Episode 634: The Economic Freedom of the World: What the Numbers Tell Us

Guest: Gene Epstein

WOODS: You are freshly returned from Romania. Maybe we can talk about that a little bit later, is that okay?

EPSTEIN: Sure, absolutely.

WOODS: Okay. I want to talk about your column on economic freedom of the world, these economic freedom of the world indexes always make for interesting discussions. I think your column is probably behind a pay wall at *Barron's*, am I right?

EPSTEIN: Yeah, I'm not sure. Yeah, I think you can get it just by Googling. After a week or so things got freed up pretty well, but indeed they're in it for the money, so they don't make it easy for people to get through to me. So that's true (laughing).

WOODS: Well, we'll try and suck all the meat out of it here in the discussion.

EPSTEIN: Let's do that.

WOODS: All right, so give people an overview. What's the basic lesson that a person who does not go into this matter of economic freedom of the world, looking into this index, what would that person take away from this? A dispassionate person, what conclusion would they draw?

EPSTEIN: Well, the basic finding is that, first that it's possible to construct a Milton Friedmanite — and I emphasize that because Milton Friedman consulted on the construction of this index when it was put together in the 1980s. It's possible to construct an index of economic freedom — or as the Fraser Institute, which is a source on this put it, it is indeed an index of the degree of entrepreneurial capitalism within a country. It's possible to construct an index on a scale of 1 to 10, if you can believe it. And once you do that, you find that the numbers that you construct over time and across countries do tend to explain rates of economic growth, slow down in economic growth, and comparisons between countries, levels of income, poverty, wealth, and so on. So if you have a high economic freedom index, you're more than likely to be a rich country; a low economic freedom index, you're more than likely to be a poor country.

And in particular, since I'm writing for *Barron's*, for a U.S. audience, and since the U.S. economy is mainly my beat, what I found, so much of the surprise of a lot of readers if we can get to that, is that the economic freedom index rose fairly steadily in each decade from 1970 to 2000, but that since 2000 it's fallen fairly steadily, and that the rise of the economic freedom index in the first 30 years from 1970 to 2000 correlates pretty well with reasonably good growth over that period. And since 2000, both under the Bush administration, by the way, and the Obama administration, we've had a marked slowdown in growth, and I believe that's also explained by the decline in the economic freedom index since 2000. So that's the main lesson.

WOODS: All right, so let's talk about what have been examples of the decline in economic freedom since 2000? What has happened in the economy and with government that could explain this result?

EPSTEIN: Yes, well first I should emphasize that there's a scale of 1 to 10, but 10 is by no means perfect. Everything is marked on a curve, and so the finding is that degrees of capitalism, degrees of entrepreneurship can actually be more or less measured by the economic freedom index. So it isn't as though the period from 1970 to 2000 was a wonderful period, but the whole point is that there's been a deterioration since 2000. Well, what can you latch upon? And the interesting thing is that the economic freedom index, because it's so abstract, it deals with actual, explicit numbers, so that, for example, the decline in a subcomponent of it called legal system and property rights, which is the most severe and the most important, the preservation of property rights and the preservation of a stable legal system, that has deteriorated since 2000.

Well, what do we find? We find a whole lot of stuff happened under Bush; stuff obviously happened under Bush. We find that the rescue of General Motors and the rescue of Chrysler in 2008, 2009, bond holders, the agreement that bond holders come first was completely abrogated. And we find as well, of course, that the rise in regulatory tightness, certainly under Obama as well as under Bush, also occurred. And the housing bubble, the intervention, the massive intervention in the markets by Fannie Mae and Freddie Mac underwritten and pushed by HUD also occurred, started under Clinton but really reached full tilt under Bush, and that led to the bust, and then that led to massive intervention and bailouts of corporations. All of that is fairly well understood.

The only thing that's been obscured is that people tend to think that the decline in economic freedom only coincided with Obama, when in fact this objective data — and I emphasize that it's objective in the sense that it lives a life of its own. The standards were compiled prior to 2000, and the findings just speak for themselves. We see the decline under Bush. We don't have to retrofit the data to our knowledge of the past. This is not hindsight; this is actually just what happened to the U.S. economy. And the reasons for it under Bush, as I mentioned Sarbanes-Oxley, and of course Dodd-Frank under Obama, all of those factors I believe are reasonably evident.

And in a way, by the way, Tom, I would say that the puzzle then becomes what was so good in the 1970s, '80s, and '90s? That's a bipartisan story too. But in fact, we find that there actually was progress, even though the best is none too good, even though again, as I emphasized, 10 on the economic freedom index still falls far short of your ideal and mine about entrepreneurial capitalism. But the whole point about the rise for the first 30 years and then the fall since 2000 I believe stares you in the face and speaks for itself.

WOODS: Just a side point, I know it's not central to the discussion, but the auto bailouts that you mentioned.

EPSTEIN: Yes.

WOODS: Now, I understand the role that that played is, you're right, the abrogation of this, I don't know, century-long understanding that the bond holders are taken care of first. But I just want to point out that Hillary Clinton has been pointing to the auto bailouts as one of her many reasons that the Democrats can be trusted, because they've done such a wonderful job. We saved the auto industry.

EPSTEIN: Yes.

WOODS: Why is she wrong to cite that as a good thing?

EPSTEIN: Well, as a matter of fact, another guest on your show, David Stockman, has been probably one of the best scholars on this point. Obviously of course it was done only because Obama wanted to clinch the state of Michigan in the election. That was his obvious motivation. Secondly, it was just sort of absurd on its face that we really needed to save auto jobs. As David Stockman pointed out, all that really happened is that we kept high-priced jobs in Michigan, and we lost a lot of lower priced and more viable jobs in the southern states, where there are a lot of auto companies already. Actually, of course, many of them are owned by the Japanese, but what difference does that make? They're employing auto workers. So the joke was that it isn't as though we would even have lost auto jobs, likely lost auto jobs to foreigners. It was really that the the high-priced jobs in Michigan had to be saved and in the South and South Carolina and elsewhere where other auto jobs could have been created, they were sacrificed, because that wasn't in Obama's in calculus to winning the election.

And of course, the idea of bailing out Chrysler, which had already been bailed out once before, is only kicking the can down the road. It obviously does no good to keep telling a lumbering bureaucratic corporation that however much it screws up you're going to get bailed out. Inevitably that leads to disaster. General Motors now has a little bit more life in it, but who knows? Most likely the next time we have a recession there'll be perhaps yet another bailout, depending on the political calculus of the president in charge. So it was clearly a disaster on any grounds and could not, as Stockman pointed out, even be justified by the idea that jobs would have gone abroad. Clearly they would have gone to the southern companies, to the American workers who work for Toyota for a decent wage and who produce cars at a prophet. That's what would have happened, as Stockman pointed out.

WOODS: All right, let's get back to the economic freedom of the world index. I've covered this is in the past, but can you explain how do the Scandinavian countries fit into all this?

EPSTEIN: Yeah. Well, as a matter of fact, you had the president of Denmark I guess was insulted by Bernie Sanders' statement that he's got a socialist country, and he negated that, as the economic freedom index consists of five components, and the only component in which the Scandinavian countries, in particular of course Denmark, Norway, and Sweden, are lower than the U.S. is with respect to size of government. And they have problems with their welfare state, but obviously if you're a small country, I mean, none of these — Norway, Sweden, Denmark — they have fewer people than New York City has. They are relatively homogeneous, and so the possibilities of sustaining a welfare state without collateral damage are much greater, even though problems have arisen with respect to the welfare state in these three countries.

But with respect to the other four components, these Scandinavian countries are on balance more capitalist than the U.S., and in particular, as I pointed out in my column, the most important subcomponent of the index is property rights and legal and rule of law. And with respect to that, Norway, Denmark, and Sweden are noticeably higher with respect to respect for property rights. And actually, what's interesting about the methodology in this case is that it's based upon surveys of executives in each of these countries, run by the World Economic Forum. And the executives are asked to rate the court system, to rate the reliability of property rights on a scale actually of 1 to 7, and these Scandinavian countries, the executives in these countries rate their court system and their property rights systems noticeably higher than American executives have been rating theirs.

So that's why, by the way, it's based on and as the sources on the economic freedom index emphasize you can ask people lots of things about which they'll know very little, but when you're talking to executives of corporations, they have firsthand experience about how they deal with the legal thicket of rules in their country, so they are dealing with knowledge, and the fact that the Scandinavian executives rate their own country higher I think says a lot, and the fact that in the U.S., executives in the U.S. are rating their country lower and lower, much lower than in 2000 — that subcomponent has fallen much greater — that also I think says a lot.

And so with respect to that most important component, these Scandinavian countries are way ahead. With respect to regulation they're about the same. With respect to soundness of money they're ahead, and with respect to openness to trade, they're also ahead. So with respect to the really important aspects of entrepreneurial capitalism, these countries are more capitalist than the U.S., not less capitalist, and so that's I think, again, stares you in the face.

WOODS: I want to talk about your trip. We only had a brief moment to talk about it before.

EPSTEIN: Yeah.

WOODS: You went to Romania and you actually gave a presentation on this very topic.

EPSTEIN: That's right, yes. Well, and they sent me too. It's interesting what happened. There's something called the Murray Rothbard Institute, which certainly the moment I heard about it of course it warmed my heart I got to go there. And the Murray Rothbard Institute actually consists of basically a couple of free market Austrian professors at the Romanian-American University that was started 25 years ago. But they call themselves — that's a great name, and that's where I want to be. But they advertised, hey, we've got this free market guy who would like to deliver a few lectures, and so they arranged to have me present the economic freedom index and the story for the U.S. and for Romania to a group of economists who work for the government. And they forewarned me that these people are very Keynesian and not at all too keen on something like the economic freedom index, but I got a very polite hearing.

And then this is the interesting thing about Romania, because I wanted to of course report on the economic freedom index there. In Romania, 4 out of 5 components have been rising, but one component, that's what I mentioned before, legal system and property rights, has been falling at the same time. And the findings of the scholarship show, as indeed the report states, if you do badly on legal system and property rights, it almost doesn't matter how well you do with the others. As I mentioned, Scandinavia does very well in that regard, and Romania not only does poorly, but has been declining, and that's the news I brought them. Like, here I am an outsider, I don't know a whole lot about your economy, but I can report that something's going on with respect to your legal system and property rights that's bad news for the Romanian economy.

And there I struck a responsive chord. A number of people raised their hands and talked about the difficulties of having title to property in Romania. And part of it actually is a throwback to the ousting of the communist dictator Ceaușescu, which happened in 1989. There still is to this day petitions with respect to property by people who claim that they've been dispossessed, and the whole thing has gotten out of hand. Almost nobody can sort of reliably own property, because you don't know if it's going to be challenged by somebody who claims his ancestor owned that property once before. Obviously they should be able to deal with that, maybe have a briefer window of opportunity, say if you want to claim property then we give you a 24-month window, please come forward, but this has gone on and on. The court system seems to be rigged. I quoted them, I said they're interviewing Romanian executives, and the Romanian executives are saying that the court system is unfair, it's unreliable, something's going on that you should attend to. I think that, as I mentioned, because of the comments I got from the audience about this, I think that in that regard at least I struck a responsive chord. So that was at least an experience and an experience worth having. I wasn't just talking to a receptive audience about the economic freedom index.

I head something else, Tom, which I emailed you about, which amused me, on a slightly different topic involving Paul Krugman. The economist at the Rothbard

Institute who was sponsoring me told me that he had raised the point about Bob Murphy wanting to debate Krugman, and he was told by two different free market economists, whom I won't name because I only got the story secondhand, that they cautioned anybody from debating Krugman, that Krugman was some kind of a smart guy and that Bob Murphy was foolish to want to debate him. And I just had a big laugh from this. I said that this — I mean, it's hard for me to imagine how those guys could talk that way. They're American economists with some free market credentials, not Austrians, but I believe that it's just — what explained the crazy story, and I said, look, you probably listen to *Contra Krugman*, and I've written about Krugman; he's an easy mark, it almost is too easy to do *Contra Krugman*, and these guys are saying that Krugman can't be contradicted, he's too smart for anybody to want to debate with him.

And I believe what must be the reason for these silly statements is this perverse sort of defense of your fellow academician. Let's say this is my wild guess, because it's hard for me to imagine how anybody who reads Krugman, as I have ever since he started his column in *The New York Times* in 1999, can possibly believe that the guy can't be debated. It's almost like something you'd do with your left hand half the time, which seems happen with even Bob not infrequently in the show that I listen to every week, *Contra Krugman*, because that does save me the trouble of actually having to read Krugman. But also of course I love most of what you guys do with Krugman and how you basically try to point out that he's off on cloud nine. But amazingly, I told my colleague at Romanian-American University that the next guy he should invite is Bob maybe to lecture on such matters involving Krugman, so that nobody's dissuaded that Krugman is beyond reproach.

WOODS: Yeah, exactly, exactly, and Bob just knows Krugman inside and out. In terms of Krugman and debates, I'd actually like to see a debate between Krugman and an actual Austrian.

EPSTEIN: Yes.

WOODS: Not a Krugman and a 70% free market guy or a Krugman and a supply-sider or a neoclassical. I want Krugman against a real, live Austrian, because I think that would be interesting, and I frankly think, in terms of his debating ability, I think he is way overrated. I think he builds up a lot of hype about himself, but I think he would be really uncomfortable in a debate with a really solid Austrian.

EPSTEIN: No, absolutely. All you have to do — you know, you did have, and my recommendation, Jeremy Hammond, who had been steeped in reading the Austrians, actually based on your reading list, and did this amusing 100-page treatment comparing Paul Krugman's wild statements for years before the Great Recession with Ron Paul's much more prescient statements, and that really comes closest to being sort of the quasi-Austrian evisceration of Krugman, because —

WOODS: Yeah, that's a good point.

EPSTEIN: — [inaudible] Ron Paul.

WOODS: I just want to make sure people know, now that you mention that, I'll link to that old episode. This episode will be at TomWoods.com/634, and on that page I'll link to that previous episode with Hammond, because it's an oldie but goodie. If you didn't get to hear it, you should listen to it.

EPSTEIN: Oh yeah, I mean, Jeremy I think in the interview was even a little bit too modest. Listeners are really cheating themselves if they don't read that book, because it really is funny the way, I mean, Krugman's calling for a housing bubble and then denied he ever did. Really just bobbing and weaving, he truly eviscerates him. But indeed, the way you approach Krugman is simply to quote him against himself, simply to put his statements side by side. He lives each day as though it were his first. Half the time he doesn't know what he said three months ago. And so just lay side by side his statements over months and years —

WOODS: Yeah.

EPSTEIN: — and then ask him he can possibly defend these remarks he keeps making which contradict each other from when he — but as indeed, inevitably a Keynesian has to contradict himself, because it's impossible to sustain a Keynesian approach consistently, I guess is the basic problem. So you just hoist him on his own petard; that's the way to approach it.

WOODS: When you were in Romania and you met these — or you had in the audience these economists who worked for the Romanian government, were they basically like Keynesians?

EPSTEIN: Yes, absolutely. I was even a bit regretful that I didn't get a chance to just lecture on Krugman, because a lot of them like Krugman. But yeah, they certainly did — lecturing on the economic freedom index was a good idea. Another guy in the department who came to two of my lectures, one of them — I delivered three. One of them was about inequality and Piketty. The final one was a much more expansive version of another interview I did with you, which is, I called it "Mommy was a Commie: How I Went from a Red Diaper Baby to an Austrian." And there I knew this Marxist economist who was at the Romanian-American University came to that lecture as well, and I especially went after Marxian economics, because there was a stage in my intellectual development that I was wrestling with it. So I kept hammering at the ludicrous formulations of Marxist economics. And there too I seem to have scored some points, because he was giving ground, asking some questions and giving ground on various points I was making. And my colleague who sponsored me in Romania thought it was a good hit, that it was a good evening. So there too, it was clearly a pretty stimulating talk.

But with respect to the Keynesians, they were sort of like too intimidated by half. When I spoke at the government-supported group, the head of it met with me later and kept telling me how important it is for me to be emphasizing economic freedom.

But every time I asked him a question, he was equivocating. So we were too polite by half. He was too polite with me by half, because he basically in the back of his — well, for example, I asked him about openness to trade. He played the usual card, and the first thing he said was, well, there's a lot of things that Romanians import that we can produce domestically, if we only — you know, that kind of card, which you immediately realize where that's coming from, you know, that he really doesn't want openness to trade, you know, basically it's the old emphasis on — the mercantilist emphasis. So there I was in a bit of a thicket with being able to sort of join the issue with the Keynesians.

But certainly as I mentioned, I said, you know, the Bob and Tom Show would be a great show if they could possibly pay for your trip and Bob's, but certainly Bob would be great appearing before these people, the Keynesians and the others. In fact, I could coach him. I could tell him what to expect and what to anticipate and ways to draw a little blood and a little push back from these people, so that could be fun if Bob goes next time. They basically — of course I get a steady paycheck. They did pay for my fees. They paid all my costs. They even paid for a business class plane flight, because it's all the way to Romania. But otherwise I earned nothing from the week. They just took out my costs.

WOODS: Well, some day when I'm an empty nester and don't have five children in the house —

EPSTEIN: (laughing) Right.

WOODS: — then I can imagine I would take a bunch of those trips, just because I would say, hey, free trip to — especially the business class flight actually would probably make the difference for me.

EPSTEIN: Well, exactly. I'm a lot older than you, so that was a necessity, being able to stretch out in the seat, anyway.

WOODS: Yeah. Yeah, yeah. We are in a way taking *Contra Krugman* on the road in Seattle in May. The Mises Institute's having an event. We're going to record an episode live in front of an audience during that event.

EPSTEIN: Oh yeah, uh huh.

WOODS: And then we've got a cruise coming up. We're going to record an episode while we're at sea. And then I haven't asked Lew Rockwell yet, so maybe I'm speaking out of turn, but this summer at the Mises University, I thought it might be fun to maybe do an episode of *Contra Krugman* where we've got the whole faculty sitting there with microphones, and anybody can chime in at any point. And so we'll just, we'll pick a really juicy Krugman column and just demolish it with a dozen faculty. It'd be like the mother of all episodes.

EPSTEIN: No, that would be great. You know, I even believe, Tom, that you haven't hit the worst. I have to think that if I were asked to put down Krugman's top hits, the top 10 Krugmanisms that are the most ridiculous, maybe you've had one or two. I'd have to think. But I mean, over the years he's really topped himself. As good as your show is, you really haven't even as of yet hit some of the craziest stuff.

WOODS: You know, actually I am glad that you said that, because basically the way we've chosen to do the show, we're held hostage by whatever he chooses to discuss —

EPSTEIN: Yeah.

WOODS: — but if there's a week — and lately he's had a lot of weeks where his two columns are both about the Republicans are stupid or healthcare, we've covered that a million times, maybe one of these weeks — I'll run it by Bob — we will — I am sure the listeners would go for this — we would say, instead, this week on *Contra Krugman* we're going to do the top 10 greatest Krugman hits.

EPSTEIN: Yes.

WOODS: I bet you that would be our most listened-to episode.

EPSTEIN: Yeah, that one you should call "Krugman Mania," you know, when he really went off — even for him, went off the deep end completely. I will say that amazingly the only thing where he was reasonably sound in the old days and was never bad was about free trade. But even there now, as you know, if you've been following, he's beginning to sound nutty, even on the subject about which he was supposed to know something about, free international trade. So he's beginning to sort of show his lunacy, even in that regard. But certainly I believe that maybe every calendar quarter you should have a lull for one of Krugman's greatest hits, because I don't know if you can cover 10 in one session. Maybe you can, perhaps. Anyway —

WOODS: Yeah, maybe — we could — obviously you could do an episode on each one, but it might also be fun just to do a lightning round type of thing. But anyway, here I am just thinking out loud about the show.

EPSTEIN: They're all good plans, Tom, which I've inspired you to do and —

WOODS: You have. This is a brilliant idea. Absolutely. And it's funny that lately on the show I've been giving other people ideas. People will come on and I'll say, here's a good book for you to go write, you know, and they've got these homework assignments. But now I've got a pretty good assignment.

EPSTEIN: Yes.

WOODS: All right, well listen, I appreciate this, Gene. I'm glad you had a good and safe and rewarding trip to Romania, and we'll look forward to talking to you again.

EPSTEIN: Sure, talk to you soon, Tom. Buh bye.