By Antony Davies and James R. Harrigan
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Conventional wisdom says that capitalism leads to poverty and inequality as the stronger, smarter and luckier run roughshod over the less blessed. Sen. Bernie Sanders and the Occupy movements are symptoms of this thinking. Each gave a loud voice to people determined to see themselves as victims of free markets, but as a recent report from Canada's non-partisan Fraser Institute illustrates, these people have misidentified the cause of their unhappiness. Indeed, they have inadvertently enabled the cause of their unhappiness.

Those skeptical of markets believe we must empower government to curb market excesses. What skeptics fail to realize though, is that the same selfish and exploitive humans they seek to restrain in the private sector also populate the public sector. And while it is tempting to see government as a check on the abuses of people in markets, who will check the abuses of people in government? Voters, who are also composed of selfish and exploitive humans? In light of human nature, the real question is whether to hedge one's bets with free markets or government.

Evidence collected from across countries and across time suggests a way forward. The Fraser Institute recently released its annual "Economic Freedom of the World Index," which measures economic freedom across 123 countries. Fraser constructs the index by looking at 42 metrics spread across five categories: government spending and taxation, property rights protections, soundness of money, freedom of trade and market regulations. Using Fraser's chain-weighted measures, as of 2014 the United States ranked 14th in the world for economic freedom, just behind Luxembourg. For comparison, Denmark, Sweden, and Norway – countries often held out as exemplars of modern socialism – ranked 17th, 30th, and 37th. In the end, they are largely economically free countries too.

It turns out that people tend not to ask the right questions about markets and government at all. Questions of economic freedom and government should be assessed, according to Fraser, not in terms of *less* government, but in terms of *good* government. Governments that are too small to protect their own people from being robbed and exploited score lower on economic freedom, as do governments that are so large as to be themselves the cause of theft and exploitation. Examination of the data reveals a "sweet spot" for the balance between markets and government.

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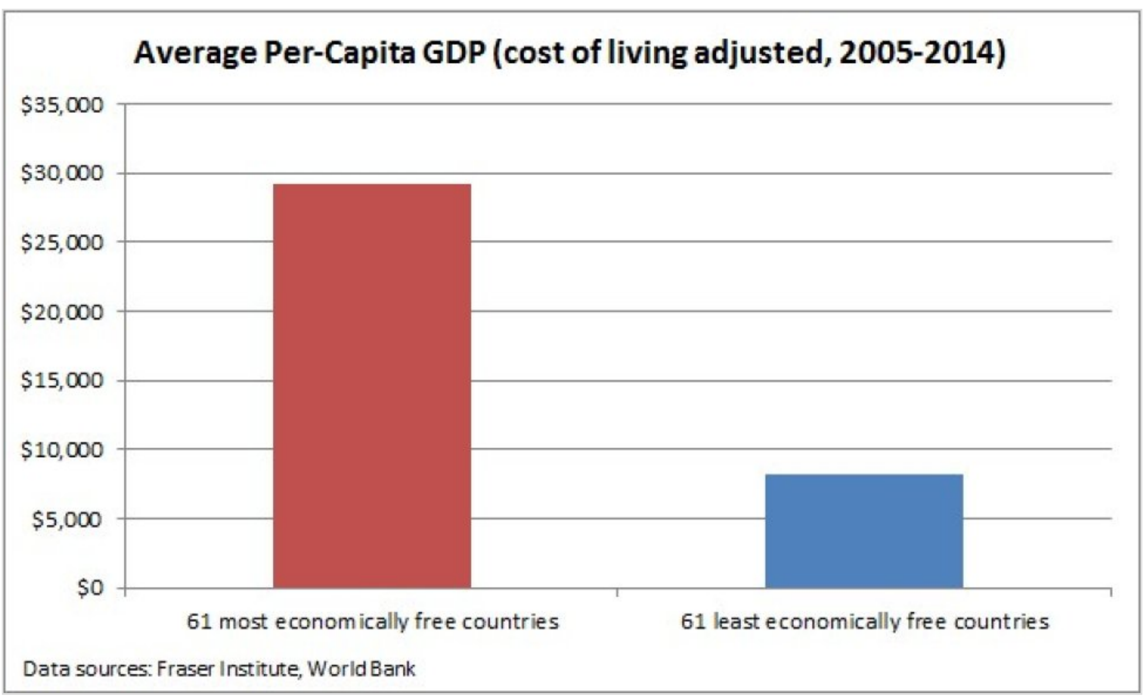
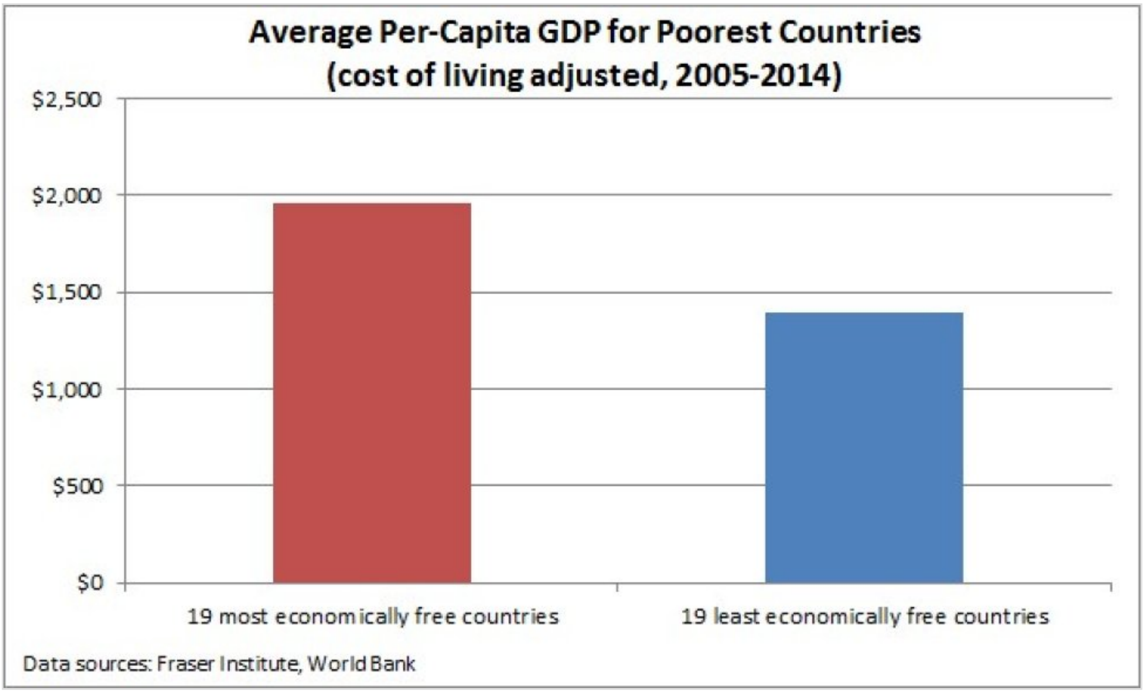
The World Bank, the United Nations, and the International Labour Organization measure social outcomes like poverty, inequality and exploitation across countries. Fraser doesn't consider these social outcomes when measuring economic freedom. The World Bank, U.N., and ILO don't consider economic freedom when measuring these social outcomes. Yet, when these disparate data sources are cross-referenced, a fascinating and undeniable pattern emerges.

Adjusting for differences in costs of living, countries that score higher on Fraser's economic freedom measure also score higher on the World Bank's measure of per-capita income – by a huge amount. Over the past decade, people in countries that score in the upper 50 percent for economic freedom earned incomes averaging almost $30,000. People in countries that score in the lower 50 percent for economic freedom averaged less than $10,000 in income. Again, these numbers account for differences in costs of living across countries.

For example, four of the five countries that score highest for economic freedom – Hong Kong, Singapore, New Zealand, Switzerland and Ireland – have per-capita incomes ranging from $50,000 to $80,000. New Zealand, the exception, has a per-capita income that is still almost 90 percent greater than the world average. Meanwhile, the five countries that scored the lowest for economic freedom – Venezuela, Algeria, Republic of Congo, Zimbabwe and Iran – average just over $11,000 in per-capita income. The average person in those countries has an income on par with that of a part-time minimum wage worker in the United States.



Of course, this might simply be a happy coincidence. People in rich countries have the luxury of being concerned with economic freedom. Perhaps economic freedom is merely a luxury the rich can afford. One way to address this is to look at only the poorest countries and ask whether the pattern persists in that group. It does. Among the poorest 25 percent of countries, those that are more economically free have average incomes that are 40 percent higher than those that are less economically free.



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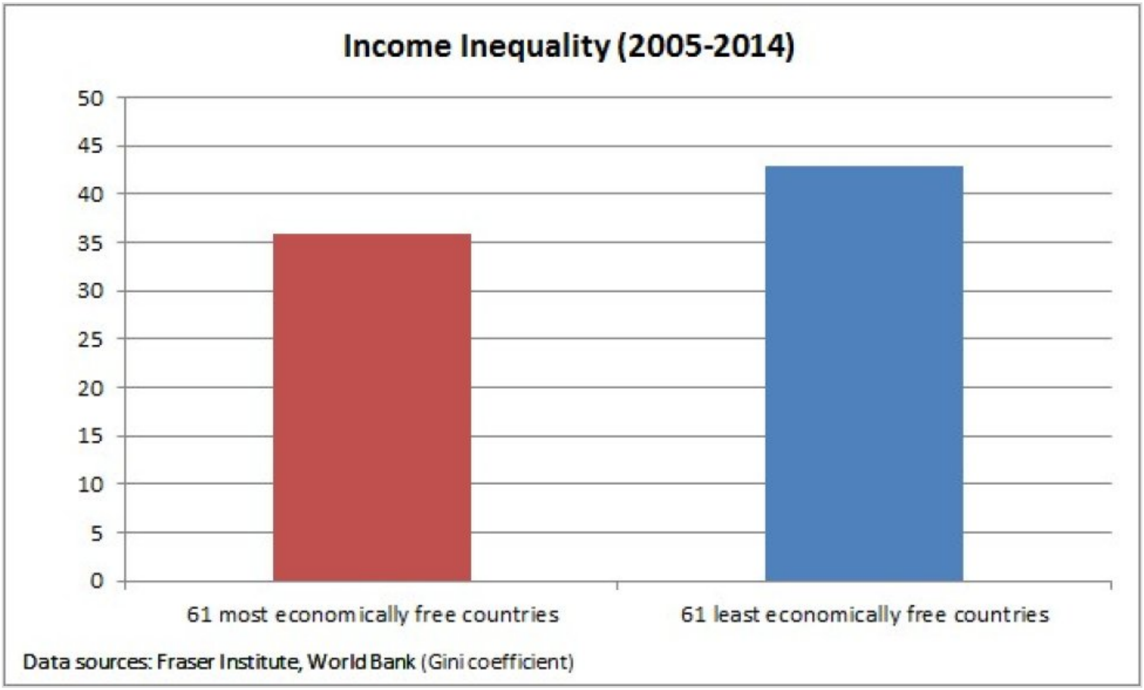
But average incomes don't tell the whole story because they don't address the gap between the rich and the poor. Cross-referencing the World Bank's income inequality data with Fraser's economic freedom data yields the pattern yet again. On average, the gap between the rich and the poor is greater in less economically free countries than in more economically free countries. For both rich countries and poor countries, on average, those that are more economically free have both higher and more equitable incomes.



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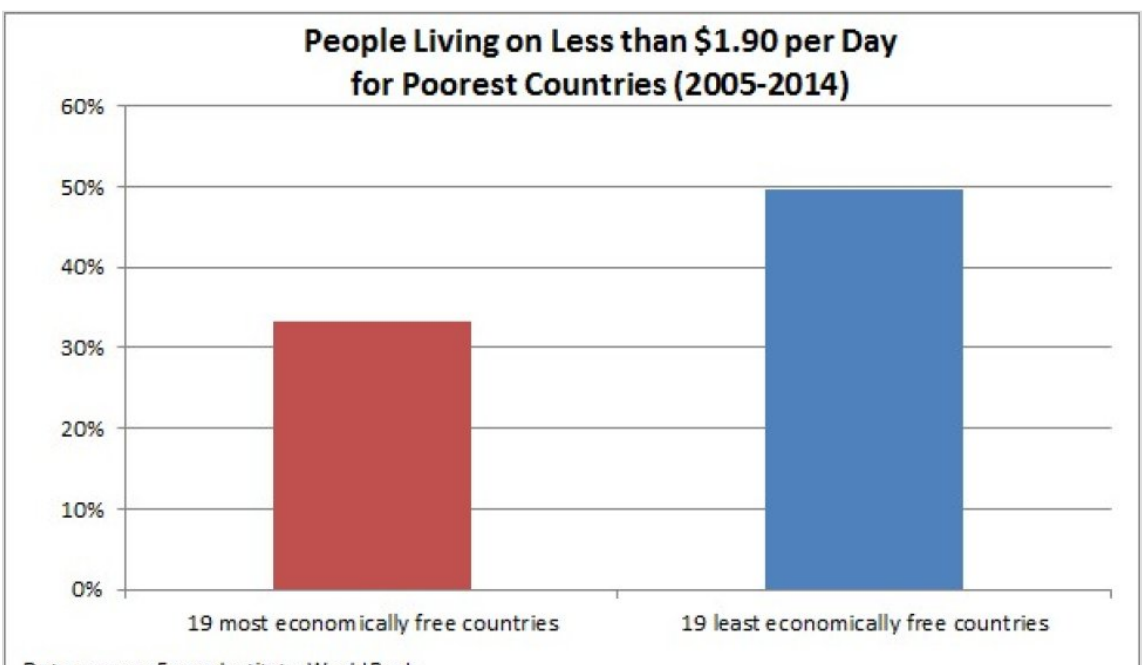
Economic freedom doesn't merely accompany a lessened gap between rich and poor. Poverty rates are actually lower in more free countries. Adjusted for differences in costs of living across countries, the fraction of the population living in poverty in economically free countries is about half what it is in economically unfree countries. And if we look only at the poorest countries, the number of people living on less than $1.90 per day (the U.N.'s official world poverty line) while unacceptably large, is substantially lower in the economically free poor countries as compared to the economically unfree poor countries.



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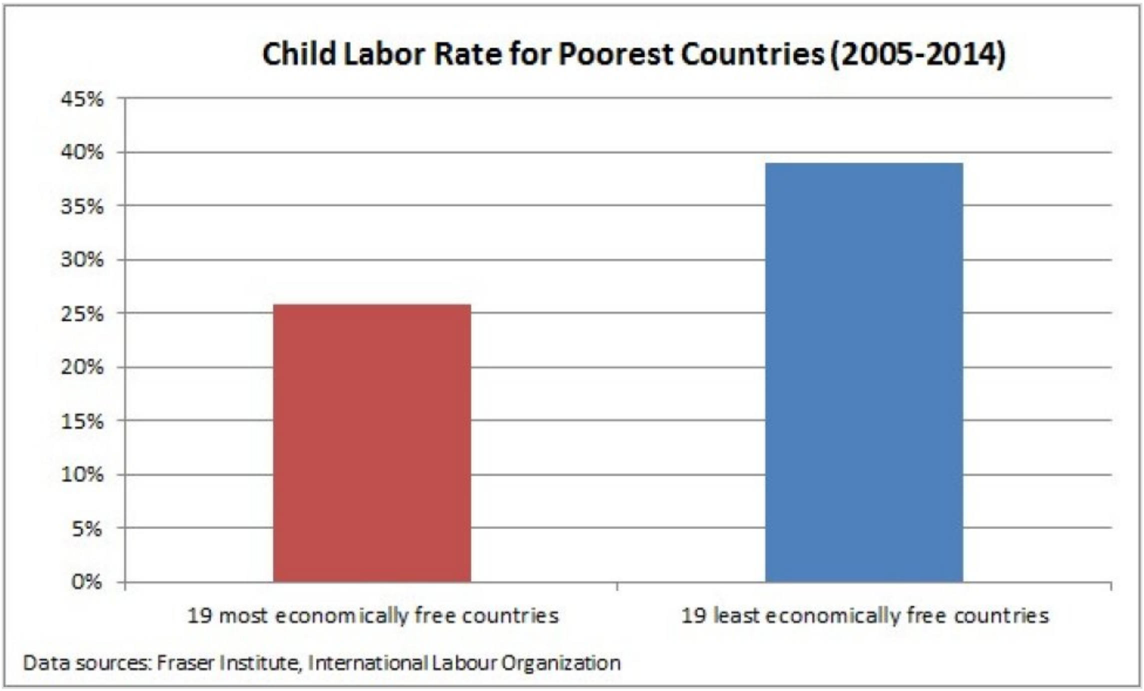
The benefits that accompany economic freedom don't stop at people's wallets. People in economically free countries also suffer less exploitation. Women in more economically free countries suffer less gender inequality, and among countries that permit child labor, those that are more economically free experience lower child labor rates.



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In the end, the call for government to curb markets is as wrong as it is well-meant. Humans are a mix of selfish, altruistic, coercive and cooperative people. In their rush to bind the hands of bad actors in markets, those who call for more government ignore the bad actors who have their hands in government. All they accomplish is to substitute the tool of markets for the tool of government, leaving the bad actors unbound.

The correct solution is not government or markets, but the right mix of government and markets. We need the "sweet spot" that gives people of goodwill the maximum ability to act and people of ill-will the minimum. Across countries and across time, the data point to the same solution. The right amount of government is enough to prevent people from imposing harm on each other but not enough to do anything more.