

Chapter 5

Economic Freedom and the Pursuit of Happiness

Sebastiano Bavetta, Ph.D., and Pietro Navarra, Ph.D.

Seventeen years of freedom measurements conducted by The Heritage Foundation show that economic freedom and economic prosperity go hand in hand. The strong relationship between the two variables is important and desirable. Nonetheless, the relationship is subject to criticism for ignoring other important aspects of prosperity that involve non-material aspects of subjective well-being such as happiness. In broadening the understanding of the relationship, it is necessary to expand the concept of economic freedom so that it can explicitly encompass individuals' conscious and responsible exercise of free choice.

This chapter looks at ways in which a measure of economic freedom like the *Index of Economic Freedom* might be broadened to include a quantitative assessment, through subjective testimony, of a constitutive aspect of economic freedom—that is, the extent of responsible exercise of free choice—and then tests the interrelationships between the more broadly defined economic freedom and well-being.

EXERCISING FREE CHOICE

In a celebrated essay on freedom, Isaiah Berlin singled out the notion of *negative freedom*: that is, being free *from* impediments (chiefly coercion by other people or the state) in the exercise of one's voluntary actions.¹ One might measure such voluntariness empirically through data that reflect an individual's opportunity to choose in a given legal or policy environment.

This, in fact, is the thrust of The Heritage Foundation's *Index of Economic Freedom*. The following passage from the 2010 *Index* is revealing in this regard:

A comprehensive definition of economic freedom should *encompass all liberties and rights of production, distribution, or consumption of goods and services. The highest*

1. See "Two Concepts of Liberty," in Isaiah Berlin, *Four Essays on Liberty* (London: Oxford University Press, 1996).

form of economic freedom should provide an absolute right of property ownership; fully realized freedoms of movement for labor, capital, and goods; and an absolute absence of coercion or constraint of economic liberty beyond the extent necessary for citizens to protect and maintain liberty itself. In other words, individuals in an economically free society would be free and entitled to work, produce, consume, and invest in any way they please under a rule of law, with their freedom at once both protected and respected by the state.²

All of the features of economic freedom mentioned by the *Index's* authors—foremost among them the explicit reference to voluntary exchange—recall, within the Berlinian frame, the idea of voluntariness of action and absence of coercion by the state. While this idea goes a long way in defining and delineating economic freedom, some thoughtful writers have suggested that there may be more to consider.

In his fundamental contribution to a contractarian theory of the state, James Buchanan writes that “the free market offers maximal scope for private, personal eccentricity, for individual freedom in its most elementary meaning.”³ Similarly, Milton Friedman highlights, chiefly in *Capitalism and Freedom* and *Free to Choose*,⁴ the intimate relationship that ties economic freedom to diversity. Consider, for example, the following:

The characteristic feature of action through political channels is that it tends to require or enforce substantial confor-

mity. The great advantage of the market, on the other hand, is that it permits wide diversity. It is, in political terms, a system of proportional representation. Each man can vote, as it were, for the color of the tie he wants and get it; he does not have to see what color the majority wants and then, if he is in the minority, submit.

It is this feature of the market we refer to when we say that the market provides economic freedom.⁵

The interesting point in both Buchanan and Friedman's quotations is that they identify the possibility of shaping one's own view of life in a unique fashion offered by market exchanges as the essential feature of economic freedom. This is hardly surprising. Many authors share the romantic view—masterfully canvassed by John Stuart Mill—that self-determination is a fundamental part of being free. In this conception, it is not enough to have the opportunity to choose; rather, the act of choosing, and the acceptance of responsibility for the consequences of the choices made, is the focal point around which one's individuality is shaped and fostered, leading to the exercise of a person's autonomy. This notion of autonomy is elaborated in a field of normative economics known as the Freedom of Choice Literature.⁶ Given its relatively recent elaboration and the difficulties of quantifying the concepts involved, it is perhaps not surprising that this idea of autonomy as a constitutive dimension of freedom has received scant treatment in conventional measures of economic freedom.

The authors of the *Index* deal indirectly with this issue by identifying what they call “fundamental principles of economic freedom—empowerment of the individual, non-discrimination, and open competition—[that] underpin and inform every measurement in

2. Terry Miller and Anthony B. Kim, “Defining Economic Freedom,” Chapter 5 in Terry Miller and Kim R. Holmes, Ph.D., *2010 Index of Economic Freedom* (Washington: The Heritage Foundation and Dow Jones & Company, Inc., 2010), p. 58.

3. James M. Buchanan, *The Limits of Liberty: Between Anarchy and Leviathan* (Chicago: University of Chicago Press, 1975), p. 18.

4. See Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), and Milton Friedman and Rose Friedman, *Free to Choose: A Personal Statement* (New York: Harvest Books, 1990).

5. Friedman, *Capitalism and Freedom*, p. 15.

6. See Sebastiano Bavetta and Francesco Guala, “Autonomy Freedom and Deliberation,” *Journal of Theoretical Politics*, Vol. 15, No. 4 (October 2003), pp. 423–443.

the *Index of Economic Freedom*.⁷ The *Index* does not, however, attempt to provide empirical data that directly measure these fundamental principles of economic freedom.

The following analysis attempts to fill that gap, using an empirical measure of autonomy introduced by Bavetta *et al.* in 2009⁸ that is based on data from the World Values Survey (WVS).⁹ The goal is to determine whether and the extent to which the effect on well-being exercised by an individual's perception of his or her autonomy (autonomy freedom) is either reinforced or moderated by the traditional measures of economic freedom involving the absence of government coercion.

THEORETICAL HYPOTHESES

The basic claim of this analysis is that economic freedom and autonomy freedom complement each other in the enhancement of an individual's well-being. This claim can be tested through the development and examination of two theoretical hypotheses.

Hypothesis 1: *For a given level of autonomy freedom, the probability of greater well-being is higher for individuals who live in countries with a higher level of economic freedom and lower for individuals who live in countries with a lower level of economic freedom.*

Consider two countries. In the first, state intervention supplants individual decision processes, leading to atrophy of people's deliberative skills and attitudes. In such a country, citizens are mere recipients of public goods and services, the quantity and quality of which are decided by others. Under these circumstances,

7. Miller and Kim, "Defining Economic Freedom," p. 57.

8. See Sebastiano Bavetta, Maria Bottero, Dario Maimone Ansaldo Patti, and Pietro Navarra, "Autonomy Freedom: An Empirical Measure for a Theoretical Concept," mimeographed, London School of Economics, Centre for Philosophy of Natural and Social Science, 2009.

9. See World Values Survey 1981–2008 Official Aggregate v. 20090901, 2009. *World Values Survey Association* (www.worldvaluessurvey.org). *Aggregate File Producer*: ASEP/JDS, Madrid.

it is unlikely that acting autonomously delivers happiness; people have few if any opportunities for self-determination, and real choices are severely constrained. In the second country, market institutions and private ownership are firmly established. People are the masters of their lives and, acting out of their own choices, determine the quantity and quality of the goods and services they consume. In such a country, though the exercise of freedom of choice entails some costs, as far as it gives people control over their lives, it makes them happier.

The first country is representative of state-led economies—for example, a former Communist country in Eastern Europe or an authoritarian state in the Middle East—where goods and services are publicly provided and people are passive recipients of heteronymous choices made by the government. The second is representative of market economies—for example, an Organisation for Economic Co-operation and Development (OECD) country—where private enterprise guides the allocation of goods and services to their most efficient use out of people's voluntary choices.

Hypothesis 2: *A given increase in autonomy freedom has a larger impact on well-being in countries where economic freedom is lower and a smaller impact on well-being in countries where economic freedom is higher.*

Although changes in the level of economic freedom affect the relationship between autonomy and well-being as described in Hypothesis 1, it is important to examine the effect on individual well-being of changes in autonomy for different levels of economic freedom. We hypothesize that a given change in autonomy grants higher well-being returns in countries that are characterized by a lower level of economic freedom.

Consider two countries with different levels of economic freedom. In the first, a high degree of economic freedom makes a wider set of opportunities to choose available to individuals. Such opportunities, however, bring

about higher deliberative costs for decision makers since processing the available information in order to make truly autonomous choices requires greater effort. The exercise of autonomous behavior has limited effects on well-being. In the second country, low levels of economic freedom leave individuals with few opportunities for choice. Under this circumstance, an increase in autonomy is unlikely to bring about the higher deliberative costs that might lead to significant improvements in the perceived level of well-being. Therefore, we expect that the same increase in the level of autonomy provides greater well-being returns in countries that are characterized by a lower level of economic freedom.

Hypotheses 1 and 2 can be empirically tested.

DATA AND EMPIRICAL METHODOLOGY

The data used in this empirical analysis are drawn from two main sources: the World Value Survey database and The Heritage Foundation/Wall Street Journal *Index of Economic Freedom*. The dataset allows a cross-country analysis that takes into consideration about 60 countries over a time span covering the period 2004–2008. The list of countries under investigation in the empirical analysis is reported in Table 1.

The dependent variable in the empirical analysis is the extent of well-being enjoyed by individuals. The two measures commonly adopted in the literature to evaluate the extent of individual well-being are happiness and life-satisfaction. Data for both variables are drawn from the WVS database. Happiness is assessed by asking respondents to indicate how happy they are, using four categories:

“very happy,” “rather happy,” “not very happy,” and “not at all happy.” On the basis of this scale, a binary dummy variable is constructed taking the value of 1 if the individual is rather happy or very happy and 0 otherwise. Life satisfaction is measured by asking respondents to indicate how satisfied they are with their life as a whole, using a scale that ranges from 1 (not at all satisfied) to 10 (very satisfied). Again, a binary dummy variable takes the value of 1 if the individual’s level of life satisfaction falls between 6 and 10 and the value of 0 otherwise.

Happiness and life satisfaction are two different elements of subjective well-being. In order to corroborate the results of the analysis, each person’s responses to the questions about happiness and life satisfaction are combined to produce a composite measure of subjective well-being (SWB) by giving equal weight to each variable. However, to accomplish this task, it is necessary to consider two facts.

- Life satisfaction is measured on a 10-point scale, while happiness is measured on a four-point scale, and
- The two survey questions have opposite polarity.

Countries Under Investigation in This Analysis

Argentina	India	Rwanda
Australia	Indonesia	South Africa
Brazil	Iran	South Korea
Bulgaria	Iraq	Serbia
Burkina Faso	Italy	Slovenia
Canada	Japan	Spain
Chile	Jordan	Sweden
China	Malaysia	Switzerland
Colombia	Mali	Taiwan
Cyprus	Mexico	Thailand
Egypt	Moldova	Trinidad and Tobago
Ethiopia	Morocco	Turkey
Finland	Netherlands	Ukraine
France	New Zealand	Uruguay
Georgia	Norway	United Kingdom
Germany	Peru	United States
Ghana	Poland	Vietnam
Guatemala	Romania	Zambia
Hong Kong	Russia	

Table 1  heritage.org

Therefore, following Ronald Inglehart *et al.*,¹⁰ the SWB composite index is constructed as follows: SWB = life satisfaction – 2.5 × happiness. If 100 percent of a given country’s people are very happy and extremely satisfied, such a country will get the maximum score of 7.5. If happiness and life satisfaction are evenly balanced, the country will get a score of zero. If there are more people dissatisfied or unhappy than satisfied or happy, the country will get a negative score. As before, a binary dummy variable takes the value of 1 if SWB ranges between 5 and 7.5 and 0 otherwise.

The determinant of individual well-being is freedom of choice. As noted, there are two aspects of free choice: *opportunity* to choose and *autonomy* to choose. To calculate the extent to which individuals enjoy opportunity to choose, we use The Heritage Foundation/Wall Street Journal *Index of Economic Freedom*. This is a numerical indicator that ranges between 0 (the lowest degree of economic freedom) and 100 (the highest degree of economic freedom). For the sake of a better data comparison, the *Index* is rescaled over a range that goes from 1 (low economic freedom) to 10 (high economic freedom). As far as the measurement of the individual’s extent of autonomy to choose, the measure of autonomy freedom (AF) introduced in Bavetta *et al.* is used. Such a measure is based on individual-level data from the WVS in which survey respondents are asked to indicate to what extent they feel they have free choice and control over their lives, using a scale that ranges from 1 (none at all) to 10 (a great deal). Therefore, the higher the value of responses, the greater the extent of autonomy to choose.

A multilevel logit (ML) model is used to establish whether economic freedom and autonomy complement each other to enhance individual well-being. The ML model allows

disentanglement of the effects of two different components on an individual’s level of well-being: a random component (upper level) given by the level of economic freedom (opportunity to choose) existing in the country where the individual lives and a fixed component (lower level) given by the extent of autonomy (autonomy to choose) that the individual enjoys.

This econometric technique allows examination of whether and to what extent the impact of autonomy on the level of the individual’s well-being is either reinforced or moderated by the degree of economic freedom existing in the country where he lives. With this objective in mind, the following equation is estimated:

$$WB_{ij} = \alpha_0 + \alpha_1 AF_{ij} + \alpha_2 HEF_j + v_{0j} + v_{1j} HEF_j + \varepsilon_{ij}$$

where *WB* is the extent of well-being of individual *i* in country *j*, *AF* indicates his level of autonomy, *HEF* indicates the extent of economic freedom in country *j*, and ε is the error term.

The terms v_{0j} and $v_{1j} HEF_j$ contextualize the relationship between an individual’s autonomy and his own well-being by considering the level of economic freedom in the country where he lives. More specifically, v_{0j} is the specific effect that shifts the intercept of the relationship between autonomy and well-being above or below the mean according to the extent of the country’s economic freedom. The term $v_{1j} HEF_j$ allows the slope of the relationship between autonomy and well-being to be steeper or flatter than the mean according to the level of the country’s economic freedom.

Therefore, according to this equation, the level of economic freedom existing in a specific country shifts the intercept term of the regression line above or below the mean and makes its slope flatter or steeper.

ESTIMATION AND RESULTS

Table 2 displays six ML regression models. In columns (a) and (b), the focus is on the relationship between freedom of choice and happiness. More specifically, in column (a) a random intercept model is carried out. This is a simplified estimation of the foregoing equa-

10. Ronald Inglehart, Roberto Foa, Christopher Peterson, and Christian Welzel, “Development, Freedom, and Rising Happiness: A Global Perspective (1981–2007),” *Perspectives on Psychological Science*, Vol. 3, No. 4 (2008), pp. 264–285.

Freedom of Choice and Individual Well-Being: Multilevel Logit Models

Standard errors are in parentheses.

Independent Variables	Freedom of Choice and Happiness		Freedom of Choice and Life Satisfaction, Subjective Well-Being			
	A	B	C	D	E	F
Constant	-1.827* (0.621)	-1.875* (0.666)	-4.551* (0.619)	-4.547* (0.693)	-4.906* (0.633)	-4.995* (0.691)
Individual-level variable: Autonomy	0.196* (0.004)	0.197* (0.004)	0.277* (0.004)	0.278* (0.004)	0.268* (0.005)	0.269* (0.005)
Country-level variable: Economic Freedom	0.036* (0.009)	0.036* (0.01)	0.035* (0.009)	0.036* (0.01)	0.026* (0.009)	0.028* (0.01)
Explained country-level variance (intercept)	12.24%	40.72%	12.34%	46.61%	12.69%	54.34%
Explained country-level variance (slope)		9.03%		10.84%		17.54%

* Statistically significant at 1 percent. **Note:** Individual-level variance: 3.29.

Sources: Authors' calculations.

Table 2  heritage.org

tion, in which the between-country heterogeneity captured by differences in economic freedom is only given by shifts in the intercept of the regression. The results indicate that a rise in autonomy as well as in economic freedom increases the probability of happiness.

The ML analysis shows also that the level of economic freedom explains 12.24 percent of country-level differences in the relationship between autonomy and happiness. This implies that economic freedom and autonomy are two complementary aspects of freedom of choice in enhancing happiness: For a given level of autonomy, the probability of happiness is higher in countries where the extent of economic freedom is higher and lower in countries where the extent of economic freedom is lower.

This finding, depicted in Chart 1, confirms empirically the prediction stated in Hypothesis 1.

Column (b) displays the results obtained by estimating a random slope model in which the full specification of our equation is estimated. As already pointed out, this model allows ex-

amination of the between-country heterogeneity in terms of economic freedom by moves in the intercept as well as in the slope of the regression line.

Results in column (b) confirm the positive effect of both autonomy and economic freedom on the probability of happiness as in column (a). They also show that economic freedom affects the relationship between autonomy and happiness in both the intercept and the slope. The level of economic freedom explains 40.72 percent of the country-level differences in the relationship between autonomy and happiness in terms of shifts in the intercept and 9.03 percent in terms of changes in the slope.

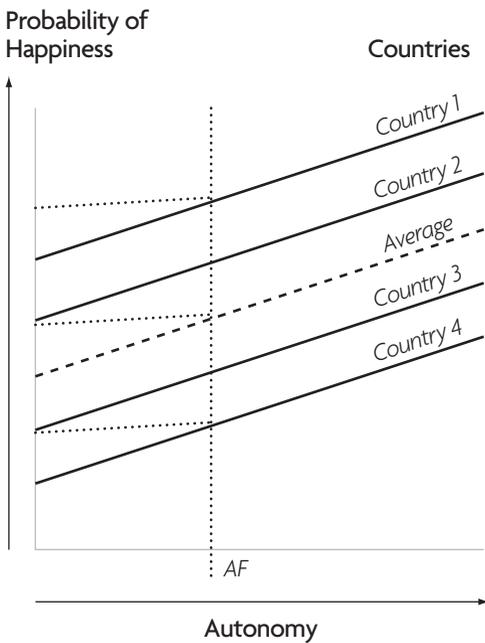
These findings bring about two important implications.

First, as in column (a), for a given level of autonomy the probability of happiness is greater in countries with higher levels of economic freedom and lower in countries with lower levels of economic freedom. Therefore, Hypothesis 1 is once more confirmed by the data.

Second, a change in the level of autonomy freedom grants higher happiness returns in

Freedom of Choice and Happiness, by Country

Taking two individuals enjoying the same extent of autonomy (AF), the probability of being happy is greater for the one who lives in a country with higher levels of economic freedom. Therefore, economic freedom and autonomy are complementary aspects of freedom of choice in enhancing happiness. The level of economic freedom is the highest in Country 1 and progressively declines in Countries 2, 3, and 4. The average refers to the average level of economic freedom in the sample of countries under investigation.

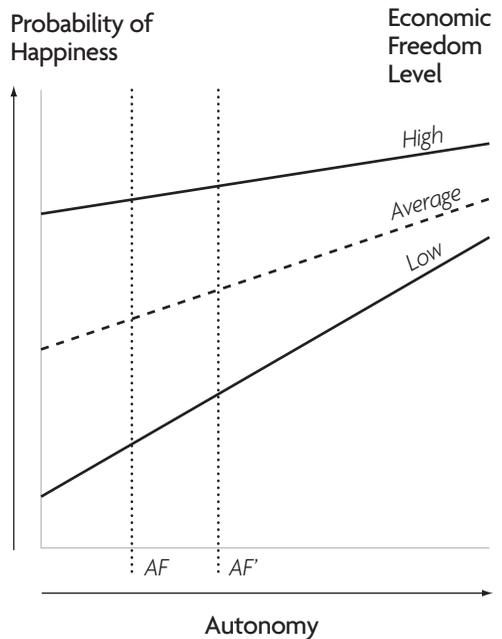


Note: Chart is based on a random-intercept multilevel logit model.

Chart 1 heritage.org

Economic Freedom, Freedom of Choice, and Happiness

In this chart, countries are clustered in two groups according to their level of economic freedom, low and high. The average indicates the average level of economic freedom in the sample of countries under investigation. Taking two individuals enjoying the same extent of autonomy (AF), the probability of being happy is greater for the one who lives in a country with higher levels of economic freedom. However, the same change in autonomy for both individuals (from AF to AF') grants higher happiness returns to the one who lives in a country belonging to the low economic freedom group.



Note: Chart is based on a random-intercept multilevel logit model.

Chart 2 heritage.org

countries endowed with lower levels of economic freedom and lower happiness returns in countries with higher levels of economic freedom. This result, depicted in Chart 2, empirically supports the theoretical predictions stated in Hypothesis 2.

Columns (c) to (f) explore the relationship between freedom of choice and both life satisfaction and subjective well-being. The same econometric analysis already implemented in

columns (a) and (b) is used. The results mirror those obtained for happiness and therefore represent an empirical validation of Hypotheses 1 and 2.

First, economic freedom and autonomy are two aspects of freedom of choice that complement each other in determining life satisfaction and subjective well-being.

Second, a given change in the level of autonomy grants higher returns in terms of life

satisfaction and/or subjective well-being in countries that are characterized by greater levels of economic freedom and lower returns in countries that are characterized by lower levels of economic freedom.

Third, the same change in the level of autonomy awards higher returns in terms of both life satisfaction and subjective well-being in countries displaying lower levels of economic freedom and lower returns in countries with higher levels of economic freedom.

POLICY PRESCRIPTIONS AND CONCLUSIONS

This chapter argues that economic freedom and autonomy are complementary measures. The claim is confirmed by means of a robust empirical analysis. Estimation results show that both economic freedom and autonomy foster individual well-being.

More specifically, a given level of autonomy leads to higher levels of happiness in countries that display a higher level of economic freedom. The reason for such a conclusion is that people in countries where market mechanisms prevail acquire the *know-how* to use their autonomy. However, a change in autonomy increases the probability of happiness more in those countries in which economic freedom is low. The reason for this conclusion is the limited *cost of choice* imposed on decision makers where opportunities are restricted by the pervasiveness of the state or the absence of material prosperity.

Our estimation results suggest some practical considerations concerning the role of autonomous choice as a policy instrument for the advancement of well-being. A dissenting view states that an increase in the complexity of the deliberative process jeopardizes the achievement of higher levels of well-being, especially in advanced countries that enjoy the benefit of high levels of economic freedom and, as a consequence, offer decision makers wider possibilities for choice. As the exercise of autonomous behavior increases, it is argued, frustration pushes individual well-being backwards because the complexity of the deliberative process imposes costs that people can hardly manage.

The results of our analysis, however, point to a different hypothesis. As a matter of fact, economically freer countries are characterized by institutional environments in which decision makers learn how to use the opportunities on offer. The positive slope of the relationship between autonomy and happiness depicted in Chart 1 shows that the know-how that people acquire systematically prevails over the complexity of the deliberative process. Contrary to some dissenting positions, this analysis concludes that autonomy never depresses well-being, no matter how the latter term is defined.

The second consideration, which applies to countries that do not experience substantial levels of economic freedom, is more an intuition than a direct consequence of the analysis. The results show that economic freedom and autonomy complement each other. Observing the incredible variety of consequences produced by liberalization processes, it is highly likely that autonomy plays a fundamental role in their success. As state-led economies open to market-oriented reforms, it is likely that both material and non-material well-being will increase. Yet, because of complementarity, this requires that the degree of autonomy enjoyed by individuals also increases. If it does not, one could observe liberalizations without prosperity or, alas, a failure of the model. Restricting reflections to the first case only, the policy consequence is that any government genuinely interested in the implementation of effective liberalization must foster autonomy or run the risk of being unsuccessful.

Be that as it may, one should always remember that autonomy can never be imposed successfully from above. Policymakers should never lose sight of the fact that the desire for responsibility, the search for one's unique identity and way of living, is a seed that delivers fruit only if planted in each individual's soul. Such a fragile trait, no less than the sense of a person's dignity inscribed in the affirmation of his or her identity, is almost certainly transmitted mainly and most effectively through cultural values and traditions that pass from generation to generation.