

Foreword

I don't know who first used the word "globalization," but he was probably no friend of capitalism. The word is bureaucratic and implies that the world economy is subject to the control of some vast, nefarious force beyond human influence. The reality is that the world economy is enjoying its strongest run of prosperity in 40 years thanks to the greater ability of billions of individuals to make free choices in their own self-interest. The *Index of Economic Freedom* has been encouraging this trend for 14 years, and at the end of 2007, we can happily say it continues.

The world economy extended its multiyear run of 5 percent or so annual GDP growth this year, notwithstanding an American slowdown due mainly to the housing correction. As I write this, the U.S. economy seems to have survived the August credit crunch related to the collapse of the sub-prime mortgage market. The summer squall showed once again how interrelated financial markets have become, with sub-prime losses popping up around the world and even

causing an old-fashioned bank run at Northern Rock in the United Kingdom.

The episode is naturally leading to soul-searching about the stability of this brave new world of global finance—including the spread of asset securitization, the rise of hedge funds, and an explosion in derivatives. This introspection ought to be healthy. The sub-prime fiasco has, at the very least, exposed the need for more careful vetting by investors, but regulators and bankers are also sure to examine the rules for transparency and capital requirements to prevent the spread of problems throughout the financial system. The event also shows the need for more careful driving by America's Federal Reserve, whose easy-money policy in the first half of this decade was the root cause of the housing boom and bust. The good news is that, at least so far, there hasn't been a regulatory overreaction that could stymie growth.

The irony of the year has been the shifting economic policy trends in America and France, of all places. The U.S. political debate

is moving in a negative direction as “fairness” and income redistribution replace growth as the policy lodestar and proposals for tax increases proliferate. The Bush tax cuts of 2003 were crucial to kicking the economy out of its post-9/11, post-dot.com doldrums. But they expire after 2010 and are in serious jeopardy. The free-trade agenda has also stalled as bilateral pacts with Latin America and South Korea face heavy going on Capitol Hill. The 2008 election will be as much a referendum on economic policy as on foreign policy.

Perhaps the rest of the world will have to teach America a policy lesson or two. As the *Index* shows, Europe overall has moved in a freer direction this decade. This is due in large part to reform in the former Eastern Europe, as well as to the policy competition caused by the success of the euro. With capital and people free to move and governments no longer able to inflate their way out of fiscal difficulty, the trend has been toward lower tax rates and labor market liberalization.

Miracle of miracles, even France has been mugged by this reality. Nicolas Sarkozy made the revival of the French economy a main theme of his successful campaign for president, and he has followed with proposals for what he called “a new social contract founded on work, merit and equal opportunity.” We should all hope he

succeeds—not merely to compensate for any slowdown in America, but for its own sake to help Europe break away from its self-imposed sense of diminished expectations. In any event, this policy churning in Europe shows how the ability to move capital freely across borders imposes a price on bad government decisions.

The larger point is that if we step back from the daily turmoil, we can see that we live in a remarkable era of prosperity and spreading freedom. Hundreds of millions of people are being lifted out of poverty around the world as global trade and investment expand and countries like India and China liberalize parts of their economies. The International Monetary Fund reported in early 2007 that every country in the world, save for a couple of small dictatorships, was growing. This prosperity can itself create discontent due to the rapidity of change, and it certainly poses a challenge to political leaders who are obliged to explain and manage its consequences. The *Index of Economic Freedom* exists to help in that explanation, and we hope readers continue to find it a source of comparative policy wisdom.

Paul A. Gigot
Editorial Page Editor
The Wall Street Journal
October 2007