The Causal Effect of Jumps in Economic Freedom on Economic Growth

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Abstract:

There is a large literature about the economic and social effects of economic freedom. However, almost none of the papers address the problem of selection bias / endogeneity. We follow the method of Hausmann, Pritchett, & Rodrik (2005) and create a sample of countries that have experienced large and sustained increases in economic freedom as measured by the Frasier Institute's index. We then use matching methods to estimate the causal effect of these jumps on growth. For a range of definitions of what constitutes a jump, a variety of matching methods, and for a range of covariates used in the matching process, we find strong evidence that increased economic freedom significantly raises growth over the following 5 years compared to experience of the matched controls. We find weaker, but still substantial, evidence that the effect lasts 10 years. Thus, we believe that this set of policies is worth seriously considering for countries that wish to accelerate their growth rates for up to a decade.

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