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Free Markets Require Good Governments, for the Sake of Liberalism

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[LINK TO ABSTRACT](#)

In my article about the measurement of economic freedom by the Fraser Institute and the Heritage Foundation (Ott 2018) and in the following discussion with Fred McMahon of the Fraser Institute (Ott and McMahon 2018), I argued that leaving out the size of government as a negative indicator for economic freedom would lead to a better measurement. Ryan Murphy, a member of the Fraser Institute research team, presented some critical remarks about my arguments (Murphy 2022a) and I replied (Ott 2022). In a further contribution Murphy (2022b) clarified his previous remarks. His clarifications are helpful and informative, and I am happy to continue our discussion.

Murphy (2022b) presents a distinction between two types of concepts. I have some remarks about conceptualization in general and about this distinction. I also pay attention to the conceptualization and measurement of economic freedom by the Fraser Institute. Concepts like economic freedom can be used in different ways, each with specific benefits.

Murphy (2022b, 243) is concerned that I oppose the study of classical-liberal freedom, interpreted as limited government. I respond to his concerns.

I withdraw my suggestion to leave the size of government out of the measurement of economic freedom, and will present some new suggestions. I also present arguments to put a higher priority on the quality of governments than on their size, as conditions of economic freedom.

1. World Database of Happiness, Erasmus University Rotterdam, 3062 PA Rotterdam, Netherlands.

Conceptualization in general

Conceptualization is about the development of concepts. Conceptualization is like organizing or re-organizing your home and your closets. You put things together because they are similar or are related to the same needs. Conceptualization is also related to the needs people share; Eskimos have more concepts for snow than have people who live in a desert. Taste and normative convictions may play a role in conceptualization. It is, however, helpful to be practical. You are entitled to put your laundry and fresh vegetables in one heap in the basement, but it is not practical and possibly confusing for other people.

Complex concepts are occasionally denoted as constructs, but I just use the term concepts. There is a taxonomy of *concreta*, *illata*, *abstracta*, and *theoretical concepts* (Boesjes-Hommes 1970). Abraham Kaplan (1964) made a very similar taxonomy. The distinction between *abstracta* and *theoretical concepts* is important. *Abstracta* are usually used in a descriptive way and are defined or stipulated in a nominal way. There are therefore no validity issues because the measurement results cover the meaning. *Theoretical concepts* refer to actual phenomena and are usually used in an explanatory way and defined in a real or realistic way. The measurement results cover the hypothetical meaning only up to a point, and there is always a difference between the meaning of the concept and the measurement results, that difference being a *surplus meaning*. The validity of the measurement is therefore an important issue to be considered in the measurement of *theoretical concepts*. Many concepts can be used in either way, as *abstracta* or as *theoretical concepts*.

Murphy's formative and reflective constructs

Murphy (2022b) makes a distinction between formative and reflective constructs or concepts. Formative concepts are comparable with *abstracta*: a stipulative definition without validity concerns. Reflective concepts are comparable with *theoretical concepts*; they refer to actual phenomena but there are validity issues.

Murphy's example is *employee performance*. If it is used as a formative concept or *abstractum* then there is no need to look at the relations between underlying factors, because there are no validity issues. The selection of factors, their definitions and their relative weights, are stipulated and fixed. This is fine, but it is nevertheless useful and informative to see what happens if we use this concept in a reflective way as a *theoretical concept*. The first step is the collection of information

about factors that might be relevant, either in a positive or negative way. In a second step we can look at their relations. If the correlation is high, with a high Cronbach Alpha, then the factors may measure the same actual phenomenon. If the correlation is low, with a low Cronbach Alpha, then there are usually three options. The first option is to keep all factors in, if they have something in common and if all of them have a specific and valuable contribution. The second option is to leave out factors with a low correlation with the other factors. The third option is to split up the concept in two or more specific concepts, with a more accurate measurement of the related phenomena. This option is attractive if the observations can be explained by two or more components with different dynamics.

Employee performance, with *punctuality*, *making change accurately*, and *getting along with co-workers* as underlying factors, can be used in Murphy's way as an abstractum or formative concept. It is interesting, however, to see what happens if we use the concept as a reflective or theoretical concept. If there is no correlation, or even a negative correlation, between *getting along with co-workers* and the other capabilities, *punctuality* and *making change accurately*, then the perfect employee is apparently rather exceptional. Employers can use such information in their recruitment policies. It obviously depends on the actual jobs, but perhaps they will have to pursue a reasonable balance of capabilities in teams, composed of different people with different but complementary capabilities. Treating employee performance as a reflective or theoretical concept is therefore helpful to get a better understanding of the situation.

My appreciation of academic freedom

Murphy (2022b, 243) is concerned that I oppose the study of classical-liberal freedom as freedom by limited government. Let me remove his concerns. I put a high priority on freedom in general and on academic freedom in particular.² So I do not oppose the study of anything, let alone the study of classical-liberal freedom or the size of government. Information about governments is always useful. I withdraw my suggestion to leave out size of government as one of the items in the measurement of economic freedom!

2. In this respect I follow John Stuart Mill, who puts a high priority on the freedom of thought and discussion (Mill 1992/1859, 17–53).

The reflective/theoretical conceptualization of freedom

Freedom can be defined in a reflective/theoretical way as personal autonomy, enabled by the possibility to choose. This possibility depends on two dimensions: the opportunity and the capability to choose. The opportunity is a characteristic of the social-economic environment and can be interpreted as the absence of inhibitions and the availability of options.³ Capabilities are characteristics of individuals; they must at least have some understanding of the situation and some courage to take decisions. This model implies that full freedom depends on a chain with three elements: absence of inhibitions, availability of options, and individual capabilities. This chain is as strong as the weakest link. The Human Development Index presents no information about freedom as the possibility to choose, as Murphy suggests (2022b, 243), but only about average levels of certain capabilities in nations through purchasing power, years at school, and health as reflected in life expectancy.

It is not unusual to leave capabilities out as a condition of freedom and to look exclusively at the opportunity to choose as a characteristic of the social-economic environment. Some examples: *Global Freedom*, *Personal Autonomy*, and *Press Freedom*, as defined and measured by Freedom House, and *Freedom to Make Life Choices*, as defined and measured in the Gallup World Poll. There is always a substantial positive correlation between types of freedom in nations, and this is an indication that individual freedom in nations is a general cultural standard and phenomenon.

The stipulative conceptualization of economic freedom by the Fraser Institute

If we look at the Annual Reports of the Fraser Institute about the Economic Freedom of the World (EFW) we always see the same enumeration of cornerstones, or economic freedom basics ([link](#)):

3. The absence of manmade inhibitions is comparable with Isaiah Berlin's *negative freedom*. The availability of options is, however, not comparable with his *positive freedom*. This positive freedom implies that an individual can be his own master and that his life and decisions depend on himself, and not on external forces of whatever kind. This freedom is about individual autonomy as an individual capability and not about the availability of options as a characteristic of the environment (Berlin 1969, 122–131).

The cornerstones of economic freedom are personal choice, voluntary exchange, freedom to enter markets and compete, and security of the person and privately owned property.

This enumeration usually goes together with the same explanation in the section “What is Economic Freedom?” in the first Chapter of the reports. We can look at the 2021 Annual Report ([link](#)) as an example.

The cornerstones and the first part of the section suggest, in my view, that economic freedom can be interpreted as the individual opportunity to choose. The second part of the specification is about institutional conditions of freedom, and in particular about the role of governments. The Fraser Institute finds that governments should protect property rights and arrange for the provision of a limited set of important public goods. Examples of such important goods are national defence and access to money of sound value. The Institute finds that governments should do little beyond these core functions. The Institute assumes, apparently, that this type of limited government, with low levels of government activities, contributes to the individual opportunity to choose. The Institute is, however, not very explicit about the relation between the opportunity to choose and the role of governments. It is not clear whether limited government is a necessary and/or sufficient condition for freedom, or just one of many factors. The Institute is critical about such discussions and holds on to the stipulative/formative conceptualization. The implication is that we have to look at the actual measurement, because there is, in this approach, no difference between conceptualization and measurement.

The measurement of economic freedom by the Fraser Institute

The Fraser Institute has selected five items to measure Economic Freedom in nations, all with equal weights. The level of Economic Freedom is expressed in summary scores on a 1–10 scale; higher summary scores indicate more freedom.

1. Size of government (more government activities → lower scores),
2. Legal system and property protection (more protection → higher scores),
3. Sound money (sounder → higher scores),
4. Freedom to trade internationally (freer → higher scores),
5. Regulation of credit, labor, and business (freer → higher scores).

This is the formative concept of economic freedom as defined by the Fraser Institute. It is interesting, however, here again, to look at this measurement if we define economic freedom as a theoretical or reflective concept. If we follow this approach we see that we can make a distinction between the first item, size of government, and the other four items. All items apparently contribute to more freedom, but in different ways.

In item 1 (size of government) nations with higher levels of government activities get lower scores. No distinction is made between appreciated activities, related to core functions, or rejected activities. This item can be interpreted, *arguably, in my view*, as *freedom by smaller government*, because smaller government usually goes together with lower levels of taxation and more individual freedom to spend money.

In the other items 2, 3, 4 and 5, nations get higher scores for specific appreciated government activities related to core functions. These items can be interpreted, *arguably, in my view*, as *freedom as the opportunity to choose*, because they create more and better options for specific economic activities.

The Fraser Institute is critical about such interpretations, but if we accept these interpretations, perhaps as a thought experiment, then we may conclude that limited government is not a necessary or sufficient condition of economic freedom, but just one of the five factors with the same weight as the other four. We may also conclude that these types of freedom are not just different, but even contradictory. Higher levels of appreciated activities contribute to more economic freedom as the opportunity to choose, but simultaneously to less economic freedom by bigger government. This contradiction is a consequence of the stipulative definition of economic freedom as a formative concept, and is not related to actual observations.

If we look at actual observations we see that the four items, if interpreted as the opportunity to choose, have a similar positive and significant correlation with the summary scores. The size of government, if interpreted as freedom by limited government, has a negative but not significant correlation with these scores.

TABLE 1. Correlation between the items of the Index and the final summary scores for 127 nations in the years 2010–2012 (Ott 2018)

1. Size of government	-.17 ^{ns}
2. Legal system and property protection	+.75 ^{**}
3. Sound money	+.82 ^{**}
4. Freedom to trade internationally	+.88 ^{**}
5. Regulation of credit, labor, and business	+.76 ^{**}
<i>Notes:</i> ^{ns} = not significant; ^{**} = significant at .01 level.	

The negative correlation between Size and the summary scores is consistent with the stipulated relation, but is peculiar if we look at the correlation between the sub-

items of Size of government and the summary scores in reality.

TABLE 2. Correlation between the sub-items of Size of government and the final summary scores for 127 nations in the years 2010–2012 (Ott 2018)

a. Government consumption as a % of national consumption	+ .18*
b. Transfers and subsidies as a % of GDP	+ .29**
c. Government enterprises and investment as a % of GDP	- .52**
d. Top tax rates	- .20*
<i>Notes:</i> * = significant at .05 level; ** = significant at .01 level.	

We see now that the sub-items (a) and (b) have a positive correlation with the summary scores, while this correlation is negative for the sub-items (c) and (d). This is peculiar because the sub-items (a) and (b) are the most typical of the general levels of government activities. The sub-items (c) and (d) are less typical in this respect. Sub-item (c) is somewhat obsolete and volatile after the implosion of communism. The sub-item top tax rates (d) is about technical characteristics and is not representative of the level of taxation in general. The total tax burden as a percentage of GDP would be more representative in this respect. The Heritage Foundation uses this sub-indicator (as Tax Burden) and the correlation with the summary scores of the Heritage Index is around zero (-0.00, not significant).

If we define economic freedom as a theoretical or reflective concept, just as a thought experiment, then we may conclude that there is a positive and significant correlation between levels of government activities and freedom as the opportunity to choose, as measured by the items 2, 3, 4, and 5. There is no contradiction but consistency. We must be critical about governments but must also acknowledge this positive correlation. Perhaps we may say that we have to be critical in order to establish and maintain this positive correlation.

In my previous contributions I suggested that size of government should be left out of the measurement, in order to get a better measurement of economic freedom as the opportunity to choose. This suggestion was based on the assumption that the Fraser Institute is defining and measuring economic freedom as a theoretical concept, related to one unequivocal phenomenon. I agree with Murphy, however, that validity arguments are irrelevant because economic freedom is defined in a stipulative way as a formative concept. In the next section I will present some new suggestions for the Index.

New suggestions for the Index

I withdraw my suggestion to leave size of government out, and present some alternative suggestions instead.

1. Split up the Summary scores: one summary score for freedom by limited government, measured by item 1, the size of government, and one summary score for freedom as the opportunity to choose, measured by the other items. The Index will be more transparent and it will be easier to analyze the relations between these two freedoms, and between these freedoms and other freedoms. The current summary scores are impractical, because they are addition sums of different and contradictory types of freedom.
2. Define and measure the size of government in a better way. It is better to look at the total tax burden as a percentage of GDP, instead of looking at some technical characteristics. The total burden is more typical for general levels of government activities. It is also an option to add government employment as a percentage of total national employment, either in persons or in full-time equivalents.
3. The Fraser Institute puts a high priority on competition and free markets. It would be nice to pay some attention to the effectiveness of anti-trust policies, as an appreciated government activity related to the core functions.
4. The quality of governments deserves more attention! The previous research results are based on observations in a full sample of 127 nations. It is informative to split up this sample in nations with a low or high government quality and to specify summary scores for these sub-samples. In the next section I present some arguments to pay more attention to the quality of governments.
5. Whatever is decided, it is wise and helpful to present a better explanation of the Index. The relation between the first item, Size of government, that can be interpreted as freedom by limited government, and the other items, that can be interpreted as freedom as the individual opportunity to choose, deserves more attention.

Quality of governments deserves more priority than their size

There are important arguments to put more priority on the quality of governments than on their size.

1. Limited government can be interpreted as the absence of totalitarian

government. Totalitarianism can be avoided by the quality of government.⁴ This quality implies a separation of powers, with an independent judiciary, rule of law, control of corruption, and respect for elementary principles of good governance.⁵ This quality of governments is more important for freedom than their size.

2. The quality of governments is a more powerful factor than their size. It has a strong impact on economic growth⁶ and the relation between the size of governments and subjective well-being in nations depends heavily on this quality (Ott 2010).
3. The quality of governments is not a vague concept. It is obviously a normative concept, but at a very elementary level. It is therefore a universal concept and not related to a specific culture or to specific policies. There is a lot of excellent information available, provided by the World Bank (Kaufmann and Kraay 2021), and there are usually practical and non-controversial options to improve this quality.⁷
4. Adam Smith (2003/1776, 879–1152) is not very explicit about the size of governments. He writes about taxation and expenditures of the government, but not in any axiomatic way. He even supports government expenditures for education. This argument is consistent with current economic theory that government expenditures are justifiable, if they are used in an efficient way to minimize the negative

4. The World Bank evaluates six dimensions of the quality of governments in nations each year: (1) Voice and Accountability; (2) Political Stability and Absence of Violence; (3) Government Effectiveness; (4) Regulatory Quality; (5) Rule of Law; (6) Control of Corruption (Kaufmann and Kraay 2021). The average of the first two dimensions can be interpreted as the democratic quality; the average of the last four as the delivery or technical quality.

5. Well-known examples are: carefulness and accuracy of decisions, attention for all relevant information, respect for all legitimate interests, accounting for decisions, fair play and equality (equal situations must be treated equally), respect for reasonable expectations, powers have to be used in accordance with their legal background, proportionality (no disproportional negative consequences for citizens, relative to public interests), decisions have to be communicated timely and in an understandable way, with information about possibilities to make objections and to appeal at a higher level. Most nations have adopted such principles, either in a specific code or in jurisprudence.

6. Kaufmann (2005) made the following observation about causality in the relation between governance and wealth: “*In fact, the evidence points to the causality being in the direction of better governance leading to higher economic growth.*”

7. It is undeniable, however, that the introduction of certain principles of good governance can be a challenge. Rule of law and control of corruption demand that relations between citizens and government agencies are based on the principle of ‘universalism’; meaning that citizens must be treated equally and without discrimination. This is difficult if personal relations are important and based on the ‘reciprocity principle’; *if I do something for you, then you should do something for me*. That is sympathetic and very understandable, but the principles of ‘reciprocity’ and ‘universalism’ are incompatible in relations between government agencies and citizens.

impact of fundamental market failures (Andersen 2021).⁸

5. The liberalization in Russia after the implosion of communism was inevitable, but has been implemented without sufficient attention for the quality of the government. This reckless liberalization is one of the causes of the current problems, namely, a dictator who started a war without any justification, and is, unfortunately, supported by some kleptomaniacs and a zombie army without any morality, killing people at random. This situation should remind us that the quality of governments deserves a high priority—also in international relations.

Conclusion

The Fraser Institute defines economic freedom in a stipulative way as a formative concept, measured with five items. If we define economic freedom as a theoretical/reflective concept and look at the measurement results, then we see that different phenomena are measured. These phenomena can be denoted as freedom by limited government and freedom as the opportunity to choose. These types of freedom are different and contradictory. It is therefore more informative to report their summary scores separately.

It is also wise to pay attention to the quality of governments as a crucial factor for freedom. The current attention for the size of governments is perhaps an inheritance of the Cold War. This Cold War is over and now we have to fight a real war. To win this war we have to pay attention to our soldiers and guns, but also to our core values like freedom. Freedom and liberalism need good governments more than anything else.

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8. Andersen (2021) explains that the Scandinavian governments invest a lot of money in education, health care, and care of elderly people. Such investments contribute to higher levels of labour productivity and more participation in paid employment. Such investments may even enhance Murphy's employee performance!

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