Foreword

Financial panics and global recessions tend to be bad times for free markets, as worried citizens look to the state for relief. So it is a pleasant surprise to learn that the 2011 *Index of Economic Freedom* has found an overall increase in liberty across the world after two years of decline. Perhaps the Great Recession of 2008–2009 will turn out to be only a detour, not a major disruption, in what had been a 30-year march of free-market reform.

If so, the turn will not have been led by the United States, which fell another spot in the world rankings to ninth, following a drop of two spaces last year. The demotion was well-earned, as Congress and the White House imposed the largest expansion of government in two generations. The health-care reform known as Obamacare will by itself push the U.S. toward European levels of spending and state economic control unless it can be repealed or replaced.

The U.S. economic recovery has also been lackluster, despite an unprecedented monetary and fiscal stimulus. Most disappointing is that the recovery momentum that began in late 2009 (5 percent growth in the final quarter) has slowed to 2 percent or less. This is in contrast to recent recessions when the American economy led the world toward new periods of expansion. U.S. businesses have cleaned up their balance sheets, but they are either sitting on their capital or investing it elsewhere around the world. My reporting suggests this is a classic "capital strike" related to government policies that have raised the costs of hiring and investment, targeted banks and corporations for political vilification, and created great uncertainty about America's business climate.

Another relative loser is the United Kingdom, which reacted to the financial panic by returning to the bad policy habits of the pre-Thatcher era. As recently as 2000, British government spending as a share of GDP was 36.4 percent; in 2007, it was 41 percent. As I write this, it is 47.5 percent following a Keynesian spending binge that was supposed to stimulate growth but has resulted in a slower recovery than the one in Germany, which spent far less. Taxes have naturally followed spending upward, with Britain's top income tax rate rising to 50 percent from 40 percent. It's thus no surprise that Britain has fallen out of the world's top 15 in this year's *Index*.

The good news comes in small national packages. Africa has been the continent least open to free-market ideas, but Rwanda and Djibouti made significant gains in 2010. Several Middle Eastern nations continued their trend toward more economic openness, albeit from a low base. As China and India have shown, however, countries can ignite a growth spurt by making even partial reforms that liberate their citizens to exploit their talents. The direction of policy is crucial.

On this point, the major question at the end of 2010 was whether the reaction that has begun against statist policies could build into another era of expanded liberty. The evidence is mixed. In the U.K., a new coalition government was cutting spending but not taxes and seemed to lack a pro-growth strategy. Europe was growing overall again but also bailing out the likes of Greece and Ireland at the price of austerity and higher taxes.

Asia is booming again, having avoided the worst of the panic and policy mistakes, but inflation was also building, notably in China. More important, some Asian nations are drawing the wrong lesson from their relative success, giving credit to state-directed industrial policy while asserting that the U.S.-led market model has been repudiated. If they believe this, they will court a political and trade backlash in the West and eventually hit a growth roadblock at home.

As for the U.S., voters have shut down Barack Obama's historic government expansion by electing a Republican House of Representatives. This should prevent further policy harm in the short term, but it doesn't repair the damage already done by regulations and higher taxes that are still moving forward or are set to take effect without legislative action. Much will depend on whether Mr. Obama accommodates the new public mood or digs in and takes a populist left turn.

The larger point is that economic prosperity is not a national birthright. Rich countries can fall into stagnation all too quickly, while long-suffering nations can ascend from poverty to powerhouse in a matter of years. Think of Argentina's decline from a country with a GDP akin to Europe's to one of South America's laggards or Japan's two-decade malaise. Or consider China's rise in a mere 30 years from a nation whose main mode of transportation was the bicycle to a global industrial giant.

The abiding lesson of the *Index of Economic Freedom* is that the most important variable in the wealth of nations is liberty. What the world economy needs above all at the end of 2010 is for the United States government to recall that truth and act on it.

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