lacks the supermajority needed to change the constitution without help from opposition legislators.

In the context of scarce and increasingly expensive capital to finance development projects, which are essential for the creation of prosperity, the budgetary freedom that the government enjoys as a result of its congressional majority has enabled it to prioritize three pet projects: the *Tren Maya*, the *Refinería Olmeca*, and the AIFA airport. All three projects merit serious scrutiny in terms of their financial sustainability, contract transparency, and environmental impact.

The *Tren Maya* (Mayan train), originally budgeted at US\$6 billion, is now expected to cost around US\$15 billion and

rising¹⁷ and has raised concerns over the potential destruction of the Mayan rainforest, significant environmental damage to its ecosystem, and the threat it poses to both local communities and travelers, given the fragile underground system of caves and rivers that lies under the Yucatán peninsula.¹⁸ Despite the fact that the train project lacks legally required environmental assessments, and that the courts have ruled in favor of suspending construction on several occasions, the government has used legal sleights to continue building. Compounding the problems, a number of private investors withdrew their support for the project, assessing it to be financially unviable. This is why Tren Maya has become a “pet project,” funded by tax resources.¹⁹

The Refinería Olmeca (Olmec refinery), an oil processing facility built over a swamp in the president’s home state of Tabasco, was inaugurated before it started to function, and has flooded every time a strong storm washes over the region. As of October 2022, the project was 46 percent over budget and has yet to refine a single drop of oil.²⁰ The AIFA airport (Felipe Ángeles International Airport), meanwhile, was built by the military with little to no transparency, was exempt from public procurement regulations, and is a long way from proving itself either operationally and economically viable.

When looking at how free Mexico really is, the significantly increased role of the military in public life is also worth consideration. Giving the armed forces the power to participate in a wide range of productive activities, in addition to control over domestic security, is in direct conflict with Mexicans’ fundamental freedoms. For almost the last century, Mexico’s military has been in charge of national security and helping respond to natural disasters such as earthquakes and hurricanes. This has been in keeping with the role assigned by Mexico’s constitution to the country’s Secretariat of Defence (SEDENA) and Navy (SEMAR). Starting with President Felipe Calderón (2006–12) and through President Enrique

Peña Nieto’s term (2012–19), the military also collaborated with civilian authorities in limited ways to ensure public safety, especially in operations to capture drug kingpins and destroy drug labs or plantations. This was done under a temporary legal exception, the constitutional support for which was questioned by advocacy groups that were hopeful the military’s role in public safety would end under AMLO’s leadership. However, despite running a campaign that promised to “return the military to the barracks” and “strengthen civil police and security agencies,” the president has dramatically changed his position since coming to office.²¹ The military has taken over responsibility for public safety through the newly created *Guardia Nacional* and has expanded its influence into other areas that were previously reserved either for the private sector or the government. Today, the military controls ports, customs screenings, and airports; builds infrastructure projects such as the Tren Maya and the AIFA airport (the latter is also operated by the military); has built over 1,000 community bank branches; distributes gasoline, gas, and fertilizers; prints textbooks for public schools; detains migrants from Central America on their way to the United States; and may soon be running a commercial airline company “to lower costs.”²² And these are just some of the dozens of functions assigned to the military that have been documented by civil society organizations and which are legally intended to be in the hands of civilian agencies.²³ Moreover, given the secrecy that protects so-called security tasks from scrutiny, the military has been able to withhold important information about all its activities, including its budget allocations. The military has thus operated with little to no accountability, affecting the rule of law. Here the Mostly Free tag clearly starts to crack.

When faced with criticism and questions from the media and civil society, the president has resorted to direct, personal attacks questioning his critics’ legitimacy and intentions. He has called out journalists by name, and even exposed the confidential

tax information of those who confront him.²⁴ Before the administration assumed office, Mexico was already one of the most dangerous countries in the world for journalists.²⁵ But the intimidating environment for media and critics has only gotten worse. Those who oppose the government are referred to as “adversaries,” or “*los conservadores*” (the conservatives), and deemed ultimately corrupt, delegitimizing them as valid interlocutors. Time and time again, those who do not subscribe to the president’s thinking have been referred to as “enemies of the people,” “racist,” “classist,” “aspirational,” “hypocrites,” “angry,” and even “fascists.”²⁶ This level of confrontation on a daily basis (the president addresses the media every morning in rambling press conferences) has a clear “chilling effect” on freedom of speech.

Mexico: Shades of gray in prosperity

Given all the above, it is clear that the Indexes do not fully account for the fragility of freedom in Mexico—and all the ways it has been undermined in recent years. A similar, though less extreme, dynamic can be seen in the Indexes’ view of Mexico’s prosperity. Here, Mexico is considered a Mostly Prosperous country, ranking 53rd out of 174 countries. Broken down by category, Mexico ranks 64th in income, 69th in environment and 78th in health. So where does the 53rd position come from? Mainly from happiness.

According to the Prosperity Index’s measurement, Mexicans are relatively happy, with a score of 71.4 (37th out of 174 countries). This result is not surprising, considering historical measures of happiness in the country derived from culture, social structures, and family safety nets.²⁷ But again, disaggregating the elements of prosperity helps shed light on important nuances.

The pandemic hit the world’s economy in an unprecedented way, and Mexico was no exception. But Mexico’s decline

in growth began before the pandemic, as did the negative follow-on effects of that lack of growth, including increased poverty, reduced access to healthcare, and decreased private investment. On most indicators, Mexico has not yet returned to its pre-pandemic levels.

Table 1. Components of prosperity

	2012–18	2019–22
Growth rate, GDP (2012–18 vs 2019–22 estimate)	2.4%	–0.3%
Real GDP per capita (2018 vs 2019)	US\$19,200.27	US\$18,736.53
Poverty rate (2018 vs 2020)	49.9% 61.8 million people	52.8% 66.9 million people
Extreme poverty rate (2018 vs 2020)	14.0% 17.3 million people	17.2% 21.9 million people
Percentage of individuals without access to health services (2018 vs 2020)	16.2%	28.2%
Gross fixed investment (July 2018 vs August 2022; 2013=100)	111.7	99.8

Source: Compiled by the author with data from INEGI (“Producto Interno Bruto Trimestral,” Instituto Nacional de Estadística y Geografía (INEGI), <https://www.inegi.org.mx/temas/pib>) and CONEVAL (“Pobreza en México,” Consejo Nacional de Evaluación de la Política de Desarrollo Social (CONEVAL), <https://www.coneval.org.mx/Medicion/Paginas/Pobrezalncio.aspx>).

As is usually the case when approaching social science questions, proving causation here may not be feasible. Are the negative outcomes a direct result of the erosion of the rule of law and the environment of uncertainty that Mexico has experienced since 2018? It is difficult to prove. But if wealth creation is a prerequisite

for better wealth distribution, the negative average growth rate of the last four years would suggest that increased poverty levels—and thus a lack of prosperity in absolute terms—are at least in part the product of a deterioration in individual freedoms, democratic retrenchment, and the resulting damage to government capacity and private sector certainty, both of which are essential for social progress and economic prosperity. The government has tried to blame the pandemic,²⁸ the war in Ukraine, inflation as a “global phenomenon,”²⁹ and even the Mexican Central Bank³⁰ for sluggish growth and the increase in poverty during its administration. But what is clear is that the country is today less prosperous than before December 2018.

To be sure, this worrying trend is also revealed by a wider look at variation in the Indexes over time. Mexico’s freedom score in 2021 was 58.2, down from 59.4 in the previous measurement (2016). Mexico’s prosperity score in 2021 was 58, down from 60.7 in 2016. Hence, even if Mexico is categorized as a Mostly Free, Mostly Prosperous country, it is on a downward trajectory, and one that could worsen abruptly over the next few years if the rule of law continues to deteriorate and if an increasingly authoritarian regime advances further. When compared with the rest of the world’s economies, Mexico is a clearly middle-income country, the fifteenth largest economy in the world, and a member of reduced-membership organizations such as the G20 and the Organisation for Economic Co-operation and Development (OECD). But a closer look at relevant data—economic growth, inequality, income, extreme poverty, poverty, and access to basic rights and services, such as food and nutrition, health, education, social security, housing, and housing quality and services (electricity, water, sewage, overcrowding)—also supports the notion that prosperity in the country is deteriorating.

Populism pills for Mexico?

At first sight, it appears that Mexico’s light green colouring on the Freedom and Prosperity Indexes map is a positive sign. In digging deeper into recent political and economic trends, this paper aims to ask new questions raised by additional qualitative information. The Indexes are more relevant than ever, not only for Mexico but for the world. When accompanied with an in-depth analysis for each country that can add a prism through which to view the Indexes’ numbers, they can serve as even more powerful tools for analysis, decision making, and advocacy. Given the reality of what is taking place in Mexico, in analysing the country one needs to ask not just how prosperous or free it is today, but how likely it is that the country could fall into the Mostly Unfree and Mostly Unprosperous categories in the near future.

Mexico is a large economy that is now fully integrated into North American value chains and, from there, with the world’s value chains. Its public finances are strong, and its fiscal stance is on a sustainable trajectory with a debt-to-GDP ratio below 50 percent. Macroeconomic variables look good despite obvious economic stagnation. Mexico is also a resilient democracy, with relatively free and fair elections organized by a still independent electoral authority, though this could become significantly weaker following reforms passed by the government at the end of 2022, which will be contested at the Supreme Court of Justice. But Mexico, like many other countries, is trapped by polarization and populism. And while populism might be producing immediate relief for some—as can be seen in the high approval rates of the president and high happiness measure in the Prosperity Index—these conditions will ultimately lead to long-term structural damage that will take decades to overcome. Constant deterioration of the rule of law and the concentration of power since 2018 has put Mexico on a slippery slope on which the norms and

institutions that have sustained our economic and political freedoms could suffer deeper damage.

Still, one needs to reckon with the fact that 60 percent of Mexicans approve of López Obrador's actions.³¹ Despite the weakening of the institutional and democratic landscape and poor economic performance (this government is in fact likely to be the worst performer in terms of growth in the last forty years), many people are unbothered by the negative results because they have taken populism's "poisoned pill": an appealing narrative that vindicates those who have been left behind, those who legitimately aspire for a better life for themselves and their families, those who are rightfully distrustful of the government given historical wrongs, and those who now receive larger subsidies from the government. AMLO is an exceptional social leader capable of speaking to a wide audience, and he connects emotionally with his political base like no other Mexican president in recent history. People relate to his simple "us vs. them" dichotomy. While there are strong arguments pointing to the current government's shortcomings in terms of performance, few can deny that the president is quite a successful politician.

What is worrisome is that more and more leaders around the world have been elected in free and fair democratic processes, only to incrementally undermine institutions, consolidate power, and grow more authoritarian once in office. This is precisely why further data and analysis of trends and nuances are often a necessary complement to the Indexes. While Mexico is still classified as a democracy—and still is one—there exists a latent risk of the country becoming just a democratic facade in front of an autocratic regime. For anyone looking at the Freedom and Prosperity Indexes in the future, the lesson this paper intends to share is that, for many countries, freedom and prosperity are still fragile ideals that depend on a series of conditions that must be constantly upheld. Some of these might be obvious, but others are quite

subtle and evolve in ways that are barely visible to an outside eye. It is thus important to complement the Indexes with layers of qualitative analysis that better detect when significant fractures are appearing in a system, before a country and its citizens suffer significant reversals in freedom and prosperity, or a return to the dark era of authoritarianism. We need to measure in order to understand, understand to advocate, and advocate in order to change for the better.

Understanding India's freedoms on the path to prosperity

Prashant Narang
Parth J. Shah

INDIA IS CURRENTLY THE WORLD'S most populous democracy and is soon going to be the most populous country in the world. Considering that every sixth person in the world is an Indian, freedom in India—because it could lead to poverty or prosperity for 1.3 billion people—matters to the world. India is a lower-middle-income country (LMIC), with a per capita income of US\$1,920 (the global average is US\$13,312). India has an income score of 2.05 on the Atlantic Council's Prosperity Index (the global average is 15.8).

So what is not working well for India? The Atlantic Council's recent work suggests that three freedoms—legal, political, and economic—lead to prosperity.¹ We assess India's position on the Freedom Index to identify the pain points. This will help prioritize the reform agenda that India should pursue domestically, as well as an agenda for multilateral organizations to follow to support India's efforts to better the lives of its people. This paper is limited to diagnosis and does not undertake any investigation of root causes or offer any policy prescriptions. It is critical to identify the challenges that India faces in an objective, evidence-based manner

Prashant Narang is a senior fellow at the Centre for Civil Society.

Parth J. Shah is a co-founder of the Indian School of Public Policy and founder of the Centre for Civil Society.

and build a consensus around this before embarking on a potential reform agenda. A wider consensus on the pain points is a must for enabling a sustained effort for reforms.

Indian exceptionalism

A consensus on the challenges is particularly important in the Indian context. International comparisons—and any suggestions or lessons for India resulting from them—are generally dismissed with a universal claim of Indian exceptionalism.² Depending on the context, this exceptionalism is based on several different arguments: No country is as large and as diverse as India. India has been one of the most prosperous countries in the world. India has twenty-one official languages and several hundred dialects in active use. India's class, caste, ethnic, and religious diversity is unparalleled. India is a vibrant and noisy democracy with more than one hundred political parties. India has been ruled and exploited by outside forces for more than a thousand years, and so on. Each of these statements is indeed true. However, as anyone who has engaged in policy debates knows, it is impossible to convince the other side that though the statements are true, they are irrelevant to the issue at hand.

Methodology

To address this concern, in this paper we eschew the more common “distance to frontier” approach—drawing comparisons with the top five or ten performers globally, or even regionally. We have tried instead to use careful comparisons to identify the lowest-hanging fruits, the commonest denominators across the Freedom Index, to find parameters for improvement.

We compare India's score with three other average scores—global average; average of countries in the same income category of LMICs; and the South Asia regional average—focusing on those areas in which India underperforms. Within this comparison we focus on identifying parameters on which the Indian score is below all three comparator averages. These are the “lowest-hanging fruits”: issues on which India's score is “very poor” (see the shaded rows in Table 1), but that can be tackled, not through exceptionally bold reforms, or reforms at high political cost, but through mostly incremental changes and tweaks in its normal business of governance.

Any given indicator in the Atlantic Council's Freedom Index is typically constructed by aggregating several components and even sub-components. To provide as granular a view as possible, we dig into the components and sub-components.

Calculating the average for the comparison scores requires a list of LMIC countries and South Asian countries, for which we rely on the World Bank definitions. The World Bank defines lower-middle-income economies as those with a gross national income (GNI) per capita between US\$1,086 and US\$4,255; this equates to fifty-four countries in the LMIC category. The World Bank places eight countries in the South Asia region.³

However, the number of countries varies from component to component. The reason is that the Freedom Index derives its data for each component from multiple indexes. Not all of these indexes have data for all countries, or all LMIC countries. For example, some of the indicators under the Index's Legal Freedom sub-index, such as Civil Justice and Criminal Justice, are derived from the World Justice Project's Rule of Law Index, which has data available for 139 countries globally, thirty-seven countries under the LMIC category, and six countries in the South Asia region.⁴ The scores for Efficient Judiciary under the Legal Freedom sub-index, and for Political Rights and Civil Rights under

the Political Freedom sub-index, are based on Freedom House's Freedom in the World 2021 index, which has data for 195 countries globally, fifty-four under the LMIC category and seven at the South Asia level.⁵

One more caveat. For some components, we chose to use median scores instead of mean averages, where these were used in the source data. These include Efficient Judiciary (0–4) under the Legal Freedom sub-index, Political Rights (0–4) and Civil Liberties (0–4) under the Political Freedom sub-index, and Risk of Expropriation (1–7) under the Economic Freedom sub-index.

India's freedoms in the past fifteen years

Table 1 in the Appendix provides data for 2021 only, but in the text, we highlight changes across the years for which the Atlantic Council Index has data, from 2006 to 2021. Two different political alliances have governed India in that time: the United Progressive Alliance (UPA) from 2004–14, and since 2014 the National Democratic Alliance (NDA).

Political Freedom

Overall, India does fairly well on the Political Freedom sub-index. Its score improved marginally from 71.2 (2006) to 72.07 (2011) and then to 74.86 (2016). Then it drops to 67.62 (2021). Overall, it has dropped by 3.58 points since 2006. The global average too declined by 2.85 points, and the LMIC average by 2.36 points. However, the regional average score improved by 6.27, as Nepal and Bhutan abandoned their constitutional monarchies and became electoral democracies.

India fares “very poorly” only on one sub-component: 2.1.1d (Political Freedom > Constraints on Government > government officials are sanctioned for misconduct). India's score is 0.38, while

the global average is 0.47; the regional average and LMIC average are both 0.39. "Government officials" includes civil servants, members of legislatures, officers of the judiciary, and police officers. It implies an accountability deficit.

Although India's score on Civil Liberties dropped by a whopping 14 points between 2016 and 2021 (to 56.25), it is still above the LMIC average (46.4) and regional average (45.8).

Legal Freedom

Between 2006 and 2011, India's Legal Freedom score witnessed a slight decline, from 37.58 to 36.97, before rising again to 41.62 (2016) and 42.23 (2021). Overall improvement over the fifteen years of the Index was 4.58 points. This is in line with the regional improvement on this sub-index over the same period (5.36). The global average improved by 0.62 and the average for LMICs by 0.54.

India's overall score on Legal Freedom (42.23), however, is not very good. Legal Freedom has five indicators: Judicial Effectiveness; Government Integrity; State Capacity; Order and Security; and Regulatory Effectiveness. Judicial Effectiveness has three components: efficient judiciary, civil justice, and criminal justice. Under civil justice, India fares very poorly on "access and affordability" (0.39) and "free from unreasonable delay" (0.20). Under Criminal Justice, India fares very poorly on "effective criminal investigation system" (0.25) and "timely and effective criminal adjudication system" (0.36). Under Government Integrity, one of the components is "public disclosure," which concerns the legal mandate for members of parliament to make two types of disclosure: (a) *values*: "the values of their assets, liabilities, expenses, income, gifts, and travel"; and (b) *sources*: "the information needed to identify assets, liabilities, sources of income, gifts and travel, as well as parties with potential conflicts of interest."⁶ India's score on this component is zero, as no disclosure is mandated; the global average is 13.77.

Under Order and Security, India fares very poorly on “people do not resort to violence” (0.32), and under Regulatory Effectiveness, India scores very poorly on “effective government regulatory enforcement” (0.40) and “application and enforcement without improper influence” (0.45).

Economic Freedom

India’s overall score for Economic Freedom declined from 59.45 (2006) to 55.18 (2011) and then further to 53.31 (2016). It then improved to 58.37 (2021). Overall, it has dipped by 1.08 over fifteen years, as did the regional score by 0.17 points. It is pertinent to mention that the decline is steep from 2006 to 2016, as was the improvement from 2016 onwards. However, the global trend is different; the global average improved by 4.59 points over those fifteen years.

Let us take a more granular view of Economic Freedom and see which components show most decline. India performs “very poorly” on one indicator and several components in the Economic Freedom sub-index. There are four indicators within this sub-index: Property Rights, Trade Freedom, Investment Freedom, and Women’s Economic Freedom. India performs very poorly on Trade Freedom. Under Trade Freedom, there are four components: “tariffs,” “regulatory trade barriers,” “black market exchange rates,” and “control of the movement of capital and people.” India does fairly well on regulatory trade barriers (6.55) and black market exchange rates (10). On tariffs (6.52), which has three sub-components, it does well on “revenue from trade taxes” and very poorly on “mean tariff rates and the standard deviation of tariff rates.” On “mean tariff rates,” India’s score is 7, while the global average is 8.16, LMIC average is 7.76, and regional average 7.18. On “standard deviation of tariff rates,” India’s score is 3.46 while the global average is 5.89, LMIC average is 5.82 and regional

average 4.42. Countries with a greater variation in their tariff rates are given lower ratings.

India's score on component 3.2.4—"control of the movement of capital and people"—stands at 0.55, while the global average is 3.4, LMIC average is 2.03, and regional average 0.59. This component has three sub-components: "financial openness," "capital controls," and "freedom of foreigners to visit." On financial openness, India's score (1.64) is far below the global average (5.5) and the LMIC average (3.34), and equal to the regional average. On both capital controls and the freedom of foreigners to visit, India scores zero. "Freedom of foreigners to visit" measures the percentage of countries from which a visitor is required to have a visa, reflecting the freedom of foreigners to travel to the country as tourists and for short-term business purposes. Countries with values outside the range between V_{max} and V_{min} received ratings of either zero or 10, accordingly.⁷

Women's Economic Freedom has four components: "mobility," "pay," "entrepreneurship," and "assets." Pay is the weak spot for India, and it contains four questions: Do women receive equal remuneration for work of equal value? And are women allowed to work as equals with men in night shifts? In dangerous jobs? And in industrial jobs? For India, the answer to three of the four is "no," (the question about dangerous jobs was the only "yes") so its score for "pay" is 25 out of 100.⁸

Conclusion

It is common to dismiss international comparisons and possible lessons by waving the flag of Indian exceptionalism. We addressed this challenge in two ways: First, we based our analysis on the Atlantic Council's Freedom and Prosperity Indexes, which use third-party data and thereby remove the subjective judgements

of the team involved in their construction. Second, we developed a comparison metric that identifies the lowest-hanging fruits: the areas where India performs more poorly than the global, LMIC, and South Asia regional averages. If an “average” country in the world has achieved something; *and* an “average” LMIC has achieved it; *and* other countries in the region have achieved it, then it becomes very difficult to argue that India cannot.

There are sixteen such low-hanging fruits:

A. Legal Freedom

1. People can access and afford civil justice
2. Civil justice is not subject to unreasonable delays
3. Criminal investigation system is effective
4. Criminal adjudication system is timely and effective
5. Public disclosure of finances and business dealings by members of parliament
6. Human rights and rule of law
7. Demographic pressures
8. People do not resort to violence to redress personal grievances
9. Government regulations are effectively enforced
10. Government regulations are applied and enforced without improper influence

B. Political Freedom

11. Government officials are sanctioned for misconduct

C. Economic Freedom

12. Mean tariff rate
13. Standard deviation of tariffs
14. Capital control
15. Freedom of foreigners to visit
16. Comparable pay for women’s work

Among the Asian and African countries that gained independence in the early twentieth century, India has consistently maintained

a high degree of political freedom. Indians around the world are rightfully proud of this singular achievement. However, two common assumptions about the other two freedoms do not necessarily hold water: one, that India lacks economic freedom more than anything else; and two, that India has an effective justice system within a British common law tradition. It is certainly true that there are several areas in which India could improve its citizens' economic freedoms, but the above list shows that India could make a tremendous difference to the prosperity of her people by improving the legal system. Ten very clear areas of legal freedom are identified by the Atlantic Council Freedom Index. One may quibble about "human rights and rule of law" as too broad a bucket and its probable reliance on subjective assessment. And in the tradition of Julian Simon, one may argue that people are a resource and not a restraint on economic prosperity and downplay the issue of demographic pressures. The remaining eight areas seem uncontroversial and would command a broad consensus across political and ideological lines in India. The Atlantic Council's Freedom Index lays out a clear path of freedom for India's rapid progress towards prosperity.

Appendix

Table 1. Atlantic Council Freedom Index scores

Sub-indexes/indicators/components (2021 Freedom Index)	Average				Source index
	India	Global	LMIC	Region	
Sub-index 1: Legal Freedom score	42.23	47.35	39.96	37.98	a
I. Judicial Effectiveness score	40.04	45.93	33.28	33.22	a
I.1 Efficient Judiciary score	50	48.56	31.42	35.42	a
I.1.1 Is there an independent judiciary?	2	2	I	2	b
I.1.1.2 Does due process prevail in civil and criminal matters?	2	2	I	I	b
I.2 Civil Justice score	34.95	49.96	36.99	31.37	a
I.2.1 People can access and afford civil justice	0.39	0.57	0.49	0.44	c
I.2.2 Civil justice is free of discrimination	0.39	0.55	0.46	0.35	c
I.2.3 Civil justice is free of corruption	0.48	0.57	0.41	0.4	c
I.2.4 Civil justice is free of improper government influence	0.6	0.52	0.38	0.45	c
I.2.5 Civil justice is not subject to unreasonable delay	0.2	0.45	0.41	0.30	c
I.2.6. Civil justice is effectively enforced	0.41	0.53	0.43	0.41	c
I.2.7 Alternative dispute resolution mechanisms are accessible, impartial, and effective	0.6	0.66	0.59	0.54	c

Sub-indices/indicators/components (2021 Freedom Index)	Average				
	India	Global	LMIC	Region	Source index
I.3 Criminal Justice score	35.17	45.93	31.44	32.88	a
I.3.1 Criminal investigation system is effective	0.25	0.42	0.36	0.36	c
I.3.2 Criminal adjudication system is timely and effective	0.36	0.47	0.41	0.41	c
I.3.3 Correctional system is effective in reducing criminal behavior	0.38	0.42	0.32	0.36	c
I.3.4 Criminal system is impartial	0.38	0.47	0.38	0.31	c
I.3.5 Criminal system is free of corruption	0.45	0.55	0.41	0.43	c
I.3.6 Criminal system is free of improper government influence	0.51	0.48	0.31	0.38	c
I.3.7 Due process of the law and rights of the accused	0.39	0.51	0.36	0.35	c
2. Government Integrity	23.42	32.68	22.22	22.72	a
2.1 Perceptions of Corruption	40	43.61	31.75	30	d
2.2 Absence of Corruption	30.3	43.44	26.49	26.88	a
2.3 Public Disclosure	0	13.77	3.2	5.95	e
3. State Capacity	39.67	45.9	34.47	29.03	a
3.1 State Legitimacy	4.3	5.77	7.02	6.73	f
3.2 Public Services	7.5	5.72	7	7.5	f
3.3 Human Rights and Rule of Law	7.7	5.41	6.82	7.38	f

Sub-indices/indicators/components (2021 Freedom Index)	Average				
	India	Global	LMIC	Region	Source index
3.4 Demographic Pressures	8.1	5.9	6.81	7.65	f
3.5 Refugees and Internally Displaced People	4.1	4.73	5.6	7.02	f
3.6 External Intervention	4.5	5.28	6.06	6.3	f
4. Order and Security					
4.1 Crime is Effectively Controlled	59.59	72.13	65.48	52.99	a
4.2 Civil Conflict is Effectively Limited	0.78	0.75	0.69	0.7	c
4.3 People Do Not Resort to Violence to Redress Personal Grievances	0.69	0.93	0.86	0.56	c
4.3 People Do Not Resort to Violence to Redress Personal Grievances	0.32	0.49	0.4	0.33	c
5. Regulatory Effectiveness	48.41	53.89	44.33	44.09	a
5.1 Government Regulations are Effectively Enforced	0.4	0.54	0.46	0.43	c
5.2 Government Regulations are Applied and Enforced Without Improper Influence	0.45	0.63	0.51	0.48	c
5.3 Administrative Proceedings are Conducted Without Unreasonable Delay	0.43	0.49	0.43	0.39	c
5.4 Due Process is Respected in Administrative Proceedings	0.53	0.48	0.36	0.38	c
5.5 The Government Does Not Expropriate Without Lawful Process and Adequate Compensation	0.61	0.57	0.48	0.52	c

Sub-indices/indicators/components (2021 Freedom Index)	Average				
	India	Global	LMIC	Region	Source index
Sub-index 2: Political Freedom score	67.62	56.22	46.09	51.55	a
2.1 Constraints on Government	55.99	54.83	43.66	47.02	a
2.1.1 Constraints on government					c
a. Government powers are effectively limited by the legislature	0.69	0.58	0.5	0.63	c
b. Government powers are effectively limited by the judiciary	0.63	0.54	0.43	0.53	c
c. Government powers are effectively limited by independent auditing and review	0.55	0.52	0.41	0.51	c
d. Government officials are sanctioned for misconduct	0.38	0.47	0.39	0.39	c
e. Government powers are subject to non-governmental checks	0.56	0.57	0.45	0.56	c
f. Transition of power is subject to the law	0.73	0.62	0.51	0.55	c
2.1.2 Open government					c
a. Publicized laws and government data	0.56	0.45	0.32	0.36	c
b. Right to information	0.58	0.51	0.42	0.47	c
c. Civic participation	0.56	0.56	0.46	0.53	c
d. Complaint mechanisms	0.71	0.59	0.48	0.55	c
2.1.3 Fundamental rights					c
a. Equal treatment and absence of discrimination	0.45	0.58	0.5	0.44	c

Sub-indices/indicators/components (2011 Freedom Index)	Average			Region	Source index
	India	Global	LMIC		
b. The right to life and security of the person is effectively guaranteed	0.41	0.59	0.38	0.32	c
c. Due process of the law and rights of the accused	0.39	0.51	0.36	0.35	c
d. Freedom of opinion and expression is effectively guaranteed	0.56	0.57	0.45	0.53	c
e. Freedom of belief and religion is effectively guaranteed	0.57	0.64	0.52	0.51	c
f. Freedom from arbitrary interference with privacy is effectively guaranteed	0.44	0.48	0.29	0.31	c
g. Freedom of assembly and association is effectively guaranteed	0.57	0.62	0.5	0.55	c
h. Fundamental labor rights are effectively guaranteed	0.49	0.59	0.51	0.48	c
2.2 Political Rights score	90.63	59.34	48.23	59.38	a
2.2.1 Electoral process	12	7.41	6.03	7.57	b
a. Was the current head of government or other chief national authority elected through free and fair elections?	4	3	2	3	b
b. Were the current national legislative representatives elected through free and fair elections?	4	3	2	3	b
c. Are the electoral laws and framework fair, and are they implemented impartially by the relevant election management bodies?	4	3	2	3	b

Sub-indices/indicators/components (2021 Freedom Index)	Average				Source index
	India	Global	LMIC	Region	
2.2.2 Political pluralism and participation	13	9.75	7.62	9.29	b
a. Do the people have the right to organize in different political parties or other competitive political groupings of their choice, and is the system free of undue obstacles to the rise and fall of these competing parties or groupings?	4	3	2	3	b
b. Is there a realistic opportunity for the opposition to increase its support or gain power through elections?	4	3	2	3	b
c. Are the people's political choices free from domination by forces that are external to the political sphere, or by political forces that employ extra political means?	3	3	2	2	b
d. Do various segments of the population (including ethnic, racial, religious, gender, LGBT+, and other relevant groups) have full political rights and electoral opportunities?	2	3	2	2	b
2.2.3 Functioning of government					b
a. Do the freely elected head of government and national legislative representatives determine the policies of the government?	4	3	2	2	b
2.3 Civil Liberties score	56.25	57.85	46.4	45.83	a
2.3.1 Freedom of expression and belief	9	10.5	8.7	7.7	b

Sub-indices/indicators/components (2011 Freedom Index)	Average				Source index
	India	Global	LMIC	Region	
a. Are there free and independent media?	2	2	2	2	b
b. Are individuals free to practice and express their religious faith or nonbelief in public and private?	2	3	2	2	b
c. Is there academic freedom, and is the educational system free from extensive political indoctrination?	2	3	2	2	b
d. Are individuals free to express their personal views on political or other sensitive topics without fear of surveillance or retribution?	3	3	2	2	b
2.3.2 Associational and organizational rights	7	7.4	5.6	6.1	b
a. Is there freedom of assembly?	2	3	2	2	b
b. Is there freedom for nongovernmental organizations, particularly those that are engaged in human rights- and governance-related work?	2	3	2	2	b
c. Is there freedom for trade unions and similar professional or labor organizations?	3	3	2	2	b
2.3.3 Rule of law	8	8	5.3	5.7	b
a. Is there protection from the illegitimate use of physical force and freedom from war and insurgencies?	2	2	1	2	b

Sub-indices/indicators/components (2011 Freedom Index)	Average				Source index
	India	Global	LMIC	Region	
b. Do laws, policies, and practices guarantee equal treatment of various segments of the population?	2	2	1	1	b
2.3.4 Personal autonomy and individual rights	9	9.4	7.5	7.3	b
a. Do individuals enjoy freedom of movement, including the ability to change their place of residence, employment, or education?	2	3	2	2	b
b. Are individuals able to exercise the right to own property and establish private businesses without undue interference from state or nonstate actors?	3	2	2	2	b
c. Do individuals enjoy personal social freedoms, including choice of marriage partner and size of family, protection from domestic violence, and control over appearance?	2	2	2	2	b
d. Do individuals enjoy equality of opportunity and freedom from economic exploitation?	2	2	2	2	b
Sub-index 3: Economic Freedom score	58.37	66.49	57.65	48.71	a
3.1 Property Rights	61.78	56.27	44.9	41.39	a
a. Protection of property rights	5.69	5.51	4.73	5.02	g
b. Risk of expropriation	3	4	4	5	h

Sub-indices/indicators/components (2021 Freedom Index)	Average				Source index
	India	Global	LMIC	Region	
3.2 Trade Freedom	61.69	74.81	66.31	62	a
3.2.1 Tariffs	6.52	7.41	7.27	6.31	g
a. Revenue from trade taxes (% of trade sector)	9.09	8.31	8.12	7.32	g
b. Mean tariff rate	7	8.16	7.76	7.18	g
c. Standard deviation of tariff rates	3.46	5.89	5.82	4.42	g
3.2.2 Regulatory trade barriers	6.55	6.1	4.72	5.53	g
a. Non-tariff trade barriers	5.76	5.66	5.15	5.16	g
b. Compliance costs of importing and exporting	7.35	6.54	4.29	5.89	g
3.2.3 Black market exchange rates	10	9.46	9.36	10	g
3.2.4 Controls of the movement of capital and people	0.55	3.49	2.03	0.59	g
a. Financial openness	1.64	5.55	3.34	1.64	g
b. Capital controls	0	3.59	2.1	0.13	g
c. Freedom of foreigners to visit	0	1.46	0.66	0	g
3.3 Investment Freedom	40	57.02	46.49	32.14	i
3.4 Women's Economic Freedom	70	80.56	73.61	65.71	a
a. Mobility	100	88.16	85.91	87.50	j
b. Pay	25	67.76	57.27	46.88	j

Sub-indices/indicators/components (2021 Freedom Index)	Average		
	India	Global	LMIC
c. Entrepreneurship	75	83.95	81.36
d. Assets	80	80.95	72.73

Source Indexes:^a Dan Negrea and Matthew Kroenig, "Do Countries Need Freedom to Achieve Prosperity? Introducing the Atlantic Council Freedom and Prosperity Indexes," Atlantic Council, <https://www.atlanticcouncil.org/in-depth-research-reports/report/do-countries-need-freedom-to-achieve-prosperity/#data>; ^b Sarah Repucci and Amy Slipowitz, "Freedom in the World 2013-2022 Raw Data," https://freedomhouse.org/sites/default/files/2022-02/All_data_FIW_2013-2022.xlsx; ^c World Justice Project, "Rule of Law Index 2021," https://worldjusticeproject.org/rule-of-law-index/downloads/FINAL_2022_wjp_rule_of_law_index_HISTORICAL_DATA_FILE.xlsx; ^d Transparency International, "Corruption Perception Index, 2021," <https://www.transparency.org/en/cpi/2021>; ^e Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, "Disclosure by Politicians," *American Economic Journal: Applied Economics* 2, no. 2 (April 2010), 179–209; ^f Fragile States Index, "Measuring Fragility: Risk and Vulnerability in 179 Countries," Fund for Peace, 2021, <https://fragilestatesindex.org/wp-content/uploads/2021/05/fsi-2021.xlsx>; ^g James Gwartney, Robert Lawson, Joshua Hall, and Ryan Murphy, *Annual Report, 2021: Economic Freedom of the World*, Toronto: Fraser Institute, 2021, <https://www.fraserinstitute.org/resource-file?mid=14828&fid=18375>; ^h "Expropriation Risk - Country Rankings," Credendo Group, 2019, https://www.theglobealeconomy.com/rankings/expropriation_risk/; ⁱ Terry Miller, Anthony B. Kim, James M. Roberts, and Patrick Tyrrell, "2021 Index of Economic Freedom," Heritage Foundation, 2021, https://www.heritage.org/index/pdf/2021/book/2021_IndexofEconomicFreedom_Highlights.pdf; ^j World Bank, "Women, Business and the Law Data," World Bank, April 2022, <https://wbi.worldbank.org/en/wbi-data>.

Scaling up the transatlantic partnership from security to prosperity: Economic resilience in Eastern Europe¹

Clara Volintiru
Camelia Crişan
George Ştefan

Context: Overlapping security, political, and economic challenges in Eastern Europe

SINCE RUSSIA INVADED UKRAINE ON FEBRUARY 24, 2022, the transatlantic community refocused heavily on the security of the region. Beyond the military battlefield in Ukraine, malign political and economic influences from Russia and China have persisted across Eastern Europe for many years—both within the European Union (EU) and in the broader Black Sea region.

The nature of the current challenges raises the need for a comprehensive course of action that deals not only with a sharper regional awareness of threats and vulnerabilities but also with their variety, in economic, social, and political dimensions.

Clara Volintiru is a professor at the Bucharest University of Economic Studies and director of the Bucharest Office of the German Marshall Fund and of the Black Sea Trust.

Camelia Crişan is assistant professor at the National School of Political Science and Public Administration in Romania and the managing director of Project Romania 2030.

George Ştefan is an assistant professor at the Bucharest University of Economic Studies.

Eastern Europe has experienced a steady process of economic and political integration with the rest of Europe over the past three decades. Gradually, up to 2016, countries from East-Central Europe (ECE)² joined the EU; after that date, the Eastern Partnership (EaP)³ countries signed Association Agreements with the EU, showing that a pathway to EU membership was possible.

The domestic politics of ECE countries like Bulgaria and Hungary, and EaP countries like Georgia or Armenia have long been divided in terms of their alignment with the Western community. The apparent lack of commitment to democratic values on the part of some political leaders led to questions about electoral integrity in the EaP states of Ukraine, Moldova, and Georgia.⁴ In East-Central Europe, rule-of-law issues, and even rising authoritarianism in the case of Hungary, have not only affected the quality of democracy, but also the fairness of institutional checks and balances in the field of economic policies.⁵ In contrast, for the countries more politically aligned toward the United States, vulnerabilities took an economic form: large investment gaps in critical infrastructure—like energy, transport, or digital technologies—have left countries like Poland, Czechia, Romania, Slovakia, or Moldova vulnerable to the current disruptions in supply chains and rising energy prices. Europe faces overlapping economic and energy crises, and if each country faces these vulnerabilities alone, it could reinforce the political discord amongst Western allies.

Therefore, as this chapter argues, the road toward freedom and prosperity in ECE and in the EaP countries requires a clear strategic engagement from Western allies in the EU and the transatlantic community, linking immediate responses to the war in Ukraine with clear longer-term prospects for development in the region as a whole. Essentially, stabilizing East-Central Europe will require a scaling-up of effort, from security to economic partnerships that deliver long-term prosperity to all partners.

This chapter is built in a telescopic manner, as it reviews the quest for prosperity from the perspective of global trends, applies these trends to the current context of Eastern Europe, and focuses further on the case study of Romania to reflect specific mechanisms of development. The chapter also engages with three major growth trajectories: through economic integration, through the development of sustainable growth models at the national and local levels, and through local developmental alliances. In our opinion, these three trajectories of growth should be seen as overlapping layers of a comprehensive development model that is resilient to overlapping crises, anchored in freedom, and delivering long-term prosperity.

Trajectory: Eastern Europe in the transatlantic community and the EU growth trajectories through European integration

The Freedom and Prosperity Indexes of the Atlantic Council allow us to trace a clear connection between growth trajectories and economic, political, and legal freedoms.⁶ EU integration consolidated the economic, political, and legal freedoms in many of the ECE countries, which in turn allowed them to develop more sophisticated economic models.⁷ While many countries in the region experienced economic growth, data in the Freedom and Prosperity Indexes raise the question of how sustainable their development trajectories have been: improvements in freedom are equally important, ensuring a greater and more durable prosperity.⁸

Unlike Western Europe, which went through a period of economic slowdown, for ECE countries the last decade saw a period of economic growth and prosperity. Overall convergence was clear in the region—to a greater extent for countries with larger development gaps to fill (e.g., Romania, Lithuania, Latvia) or a lesser extent for better-integrated economies in the regional supply chains

(e.g., Hungary, Czechia, Slovenia). EU member states from this region are in fact net beneficiaries of European funding, receiving much more than they contribute to the EU budget, mainly in the form of cohesion funding. However, because much of the economic convergence has been based on foreign direct investment (FDI) and not domestic companies, the amount of profits that flow *from* Eastern to Western member states exceeds the EU funding *into* the ECE.⁹ Still, the EU funding has provided ECE member states with very strong leverage in attracting higher-value-added foreign investments—a game which some countries played virtuously (e.g., Hungary, Czechia, Poland), while others less so (e.g., Bulgaria). Essentially, EU funds were used in the ECE region to provide direct state aid to large foreign investors in key strategic sectors (e.g., automobile manufacturing, information and communication technology (ICT), energy), or to finance enabling infrastructure for foreign investments (e.g., road, rail, and even air transport facilities, digital infrastructure, or human resource formation in targeted specializations like science, technology, engineering, and mathematics).

But large subnational disparities mean the beneficial effects of economic integration are not felt equally, and the relative economic deprivation in some parts of Central and Eastern Europe can be linked to growing anti-liberal political sentiment. For example, Czechia's poorest regions, home to the declining coal industry, are strongholds for the ANO (Action of Dissatisfied Citizens) populist party, while poverty-stricken rural areas in Poland all voted for PiS (Law and Justice) in the last presidential election. European funding has contributed to local development, but it has also placed a heavy burden on administrations that often lack both technical capacity¹⁰ and capital to fulfill the co-financing requirements.¹¹

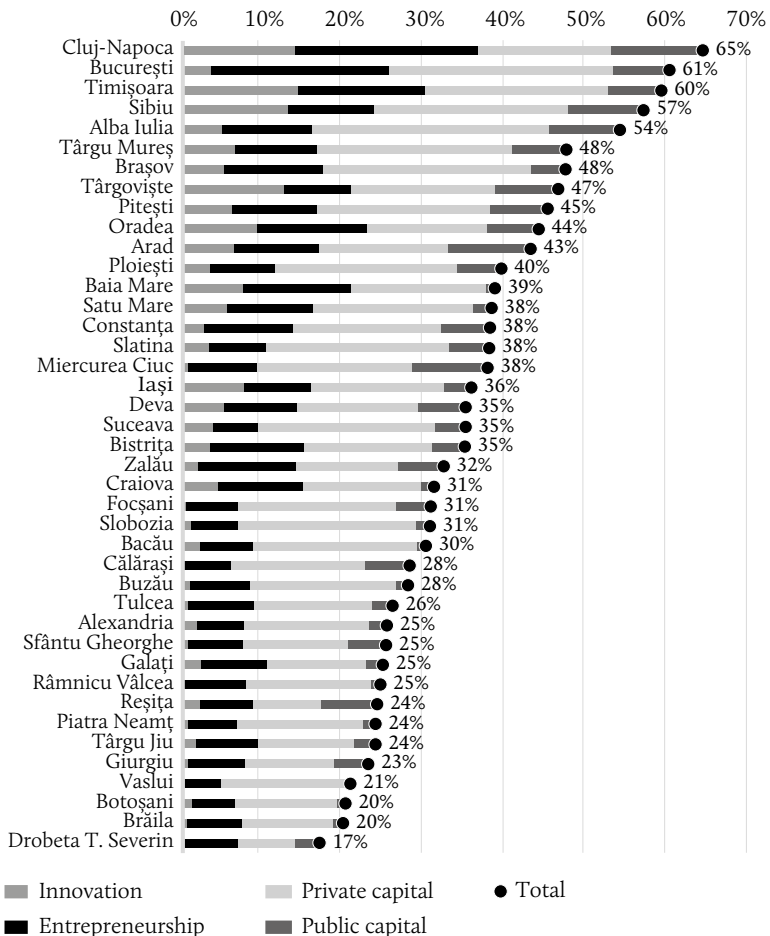
Local resilience can be defined as “a community’s capacity to resist, adapt and recover its functions and structures after a crisis or a disruptive event.”¹² Based on a review of several existing resilience indicators, the authors of this chapter have developed

a pilot index on local resilience in Romania and Moldova in 2022 (as an example, Figure 2 shows results for the socioeconomic pillar for Romania). Our Local Resilience Index (LOCRES) comprises three dimensions: economic, societal, and security. For economic local resilience, we used three pillars: socioeconomic policies (i.e., adaptive economic policies and targeted social policies responding to the specific context of the local community), access to basic services (i.e., basic level of quality of services, and intra- and inter-community connectedness), and local economic opportunities (i.e., employment perspectives, mobility or availability of financial resources, entrepreneurship, and private sector development). All three socioeconomic pillars have been measured through a mixed data set, comprising both statistical indicators and population survey data. We found that in the case of Romania, there is a balanced level of development in terms of policies' capacity to cater to local needs and in terms of access to public services (see Figure 2). However, the large prosperity gaps are correlated with large discrepancies in economic opportunities between localities—with people in the capital region of Bucharest having nine times more economic opportunities than those in the county of Vaslui, near the eastern border (see Figure 2).

Regions that lag behind on the LOCRES Index are extremely vulnerable to economic shocks, with low resilience, and lower capacity to recover, regardless of the dimension of local resilience—political, security, or economic. These regions usually share some common characteristics: a lack of critical infrastructure and medical supplies; poor access to basic education; a low level of digitalization; social divisions, and social polarization in general; a high level of corruption and clientelism at the local level; and a high level of non-conventional threats like fake news and disinformation. Low gross domestic product (GDP) per capita and limited labor market opportunities diminish further the local capacity. Moreover, there is a salient mistrust in public authorities

in these regions, and the civic culture—expressed as personal involvement in civic actions at the local level—tends to be limited.

Figure 1. Romanian local development—innovation, public and private capital, and entrepreneurship (2022)



Source: Clara Volintiru and George Ștefan, *Economic Development and Opportunities in Romania: Local Business Environment Index (LBEI)*, Aspen Institute Romania, December 14, 2018, https://aspeninstitute.ro/wp-content/uploads/2018/10/WHITE-PAPER_Economic-Opportunities-Program_2018.pdf.

Figure 2. Economic resilience at local level in Romania, 2021



Source: Local Resilience (LOCRES) Index: Romania, “Understanding Local Resilience: Definitions, Dimensions, and Measurement,” October 2021, https://locres.eu/wp-content/uploads/2022/02/Raport-Oct-21_logo.pdf; data not yet published.

Malign economic and political influences have swept through the region's democracies for a long time and there is a sense of complacency in the way the transatlantic community has approached them. First, it took too long for us to connect the dots, and realize that political actors supported by the Kremlin had similar narratives and strategies across Central and Eastern Europe and beyond.¹³ Second, the desirable plurality of elections and the quest for foreign direct investment meant that too often malign interventions were welcomed as endogenous elements of liberal economies. Third, there was a reluctance in the West to admit that some of the malign influences—Russia and China, for example—were targeting salient economic and political vulnerabilities: low political influence in international relations, and large investment gaps, including in key strategic sectors (e.g., energy, infrastructure, digital technologies).¹⁴ Our data show the importance of attending to the local level within Eastern European democracies, both to understand their vulnerabilities to malign political influences from Russia, and to address the persistent economic divides at subnational level.

Growth trajectories in a new economic model

While initially the economic convergence was built on the back of economic growth, the persistent inequality levels highlighted the need for a more comprehensive approach to European convergence. As such, aligned with international trends, evidence on human development levels enabled decision makers to craft targeted, informed policies that helped people take full advantage of the opportunities created by economic growth.¹⁵

Several layers of transformation occurred in the global economy over the past decade that are changing the growth model for Eastern Europe. These can all be linked to the way the traditional bottom lines of business strategies have changed. One dimension of transformation is linked to the way productivity is achieved,

and the way competitiveness is defined more in relation to sustainability than to profit margins. To this end, increasing amounts of public capital are being used to derisk private investments in new technological sectors that can support both sustainable and competitive objectives. Thirdly, enabling endowments such as infrastructure, skills, and governance are as important as profit margins. Finally, profit margins are increasingly becoming a secondary priority to geopolitical alignments.

Across Europe and in the United States, there has been a concerted effort to reorient economic policy in a new direction informed by climate action. As the EU coins the term “competitive sustainability,” which can be defined as “the ability of an economy, companies and industrial ecosystems to excel relative to international competitors in their transition to a sustainable economy – with climate neutrality at its core – through investment in the necessary innovation.”¹⁶ The European Commission thus links unequivocally the pursuit of economic growth and prosperity to a “fair, just, green, and digital transition.”¹⁷ Similarly, the United States is engaged in a comprehensive effort to link economic transformations to climate action goals such as reducing carbon emissions (as seen, for instance, in the Inflation Reduction Act of 2022¹⁸). As the economic and energy crises are increasingly interconnected, the dual pursuit of prosperity and sustainability will likely pose a new economic challenge to Eastern Europe.

The new ambitions of linking competitiveness to sustainability have required more and more blended financing. Public capital is increasingly used to leverage private resources—both financial and intellectual—to develop niche sectors in leading economies of the United States, EU, or China. This new form of industrial policy is not, however, led by the state, but rather a codesign process, which some authors characterize as the “Wall Street consensus,”¹⁹ “state capitalism,”²⁰ or a “hidden investment state.”²¹ Either way, the disadvantage of smaller economies with poorer national

budgets is clear, and the need for concerted action amongst Western allied economies is very large.

Within the EU, there is an East-West divide on measures of basic competitiveness indicators in the Eurostat Regional Competitiveness Index: quality of institutions, macroeconomic stability, infrastructure, health services, and basic education.²² Eastern Europe was also much less competitive than the West in technological innovation. The values of these metrics in ECE countries were, on average, two times smaller than the average of older member states (e.g., Denmark's maximal value of 0.89 vs. Romania's minimal value of -1.44 on the national averages of the Regional Competitiveness Index).²³ While recent growth patterns in Eastern Europe have shown increases in labor productivity, the region had not gained ground in innovation or technology.

Geopolitical realignments have become increasingly visible over the past decade, with the war in Ukraine drawing firm ties between allies. These realignments have been amplified by the dire realities of global value chain (GVC) vulnerabilities that surfaced during the COVID-19 pandemic. Eastern Europe is looking for economic support in this context from its security allies in the transatlantic space. The geopolitical positioning of countries like Romania and Poland comes with expectations for strengthening economic ties. This is not just a transactional logic in the diplomacy of nation states, but an important policy commitment for ensuring governments retain the support of their populations for the security pledges they make. Further shifting the sands of the regional economy, by the beginning of 2023 over 1,000 Western companies had curtailed operations in Russia, according to the Yale School of Management monitoring data.²⁴

For all of these reasons, Eastern European economies are prone to engaging in a redesign of their national economic models, moving away from the lure of cheap labor, and fighting hard for high-value-added (HVA) investments. Moving beyond the

automotive and basic manufacturing sectors, countries in Eastern Europe are now focusing on attracting FDI in biotech, aviation, information and communications technologies (ICT), and cyber, defence, or energy. These can deliver more prosperity to the local economies, and would be supported by more complex pull factors. HVA investments can make use of a skilled labor force, can access EU funds for leveraging foreign investments, and can build on geopolitical alliances in near-shoring or allied-shoring processes. As opposed to Hungary, both Romania and Poland share a better territorial distribution of HVA investments (see Table 1). While Hungary has been more skilled in leveraging EU funds to attract and increase its HVA investments, its decreasing level of freedom (according to the Atlantic Council Freedom Index) leaves it unable today to mobilize the full spectrum of drivers of a new economic model that might otherwise be possible through allied-shoring and pooling public resources such as EU funds.

Table 1. Territorial distribution of high-value-added (HVA) foreign investments in Hungary, Poland, and Romania (top 15 localities with at least 15 foreign investment projects between 2004 and 2020)

Hungary			
Locality	No. of foreign investments	HVA foreign investments	Share (%) of HVA
Budapest	509	467	91.75
Szeged	15	11	73.33
Debrecen	47	22	46.81
Biatorbágy	15	7	46.67
Pécs	29	13	44.83
Miskolc	27	9	33.33
Győr	71	22	30.99
Székesfehérvár	54	16	29.63
Veszprém	27	8	29.63
Kecskemét	29	8	27.59
Szombathely	17	4	23.53
Tatabánya	36	5	13.89
Esztergom	15	2	13.33
Mosonmagyaróvár	16	2	12.50
Zalaegerszeg	19	2	10.53
Romania			
Locality	No. of foreign investments	HVA foreign investments	Share (%) of HVA
Iași	65	59	90.77
Bucharest	607	548	90.28
Constanța	24	19	79.17
Cluj-Napoca	125	93	74.40
Timișoara	126	83	65.87
Brașov	81	38	46.91
Sibiu	57	25	43.86

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Romania			
Locality	No. of foreign investments	HVA foreign investments	Share (%) of HVA
Craiova	32	14	43.75
Târgu Mureş	15	6	40.00
Piteşti	24	8	33.33
Arad	29	9	31.03
Ploieşti	46	13	28.26
Oradea	38	10	26.32
Satu Mare	19	3	15.79
Slatina	17	0	0.00

Poland			
Locality	No. of foreign investments	HVA foreign investments	Share of HVA (%)
Warsaw	685	653	95.3
Kraków	211	185	87.7
Gdynia	31	27	87.1
Gdańsk	131	113	86.3
Poznań	160	130	81.3
Wrocław	243	183	75.3
Strykow	18	13	72.2
Bydgoszcz	34	24	70.6
Katowice	101	69	68.3
Szczecin	59	40	67.8
Lublin	28	16	57.1
Opole	19	10	52.6
Torun	18	9	50.0
Łódź	139	68	48.9
Sosnowiec	26	12	46.2

Source: Cornel Ban, Clara Volintiru, and Gergő Medve-Bálint, "The Politics of Local Developmental Alliances and Industrial Policy: Upgrading Strategies in Three Central European Cities," *Competition and Change* (forthcoming); based on FDI markets, <https://www.fdimarkets.com>.

Growth trajectories and freedom as an enabling condition for prosperity

Societal actors (e.g., civil society, media, lawyers, or political parties) are key in ensuring a free and vibrant democracy, one in which economic opportunities prevail, and public sector development leads to shared prosperity. Not only are societal actors able to implement checks and balances that uphold the quality of our democracies, but they are increasingly more involved in codesigning solutions in times of crisis (e.g., COVID-19,²⁵ the war in Ukraine), and long-term growth trajectories for local communities.

Of all the countries in Eastern Europe, Romania has by far the strongest civil society,²⁶ including the largest number of civil society organizations (CSOs). These CSOs have been part of large EU or international networks, or gained experience locally, in multimillion-euro projects and with large, diverse networks. Romanian CSOs have proven their resilience, and the sustainability of their business model, not only by working well internationally, but by partnering effectively with government when crisis situations required it.²⁷ Apart from Moldova, where the situation for nongovernmental organizations (NGOs) has seen improvements, the situation of NGOs in all other countries of the Black Sea region has either remained the same (e.g., Georgia) or became worse (e.g., Armenia). While some countries (e.g., Romania) have seen constant improvements in press freedom, others (e.g., Poland, or more noticeably, Hungary) have shifted more and more towards autocracy, with several independent media outlets in Hungary being closed by direct government intervention.²⁸ This has not led to immediate economic consequences for ordinary citizens, but we see signs that the economic situation in Hungary has deteriorated, with both its GDP and consumption decreasing in 2021, falling below most countries in the region.²⁹

A strong civil society is not only a prerequisite for prosperity, but an important facilitator for other factors associated with an open and free society, and a way to hold the government accountable for its decisions. Romania's case is particularly interesting from this point of view. From the summer of 2017 onwards, movements against internet regulation and for a stronger voice for local communities cohered into increasingly strong activist networks (e.g., #rezist, #insist, #unitedwesave). These networks became vocal opponents of corruption, fueling new political parties, and thus increasing the quality of democracy.³⁰

Online groups and social media were at the heart of these burgeoning movements, but free access to information has been a double-edged sword. It has not only driven a stronger civil society, but, as an unwanted consequence, allowed Russian propaganda and its anti-democratic narratives to find a way into people's minds—especially when events coincide with a crisis like the COVID-19 pandemic. The restrictions imposed by the governments during the pandemic had an impact on the overall feeling of freedom people were experiencing, and this created fertile ground for propaganda pushed by Russian actors.

Despite this, Romanian civil society witnessed a surge in solidarity during the pandemic, and a broad community effort to support the vulnerable and those in need. Networks grew stonger, and new partnerships were fostered between the state and civil society, particularly in terms of social innovation. For example, Code for Romania (an association of volunteers from the IT industry) created a digital platform to support the COVID response. As a result of this growth, when Russia attacked Ukraine in February 2022, the response of Romanian society was swift and overwhelming: Tools built in COVID times were quickly repurposed in support of refugees.³¹ Local networks of NGOs, which had supported older people during the pandemic (with medicines, etc.), became active collectors of goods and first aid materials to be

sent to Ukraine. Over 300 Romanian NGOs have been involved in supporting the Ukrainian people since the beginning of the war. This strong, robust, and healthy civil society in Romania has proved to be a pillar of resilience when the country has been confronted with pro-Russian narratives related to the war: 65 percent of the population believe that there was no justification for the Russian invasion of Ukraine and 75 percent believe in NATO's capacity to defend the country.³²

In particular, the United We Save (#unitedwesave) movement was, in our opinion, the most important turning point in the Romanian civil society movement, from 2013 onwards.³³ Its major success was that it proved united citizens could influence government politics—especially noteworthy given the common perception, that a government ostensibly *of* the people was led neither *by* the people (but by a few corrupt politicians) nor *for* the people (but rather for corporate interests). Following this important milestone in the Romanian civil society movement, mass protests have managed to take down several governments for corruption-related issues,³⁴ when the state has not been perceived as functioning to the benefit of the citizens. These movements provided a strong indication that it was not only the government that needed reform, but the political class as well.

Romanian civil society has strongly supported the country's democratic institutions in their attempts to resist corrupt practices of politicians, or laws perceived as being made solely for corporate interests. Russian propaganda, trying to use the same channels as these movements, has had some minor success, especially in supporting the movement against COVID regulations, but as we have seen, in general the large mass of people has been well inoculated for defending liberal democratic values. In our view supporting a robust civil society that can withstand such challenges is the most important investment one can make, especially if we look toward the future reconstruction of Ukraine.

The resources that will be spent in repairing bridges, buildings, roads, and other infrastructure have to be matched by continuous investments in the strengthening of civil society. Here, Romania has useful experience, which can be transferred and used to the benefit of the Ukrainian people.

Mutual engagement between civil society and local administrations has been relatively poor in Hungary, Poland, and Romania.³⁵ However, the last decade has seen the creation of new formal and informal avenues of engagement between citizens and local governments. The key to collaborations that push back against the shrinking of civic space lies with civic actors' ability to participate, and with local governments' engagement in consultations, collaborations, and public deliberations. CSOs are essential actors in mediating the relationship between citizens and the state by building trust and social capital. They can play a role in advancing transparent and accountable governance by articulating and representing citizens' concerns, thereby furthering participatory governance, and by increasing the legitimacy of public actors and the relevance of their projects.

Conclusion: Ways forward for economic resilience in Eastern Europe

Since the war in Ukraine began in 2022, it is clearer than ever that Eastern Europe is a key battlefield for democratic values. It is no longer the region's inner transitional risks, but outward hybrid threats from Russia that pose the challenge to democratic alliances. Winning hearts and minds, however, is not only a battle of ideas—however important those might be—but also of ensuring that democracy and prosperity go hand in hand. Our central argument is that, considering the overlapping crises that are unfolding (e.g., energy security, inflation), economic

resilience should be seen as a key element of the security strategy for Eastern Europe.

The chapter tells the story of economic trajectories of growth for Eastern European countries. In a time when economic growth seems to be only a memory of the good times past, the region still relies heavily on a sustained dynamic of growth in order to maintain its stability. There are three core arguments that we present. First, European integration has been the life-line of the economic growth trajectory of the region, with large influxes of FDI and EU funding for investments. However, this has not translated into the pace of economic convergence that would have stabilized the overall trajectory of the region within the EU single market, as large economic disparities between and within member states persist. Second, the path to prosperity for the region has to account for a transition to a new economic model—one that is more embedded in national endowments, but also better aligned with the overarching energy and technological transitions of its Western peers. This will mean doubling down on efforts to attract high-value-added investments that allow for its growth trajectory to be maintained. Finally, in order to achieve a sustainable and shared prosperity, Eastern Europe must capitalize on all societal actors. A free and empowered society allows for a consolidation of capabilities. It is only through mutual engagement, mobilizing both public and private sector investments, and aligning strategic priorities in a way that reflects both freedom and prosperity, that the countries of Eastern Europe will achieve lasting stability and societal resilience in the face of malign threats and ever-emerging risks.

The freedom and prosperity equation: Government interventions in Nigeria

Danladi Verheijen

AS THE BODY ULTIMATELY WITH the most influence on prosperity, governments must ensure the correct balance of interventions to ensure citizens' economic, political, and legal freedoms are upheld.

The following essay will explore the nature of the particular balancing act that exists, and which must be maintained, between the economic and legal freedoms currently outlined by the Nigerian federal government, and the arguments that are to be made for either expanding upon or decreasing government intervention with regards to those freedoms so as to ultimately ensure the overall prosperity of the Nigerian public. To this end, this essay will be in two halves: The first, an assessment of the federal government's approach to economic freedoms, with particular emphasis on the role of subsidies and subsidy reform in poverty reduction. The second half will address the central importance of order and security (the "legal freedoms" as identified by the Atlantic Council's Freedom and Prosperity Indexes),¹ and the role they play in underpinning societal prosperity more broadly.

At the time of writing (January 2023), a general election is looming large in Nigeria. Exactly a century after the nation's first general election—albeit to a colonial legislative council—the public will return to the polls in February and March 2023 to elect a new

Danladi Verheijen is CEO of Verod Capital, a leading West African private equity firm.

president and national assembly, and state governors and state houses of assembly, respectively. Any election cycle brings with it an intense period of scrutiny and speculation as to how a new administration will seek to address the elusive balance. The issues at stake are significant: the past few years have seen the nation's security situation deteriorate drastically,² with non-state armed actors and bandits continuously encroaching within the nation's borders, threatening livelihoods and civil liberties. Economically, a country whose meteoric development once led to it being dubbed a "rising star" in West Africa has stagnated, leaving 80 million in poverty by 2020, up from 68 million just a decade before.³

With broad prosperity amongst the Nigerian people clearly lacking, it would seem the balance between economic and legal freedoms in Nigeria, when viewed through the lens of government involvement and intervention, is in need of alteration. With a focus on the correlation and causality between economic freedom, security, and prosperity, the Nigerian government could engineer a return to past economic successes.

Economic freedom and the state's intervention

The economic potential of this former "rising star" still exists—after all, Nigeria remains the continent's largest economy. It is a question, in part, of redressing the elusive balance in order to release said potential. Though there are myriad ways in which this can be approached, from a private sector perspective, the government's first step should be to reassess its relationship with its economic freedoms—and focus on the level of intervention the state is willing to forgo to create the space for economic growth, and therefore greater prosperity, in the medium to long term.

At present, Nigeria is not alone in its cautious approach to free trade. Protectionist policies have increased on a global scale in

recent years, and this trend is anticipated to continue as the war in Ukraine rages on. In Nigeria, the past two decades have seen import bans, tariffs, and foreign exchange restrictions slow the flow of goods into the country,⁴ culminating with the closure of its land borders to goods in 2019—a move that contrasted sharply with the nation’s outward push for wider West African market integration in the shape of the African Continental Free Trade Area (AfCFTA), which Nigeria joined that same year. The government’s rationale for closing the borders was that it was an attempt to mitigate cross-border illicit trade, and to curb the smuggling of goods, the federal government wished to increase production of, particularly rice.⁵ World Bank analysis at the time found that the decision in fact contributed to higher inflation—particularly in relation to food items such as rice, despite the relatively low impact the policy had on agricultural output. By the following year, Nigerians were paying 100 percent more for the same goods basket, resulting in a negative impact on consumption.⁶ Though the reasoning for these protectionist policies may be sound, more often than not they represent a significant missed opportunity, since a more open approach to free trade has been shown to support poverty reduction. As Jonathan Lain and Jakob Engel note in their article on the World Bank’s 2022 report: *A Better Future for All Nigerians: Nigeria Poverty Assessment 2022*, the ripple effects of open trade in the shape of increased investment, and knowledge and technology transfer (as well as the crucial competition it brings), all serve to boost job creation, raise domestic value added, and finally reduce the price of goods available to the Nigerian public. In short, by removing trade barriers rather than creating new ones, the government would be reducing poverty levels in Nigeria.⁷

Indeed, data aggregated in May 2022 by the World Bank’s Household Impacts of Tariffs (HIT) analysis (which accounts for both the value of what households produce as well as what they consume) indicates that, were trade fully liberalized in Nigeria,

household income would increase by an average of 3.8 percent, whilst simultaneously seeing a reduction in the share of people living in poverty by 2.3 percent. More specifically, the HIT data suggests average incomes would be set to increase across all states, with the sole exception of Cross River, whilst poverty was predicted to increase in just four of the thirty-six states—Benue, Cross River, Edo, and Ondo. Liberalization would have a mitigable negative impact on some vulnerable Nigerians in those four states, in part due to the mix of income-generating activities that are prevalent in those regions. Lain and Engel argue that mitigation of these potential risk factors could take a variety of forms: In the short term, it could entail social protection schemes from the government to support those whose well-being is at risk. In the medium to long term, deeper reforms, in part aided by the act of liberalization itself, could include the improvement of infrastructure, which, if coupled with an increase in private investment from abroad, would result in significant and much needed domestic job creation.⁸

Another policy emblematic of the government's stranglehold on economic freedoms is the enduring presence of a range of subsidies whose existence is widely recognized as inhibitive to overall prosperity. Nowhere is this clearer than in the state's approach to fuel subsidies. Though the rationale for this historic subsidy is to allow its citizens to benefit from the fact that it is an oil-producing nation, the benefits are widely argued to be hugely outweighed by the drain it places on the federal government's financial reserves, a drain that only intensifies in times of economic volatility—the likes of which we are currently experiencing due to the ongoing war in Ukraine. Furthermore, it is widely acknowledged that these subsidies do little to benefit poorer households due to their already low consumption expenditure. According to World Bank estimates, the nominal cost of the petrol subsidy reached a staggering 1.43 trillion naira in 2021, amounting to approximately

0.8 percent of GDP—double the government’s spending for that year on health and social protections *combined*.⁹

At present, the government is on course to spend an estimated 3.36 trillion naira until mid-2023, when the subsidy is due to end.¹⁰ Since as long ago as 1982, several governments have attempted—unsuccessfully—to reform subsidies. The repeated failures illustrate the scale and complexity of the challenge of subsidy reform. However, Jun Erik Rentschler of the Oxford Institute for Energy Studies is among those who have argued that, in other countries, past reforms of similar subsidization policies suggest a successful change is possible, if approached adroitly. He suggests that if 100 percent of existing subsidies were removed, and the funds reallocated via direct cash transfers to the poor, there would be an instant and significant reduction in poverty levels.¹¹

Though any sweeping generalizations should be made with caution, the above exercise does make for a compelling argument for subsidy removal and redistribution of revenue for improvement of both short- and long-term prosperity through poverty reduction. Overall, when one considers this in tandem with the possibilities that a broadening of economic freedoms via the liberalization of trade could bring, the opportunities for a tangible improvement to national prosperity (when assessed in terms of household income particularly) are compelling.

Legal freedom and the state’s intervention

Within the Freedom and Prosperity Indexes’ definition of legal freedoms sit two crucial measures: those of order and security, which “evaluate the ability of the state to protect citizens from harm.”¹² An absence of these factors in any society makes for perhaps the most immediate indicator of a lack of prosperity with regards to more tangible short-term factors such as health,

education, general rights, or indeed citizen happiness. However, for the purposes of this essay, we will emphasize the correlation between order and security on one hand, and income as a measure of prosperity on the other. Though the previous section argued for an increase in economic freedoms through liberalization of trade, there is an argument to be made for an intensified government approach with regards to security and order. Namely, sparing nothing to engage more decisively with the issues of security and order—and to ensure the legal freedoms of the Nigerian people—are fundamental means to ensure greater economic prosperity.

This is perhaps best illustrated in the case of the Boko Haram insurgency in the north of the country, which has had a marked impact on the region's agricultural sector for well over a decade. The group has been known to levy taxes on farms and on the sale of agricultural products in the regions it takes over,¹³ and its presence has also been shown to lead to a "sharp decline in agricultural production, as farmers suffer the consequences of a destruction of assets, lost access to farm inputs, and in some cases faced total displacement." According to a report by the World Bank, between 2010 and 2015 the northeast region suffered an accumulated output loss of US\$8.3 billion.¹⁴ As is to be expected, the loss of work and severe reduction in agricultural output due to sustained attacks in the region have a significant impact on the cost of food for average households. This, in turn, leads to inflation and subsequently a reduction in people's incomes, ultimately leading to a reduction in overall prosperity.

In the longer term, these perennial security challenges and the difficult economic conditions they entail lead to a more pervasive impact on prosperity in the form of the so called "brain drain," as skilled Nigerians seek to leave the country in search of both security and financial reward. As Adebisi Adenipekun rightly observes in his article on the brain drain phenomenon: "The push factor in Nigeria transcends the challenges with the healthcare

system. . . . Healthcare providers and their families are not immune to the impact of inflation, increased rates of banditry, and kidnapping experienced in the country.”¹⁵ With those able to leave doing so in droves (between 2021 and 2022 alone, the United Kingdom received 13,609 healthcare workers from Nigeria¹⁶) and those who choose to stay suffering from a significant impact on their economic well-being, there is little doubt that a redress of the security and order balance in Nigeria is a priority for its government.

However, significant funding gaps have emerged in Nigeria’s security forces over the past two decades, inhibiting any improvements. In 2022, Nigeria’s budget for military defence expenditure was about 1.19 trillion naira (\$2.87 billion), amounting to 0.6 percent of GDP.¹⁷ That same year, spending on fuel subsidies across the country amounted to about 4.4 trillion naira (\$10 billion), measuring 2.20 percent of GDP.¹⁸ At present, Nigeria has one of the lowest military-to-population ratios in the world, the Nigerian military stands at 223,000 with a military personnel per 1,000 capita of 1.14. In contrast, the United States military stands at 2.13 million with a military personnel per capita of 6.5, China has 4.02 million personnel with 2.9 per capita, Egypt has 1.3 million personnel with 13.21 per capita and Indonesia has 1.1 million personnel with 4.11 per capita.¹⁹ These figures highlight the significant disparity in the availability of the military personnel between Nigeria and these countries in comparison to their population sizes. With increased security threats posed by insurgencies in the northeast, conflict between herders and farming communities in the northwest, and the high levels of recurrent abductions and banditry across the nation, this force requires commensurate funding in order to guarantee order and security for the Nigerian public.

Both the more tangible threats to physical safety, and longer-term issues such as food insecurity and mass migration that are in part a direct result of these threats, lead to the following conclusion: a reevaluation and ultimate strengthening of government’s

role in the shaping of the nation's legal freedoms—with particular reference to order and security—is needed to ensure prosperity in both the immediate and long term. Ultimately, hypotheticals surrounding the liberalization of trade or the removal of subsidies prove aimless if they fail to take into account the fact that they are underpinned by security needs that must also be met.

Conclusion

As a businessperson, one may enjoy the freedom of hypothesizing from the sidelines, and perhaps indulging in a degree of blue-sky thinking, that is not enjoyed by those in government. In exploring these two indicators of prosperity—economic and legal freedoms—in the context of an excess or lack of government intervention, the equation that emerges is one of significant potential surplus with regards to the former, with a marked level of need in the latter. How then would this equation look were government to liberalize trade, remove subsidies, and redirect funding to nurture other freedoms, such as security and order? Could this, perhaps, be a step toward solving the elusive equation of true, sustained prosperity? One thing, however, is left in no doubt: Nigeria boasts immeasurable potential, and with its abundant natural resources and a young, growing population, its star has the potential to rise once again.

Freedom and prosperity in Eastern Europe¹

Dan Negrea
Joseph Lemoine
Yomna Gaafar

IT IS ONE OF THE most important development questions of all time: Do countries need freedom to achieve prosperity? Our paper explores this question by analyzing the evolution since the early 1990s of a select group of Eastern European countries.

The countries we studied shared many similarities in the early 1990s. Politically, they had all been under Communist rule until the late 1980s, and some had never even been independent countries before the dissolution of the Soviet Union and Yugoslavia. Economically, they were at a comparable development level at the time of the democratic revolutions that swept Eastern Europe in the late '80s and early '90s.

But by 2021 the group was no longer homogenous: they had different levels of freedom and some experienced robust prosperity while others stagnated. Using the scoring and ranking analysis of the Atlantic Council's Freedom and Prosperity Indexes,² and other measurements, we show that the countries that experienced more political, economic, and legal freedoms enjoyed greater prosperity.

Dan Negrea is the senior director of the Freedom and Prosperity Center at the Atlantic Council.

Joseph Lemoine is the deputy director of the Freedom and Prosperity Center at the Atlantic Council.

Yomna Gaafar was an assistant director of the Freedom and Prosperity Center at the Atlantic Council.

Conversely, those that made less progress on the path of freedom are also less prosperous.

The context

The question of the correlation between freedom and prosperity is always worth studying. But the war in Ukraine gives the debate over development models new timeliness.

Russia's invasion of Crimea in 2014 was preceded by an internal crisis in Ukraine. When President Viktor Yanukovich rejected a deal for greater integration with the European Union (EU), Russia backed Yanukovich's violent attempt to put down protests by Ukrainian citizens who disagreed with his decision. Russia did not want Ukraine to become prosperous and democratic. This would have contrasted with the economically moribund and politically oppressive authoritarian regimes in Russia and Belarus, and might have inspired the peoples in these countries to ask for change. The 2022 Russian invasion was an attempt to finish the job started in 2014. Putin is trying to keep Ukraine in the Russian sphere of influence, and have it resemble Russia, politically and economically.

In its essence, the Ukraine war is about two visions for Eastern Europe: Will Russia succeed in using political subversion and military force to impose its authoritarian model? A model in which democratic opponents are imprisoned and killed, and economic activity is rife with corruption and arbitrary interventions by the dictatorial elite. Or will the peoples of Eastern Europe be able to choose their own political and economic system without interference and adopt the democratic and free market model represented by the EU?

This is a pivotal moment of change for Eastern Europe, similar in significance to that of the collapse of the Soviet Union. Examining the progress made by several former Communist countries

over the past thirty years can provide useful lessons for the countries of the region and elsewhere.

The analysis

We started by selecting, from among Europe's formerly Communist countries, a group with a comparable level of economic development in 1996, the first year for which World Bank data are available for all post-Communist countries. We selected only countries that were categorized as lower-middle income, according to the World Bank's classification for that year: Albania, Belarus, Bulgaria, Estonia, Latvia, Lithuania, Montenegro, North Macedonia, Romania, Russia, Serbia, and Ukraine.

We excluded from our analysis higher-middle income formerly Communist countries: Poland, Croatia, Czech Republic, Hungary, Slovak Republic, and Slovenia. These countries were more developed at that time and were on a different trajectory than the selected countries.

For best comparability, we also excluded low-income formerly Communist countries: Moldova, and Bosnia and Herzegovina. Because of the catch-up effect, low-income countries tend to grow faster, which would have distorted the results of our analysis.

We then ranked the selected countries using their 2021 scores in the Atlantic Council's Freedom Index. This Index assigns scores to 174 countries on their economic, political, and legal freedoms, the latter reflecting the strength of the rule of law in a country. Depending on their score, countries are then categorized as Free, Mostly Free, Mostly Unfree, and Unfree.

We then created two groups of countries. Group 1 includes all countries in the selected group that are in the "Free" category of the Freedom Index. Group 2 includes all other countries in our selected group.

Next, for countries in both groups, we compared their GDP per capita levels in 1996 and 2021, and calculated GDP growth multiples for each country and for both groups.

We also checked which countries had escaped the “middle-income trap” by 2021. This term refers to the fact that, over the years, many developing countries succeeded in advancing from the World Bank’s low-income to the middle-income category but did not cross the threshold of the high-income category.

The final element of our analysis was to look at 2021 measures of development, in addition to GDP per capita. We used the Atlantic Council’s Prosperity Index, which measures health, the environment, happiness, and government treatment of minorities in addition to GDP per capita (Table 1).

The results

- In 2021, the countries in Group 1 had a freedom score 40 percent higher than that of the countries in Group 2. The average freedom score for Group 1 was 82, which compares favorably with the average of OECD countries in this Index at 85. The freedom score average for Group 2 was only 57.
- By 2021, the countries in Group 1 were more prosperous than those in Group 2. Looking at GDP per capita, Group 1 countries grew 32 percent faster (GDP per capita increased threefold, on average) than those in Group 2 between 1996 and 2021 (Table 1 and Figure 1). In Group 2, only Albania and Montenegro reached growth levels similar to those of Group 1 countries. Although belonging to the lower-middle income group, their respective GDP levels were the lowest of the two groups in 1996. This confirms that, other things being equal, economic growth is faster when a country starts from a lower level.

Table 1. Former Communist lower-middle income countries in Eastern Europe

	Freedom score 2021	Freedom category	GDP per capita 1996	GDP per capita 2021	GDP growth multiple	Escaped middle-income trap	Prosperity score 2021
Estonia	87	Free	13,559	38,207	2.8	Y	66
Lithuania	82	Free	11,275	38,958	3.5	Y	64
Latvia	82	Free	9,961	31,689	3.2	Y	63
Romania	76	Free	12,627	30,855	2.4	Y	60
Group 1 average	82		11,856	34,927	3.0		63
Bulgaria	71	Mostly Free	12,016	23,432	2.0	N	56
Montenegro	64	Mostly Free	12,579 ^a	20,567	1.6	N	55
Albania	64	Mostly Free	4,909	14,520	3.0	N	56
North Macedonia	63	Mostly Free	9,104	16,464	1.8	N	54
Serbia	62	Mostly Free	8,246	19,762	2.4	N	60
Ukraine	54	Mostly Free	7,180	12,944	1.8	N	48
Russia	41	Mostly Unfree	12,827	27,970	2.2	N	49
Belarus	39	Mostly Unfree	5,988	19,751	3.3	N	50
Group 2 average	57		9,106	19,426	2.3		54

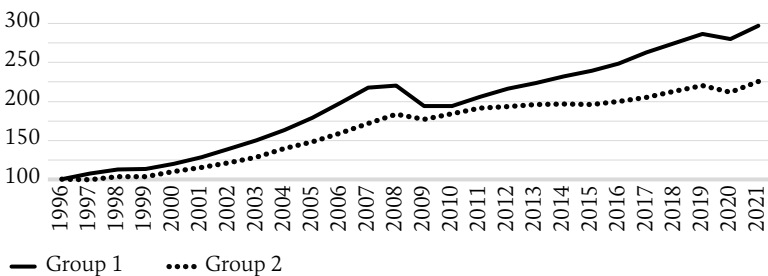
^a For Montenegro, the 1996 GDP value is for 1997, the earliest available.

The Freedom and Prosperity Equation

Sources: Scores and categories are from the Atlantic Council's Freedom Index and Prosperity Indexes (Dan Negrea and Matthew Kroenig, "Do Countries Need Freedom to Achieve Prosperity? Introducing the Atlantic Council Freedom and Prosperity Indexes," Atlantic Council, <https://www.atlanticcouncil.org/in-depth-research-reports/report/do-countries-need-freedom-to-achieve-prosperity>.) GDP per capita data are measured by purchasing power parity (PPP), constant 2017 international dollars: data from the World Bank, <https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.KD>. The high-income threshold (middle-income trap limit) for 2021 was set by the World Bank at \$13,205 GNI per capita, Atlas method, current US dollars (different scale from the GDP per capita values in Table 1).

- The gap between the two groups consistently increased over time (Figure 1). Freedom takes time to materialize, but the benefits compound.
- All countries in Group 1 escaped the middle-income trap. None of the countries of Group 2 did so.
- All countries in Group 1 also tend to rank better in the broader Prosperity Index than those in Group 2. Serbia is the only Group 2 country to achieve a prosperity score within three points of the Group 1 average. Although Serbia's GDP growth multiple is consistent with those of the other countries in Group 2, it outperforms them on the environment and happiness indicators in the Prosperity Index, thus raising its total prosperity score.

Figure 1. GDP per capita growth, 1996–2021

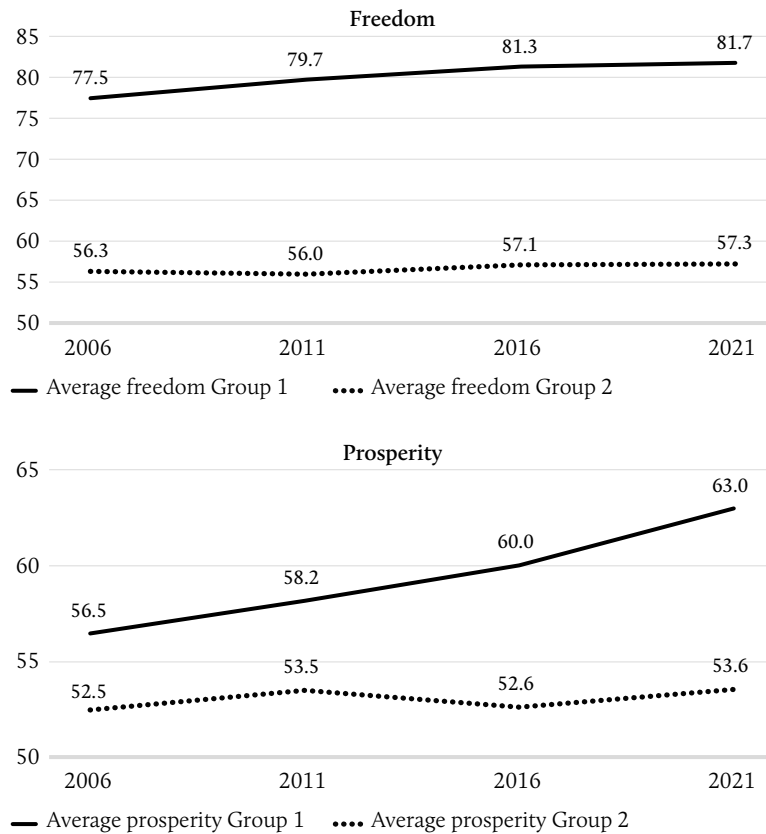


Note: Average GDP per capita, PPP, constant 2017 international dollars, (1996=100)

Source: Data from World Bank.

Another way to explore the performance of the two groups of countries is to use the scores in the Freedom Index and the Prosperity Index for the past fifteen years (Figure 2). Over that period (2006–21), the Group 2 countries improved their average score in both the Freedom Index and the Prosperity Index by 2 percent. But the Group 1 countries improved their scores on each index by 5 percent and 11 percent, respectively.

Figure 2. Average freedom and prosperity scores, 2006–21



Source: Atlantic Council's Freedom and Prosperity Indexes.

Higher and improving freedom scores are associated with countries that also achieved increased prosperity. Such situations create virtuous cycles of mutual reinforcement in which more freedoms build a prosperous middle-class citizenry that demands yet more freedoms that in turn perpetuate more human flourishing.

Policy implications

Our data suggest that countries that want to increase their prosperity should increase their economic, political, and legal freedoms, with legal freedom being defined as an impartial rule of law; transparent, corruption-free, and effective political institutions; and good governance.

Our analysis also points to a positive role for the EU. All the countries in Group 1 are members of the EU, as is Bulgaria, the Group 2 country with the highest freedom score and second highest prosperity score in that group. All the other countries in Group 2 are candidates to EU membership, with two exceptions: Russia and Belarus. These two countries have the worst freedom scores and the second and third worst prosperity scores in our sample.

The source of the appeal of EU membership is clear. In 2021, the average freedom score of EU member countries was 82, which compared with 62 for our group of EU candidate countries, or 32 percent higher. The respective prosperity scores were 75 and 55, or 37 percent higher. Using a narrower measure of prosperity, the respective 2021 GDP per capita numbers were \$44,024 and \$16,851, or 161 percent higher.

Former Soviet Bloc countries that joined the EU left behind the Communist world of political repression, inefficient centrally planned economies, and corrupt judicial processes. Instead, they entered a world of political and economic freedom, respect for the

rule of law, and prosperity. The EU offers these countries a free trade area for their companies pursuing business growth, and freedom of movement for their citizens seeking educational and work opportunities.

During the long years of preparation for EU accession, candidate countries have had to implement many profound reforms and show perseverance in their progress away from their Communist past. Corruption, in particular, was a pervasive problem. The current EU membership candidates will need leaders with strong political will, who are prepared to push meaningful reforms—especially in their national judicial and law-enforcement systems.

Some analysts and public commentators in Western democracies complain that the EU's leadership is unelected and unaccountable to voters, that the EU is overly bureaucratic and growing more so, and that it is often insensitive to the cultural traditions of member countries. To a majority of the Brexit referendum voters in the UK, a developed country with a long democratic tradition, these and other perceived disadvantages of EU membership outweighed its benefits.

But for Eastern Europe's former Communist countries, the EU's many rules and standards catalyzed a national consensus for the profound reforms needed in order to leave behind the malevolent and malfunctioning Communist political and economic system. Today, EU support and guidance for reform in candidate member states, towards their EU membership, contributes to more freedom and prosperity in these countries.

Which leads us to Ukraine, whose strong desire to join the EU, and the free world in general, was one of the main reasons for the Russian aggression against it, both in 2014 and in 2022. The Ukrainian people have heroically proven their firm determination to be forever free from domination by the Russian state, which is

still beset by many of the Soviet Union's pathologies in its political and economic structure.

In 2022, Ukraine asked for accelerated consideration of its EU membership, and the EU granted it candidate status. But Ukraine has a long way to go to meet EU standards. Its standing in the Atlantic Council's Indexes makes this very clear: in 2021, before the full-scale Russian invasion, Ukraine had the third lowest freedom score among Group 2 countries and the lowest prosperity score.

In time the war will end, and Ukraine will rebuild. Ukraine will need profound societal reforms as part of its rebuilding process, especially regarding corruption. Its people will have to show in this task the same courage and determination as they are showing in the war. But they are very clear about their choice. They believe that greater economic, political, and legal freedoms are the surest path toward prosperity. And that the EU has an important role to play in helping them along the way.

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Who came first: Freedom or prosperity? An inquiry about liberty and well-being

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$$y(t) - y(t-1)$$

Where $y(t)$ is the variable’s value at time t , and $y(t-1)$ is its value in the previous period. The resulting time series of first differences is often used in econometric models such as ARIMA and VAR.

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Violence against journalists: A tool to restrict press freedom in Mexico

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Understanding India’s freedoms on the path to prosperity

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**Scaling up the transatlantic partnership from security to prosperity:
Economic resilience in Eastern Europe**

- 1 “Eastern Europe” will be used throughout the chapter to refer both to EU member states from East-Central Europe (ECE) and non-EU member states from the EU’s eastern periphery or Eastern Partnership (EaP).
- 2 East-Central Europe (ECE) consists of the eleven post-communist EU member states: Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, Slovakia, and Czechia.
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Contributors

Sergio M. Alcocer (Mexico)

Sergio is the president of the Mexican Council of Foreign Affairs (COMEXI). He is also a research professor at the Institute of Engineering of the National Autonomous University of Mexico (UNAM) and the former undersecretary for North America in the Ministry of Foreign Affairs of Mexico. He earned his PhD from the University of Texas at Austin.

Elakiya Ananthkrishnan (India)

Elakiya is a research staff at the London School of Economics. She works on “Women’s Empowerment, Economic Freedom, and the Role of Law in Driving Prosperity,” a research project funded by the John Templeton Foundation.

Ignacio P. Campomanes (Spain)

Ignacio is resident fellow of the Navarra Center for International Development at the Institute for Culture and Society at the University of Navarra. He holds a PhD in economics from the University of Minnesota.

Camelia Crișan (Romania)

Camelia is assistant professor at the National School of Political Science and Public Administration in Romania and the managing director of Project Romania 2030—an accelerator of ideas and solutions as part of a movement to generate a “historical leap” for

Romania. She holds a PhD from the National University of Political Studies and Public Administration in Bucharest.

Juan José Daboub (El Salvador)

Juan is the former minister of finance of El Salvador and former second ranking official at the World Bank.

Mohamed M. Farid (Egypt)

Mohamed is a member of the Egyptian Senate and the deputy chair of its Committee on Human Rights and Social Solidarity. He is also a founding member of the Liberal Club in Cairo.

Yomna Gaafar (Egypt)

Yomna was assistant director of the Freedom and Prosperity Center at the Atlantic Council. She worked previously at the Egyptian Ministry of Economic Development.

Jeziret S. Gonzáles (Mexico)

Jeziret is a journalist with expertise in geopolitics and human rights. She is a member of the Mexican Council on International Affairs.

Ulisses Monteiro Ruiz de Gamboa (Brazil)

Ulisses is a researcher at the Mackenzie Center for Economic Freedom and a professor of the graduate program in economics and markets at Mackenzie Presbyterian University. He holds a PhD from the University of California, Los Angeles.

Markus Jaeger (Germany)

Markus is adjunct associate professor of international and public affairs at Columbia University School of International and Public Affairs and a fellow at the German Council on Foreign Relations. Previously he was a director at Deutsche Bank in New York and London, where he held advisory and research roles. He attended

Sciences Po and holds an MSc and PhD from the London School of Economics.

Khémaies Jhinaoui (Tunisia)

Khémaies is a former minister of foreign affairs of Tunisia and former ambassador to the United Kingdom, Russia, and Ukraine. He is president and founder of the Tunisian Council for International Relations. He holds a PhD from the National Defense College in Tunisia.

Michael Klein (Germany)

Michael is a professor at the Frankfurt School of Finance and Management in Germany and a senior adjunct professor at the School of Advanced International Studies at Johns Hopkins University in Washington D.C. Michael held senior leadership positions at the World Bank between 1982 and 2009. Most recently he was vice president for financial and private sector development and before that was chief economist for the International Finance Corporation. He holds a PhD from the University of Bonn.

Joseph Lemoine (France)

Joseph is the deputy director of the Freedom and Prosperity Center at the Atlantic Council. He worked previously on indexes at the World Bank.

Brad Lips (United States of America)

Brad is the CEO of Atlas Network, which increases opportunity and prosperity by strengthening a global network of independent civil society organizations that promote individual freedom and remove barriers to human flourishing.

Julio C. Amador Díaz López (Mexico)

Julio is an assistant professorial lecturer in the Data Science Institute at the London School of Economics. He holds a PhD from the University of Essex.

Vladimir Fernandes Maciel (Brazil)

Vladimir is the head of the Mackenzie Center for Economic Freedom and professor in the graduate program in economics and markets at Mackenzie Presbyterian University.

Kris Mauren (United States of America)

Kris is the co-founder and president of Acton Institute, a think tank whose mission is to promote a free and virtuous society characterized by individual liberty and sustained by religious principles.

Prashant Narang (India)

Prashant is a senior fellow at the Centre for Civil Society in India.

Dan Negrea (United States of America)

Dan is the senior director of the Freedom and Prosperity Center at the Atlantic Council. He formerly held leadership positions in the Policy Planning Office and the Economic Bureau at the US Department of State.

Jamie Bologna Pavlik (United States of America)

Jamie is an associate professor of agricultural and applied economics at Davis College of Agricultural Sciences and Natural Resources at Texas Tech University. She earned her PhD from West Virginia University.

Julian Alexienco Portillo (Brazil)

Julian is a researcher at the Mackenzie Center for Economic Freedom and professor in the undergraduate program in economic

science at Mackenzie Presbyterian University. He holds a PhD from Mackenzie Presbyterian University.

Benjamin Powell (United States of America)

Benjamin is the executive director of the Free Market Institute at Texas Tech University and a professor of economics at the Rawls College of Business. He holds a PhD from George Mason University.

Luis Ravina Bohórquez (Spain)

Luis is the director of the Navarra Center for International Development and professor of international economy at the University of Navarra. He holds his PhD from the Complutense University of Madrid.

Vanessa Rubio-Márquez (Mexico)

Vanessa is the associate dean for extended education in the School of Public Policy at the London School of Economics. She had a twenty-five year career in Mexico's public service, including serving as senator and three times deputy minister.

Paulo Rogério Scarano (Brazil)

Paulo is a researcher at the Mackenzie Center for Economic Freedom and head of the graduate program in economics and markets at Mackenzie Presbyterian University. He holds his PhD from the Pontifical Catholic University of São Paulo.

Parth J. Shah (India)

Parth is the founder and president of the Centre for Civil Society, one of India's leading free-market think tanks. He teaches at the Indian School of Public Policy. He holds a PhD in economics from Auburn University.

George Ștefan (Romania)

George is assistant professor at the Bucharest University of Economic Studies, where he also obtained his PhD.

Danladi Verheijen (Nigeria)

Danladi is a leading Nigerian venture capital and private equity investor. He previously held roles with Citibank and McKinsey & Company. He holds an MBA from Harvard Business School and an MSc from Stanford University.

Clara Volintiru (Romania)

Clara is a professor at the Bucharest University of Economic Studies and director of the Bucharest Office of the German Marshall Fund and of the Black Sea Trust. She earned her PhD from the London School of Economics.

Andrew Young (United States of America)

Andrew is a professor of economics at the Rawls College of Business at Texas Tech University, and research fellow and director of graduate students at the Free Market Institute. He earned his PhD from Emory University.

Thirty scholars and political leaders from twelve countries have contributed seventeen essays to this volume. They make the case that durable prosperity is achieved in countries with economic, political, and legal freedom.

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Aigboje Aig-Imoukhuede, Chairman and Co-Founder, and Ofovwe Aig-Imoukhuede, Executive Vice-Chair and Co-Founder, Aig-Imoukhuede Foundation, Nigeria

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Keith Krach, Chairman of the Krach Institute for Tech Diplomacy at Purdue and former Under Secretary of the U.S. Department of State and CEO of DocuSign

“This volume offers a diverse set of perspectives on how to align freedom and prosperity as the determinants of the democratic equation.”

Vanessa Rubio-Márquez, Professor at the London School of Economics, and former Mexican Senator and Under Secretary of the Departments of Finance, Social Development, and Foreign Affairs

“This wide collection of essays demonstrates how true freedom and prosperity can only be achieved through policies that prioritize the empowerment of individuals and promotion of entrepreneurship, innovation, and inclusive growth.”

Lakshmi Goyal, Chief Executive Officer, Center for Civil Society, India



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