

RESEARCH FINGERPRINT

IDENTIFIER

LJRHSS-226072

PEER REVIEW

Double Blind

SIMILARITY CHECK

Perplexity AI and iThenticate

ACCESS

Open Access

LANGUAGE

English

PRINT ISSN

2515-5784

ONLINE ISSN

2515-5792

EDITION

ABBREVIATION

LJRHSS

VOLUME

26

ISSUE

3

YEAR

2026

KEY DATES

RECEIVED

2026-02-19

ACCEPTED

2026-02-25

ONLINE PUBLISHED

2026-04-16

PUBLISHED

2026-06-17

CATALOGING

CROSSMARK DOI

10.34257/LJRHSS226072UK

LCC CLASS

HB95, HB501, JC574

Article Record

Surrendering Economic Freedom, Losing Prosperity and Peace

CORRESPONDENCE → +



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ABSTRACT

In the 1990s supporters of economic freedom had reasons to be optimistic. Because of its economic superiority the West had just won the Cold War. The Soviet Union and its empire were dissolved. The threat of nuclear war and mutual assured destruction had receded. Western economic superiority was ultimately rooted in economic freedom and decentralized decision-making. As Mises (1922/1988) and Hayek (1945) had recognized, private property rights in the means of production and decentralized decision-making are essential, if we want to benefit from of a rational allocation of scarce resources and to exploit human knowledge which is dispersed across millions of minds. Decentralized decision-making is maximized in market economies with limited government where consumers rule and people enjoy entrepreneurial freedom. It is minimized in centrally planned economies.

Index Terms: Economic freedom • globalization • capitalist peace • geopolitical rivalry • hegemonic stability • extended deterrence • public debt • China-US relations

FUNDING

No external funding was declared for this work.

CONFLICTS

The authors declare no conflict of interest.

AI USAGE

No generative AI was used for analysis or results.


HOW TO CITE

Weede (2026). Surrendering Economic Freedom, Losing Prosperity and Peace. London Journal of Humanities and Social Science, 26(3), 28-31. DOI: 10.34257/LJRHSS226072UK

ACCESS
ONLINE

METADATA CONTINUATION

AUTHOR CONTACT QR LEDGER

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ARCHIVAL RECORD

LJRHSS · Vol 26 · Issue 3 · 2026
Article ID LJRHSS-226072 · DOI 10.34257/LJRHSS226072UK
Print ISSN 2515-5784 · Online ISSN 2515-5792

RESEARCH ARTICLE

Surrendering Economic Freedom, Losing Prosperity and Peace

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Abstract

In the 1990s supporters of economic freedom had reasons to be optimistic. Because of its economic superiority the West had just won the Cold War. The Soviet Union and its empire were dissolved. The threat of nuclear war and mutual assured destruction had receded. Western economic superiority was ultimately rooted in economic freedom and decentralized decision-making. As Mises (1922/1988) and Hayek (1945) had recognized, private property rights in the means of production and decentralized decision-making are essential, if we want to benefit from of a rational allocation of scarce resources and to exploit human knowledge which is dispersed across millions of minds. Decentralized decision-making is maximized in market economies with limited government where consumers rule and people enjoy entrepreneurial freedom. It is minimized in centrally planned economies.

Keywords: *Economic freedom, globalization, capitalist peace, geopolitical rivalry, hegemonic stability, extended deterrence, public debt, China-US relations*

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1 INTRODUCTION

In the 1990s supporters of economic freedom had reasons to be optimistic. Because of its economic superiority the West had just won the Cold War. The Soviet Union and its empire were dissolved. The threat of nuclear war and mutual assured destruction had receded. Western economic superiority was ultimately rooted in economic freedom and decentralized decision-making. As Mises (1922/1988) and Hayek (1945) had recognized, private property rights in the means of production and decentralized decision-making are essential, if we want to benefit from of a rational allocation of scarce resources and to exploit human knowledge which is dispersed across millions of minds. Decentralized decision-making is maximized in market economies with limited government where consumers rule and people enjoy entrepreneurial freedom. It is minimized in centrally planned economies.

In the 1990s the West still believed in the expansion of free trade and in the benefits of globalization. By promoting economic freedom globally we wanted to increase economic growth rates and to expand prosperity globally. Faith in socialism and central planning receded to a few miserable outposts like North Korea. Even critics of capitalism like Piketty (2015) had to concede that in the long run mass prosperity was more dependent on economic growth than on the distribution of income. Economic freedom expanding reforms in giant countries, like China and India, enabled hundreds of millions of people to escape from dire poverty during the era of globalization (Milanovic, 2016). Poorer countries could grow faster than richer countries. This was an opportunity, no more. Asians benefitted more from this opportunity than Africans. The Chinese did not yet benefit from it under Mao's rule, when tens of millions were starved to death (Dikötter, 2010). They had to reform their economy first and to find their comparative advantages in the global division of labour (Lin, 2012).

One may label this opportunity the 'advantages of backwardness' and explain it partially as an external effect of economic freedom in other countries which provide a model for emulation as well as destination for poor country exports (Weede, 2006). During the era of globalization the global distribution of income between individuals or households became more equal in spite of the opposite trend within some countries, including the United States or China (Milanovic, 2016). If one includes home ownership as well as social insurance entitlements, the distribution of wealth nevertheless became more equal within most Western societies (Waldenström, 2024). Although the fruits of economic freedom and prosperity were not equally shared, they certainly were widely shared.

2 A CREEPING LOSS OF ECONOMIC FREEDOM, FUTURE PROSPERITY ENDANGERED

At the turn of the millennium one could still overlook the problems which accumulated below the surface. The ratio of government expenditures to GDP had grown. At the beginning of the 20th century it was about 10 percent in most Western countries, at the end it was about 40, in some countries even about 50 percent (Tanzi, 2011). The most dynamically growing part of government expenditures had been social transfers which currently tend to be close to 30 percent of GDP. The expansion of the welfare state and social transfers implies a loss of individual freedom and responsibility of adults for themselves. Since government revenues tend to be lower than government expenditures in most places, public debt is growing. Among the biggest Western economies, it is safely below GDP only in Germany. But the current German government is following the poor example of others and rapidly expanding its debt. On top of the explicit government debt referred to above, there is the implicit debt arising out of government promises to pensioners and those in need of medical care. Including these,

government obligations are a multiple of GDP almost everywhere in the West. This burden darkens future prospects by either growing tax burdens or inflation or a mixture of both.

In Europe, the transformation of the European Union from a common market towards a transfer union generates a further problem. Since Greece and other nations in financial trouble received financial assistance from the ECB and the EU in the 2010s, the no bail-out rule has been replaced by the expectation that countries in need will receive assistance. Such an expectation necessarily undermines incentives for responsible budgeting. Why should politicians impose austerity at home and suffer the electoral consequences, if the more comfortable option of outside assistance is available? Currently, the evolution of the French public deficit and debt are the main issues of concern. Since France is a much bigger economy and a more important member of the EU than Greece, surviving a French debt crisis would be a much bigger challenge for the EU than the trouble with Greece ever could be.

To make matters worse the negative outlook for government finances is combined with a poor demographic outlook (Morland, 2024). In almost all Western countries the number of children per women is significantly below the 2.1 required for population stability. Among the major democracies the outlook is worst in Germany, Italy, and Japan. Migration from poor countries with lots of young people to rich countries with too few of them theoretically looks like a solution. Since childbirths are below replacement level and falling almost everywhere, including even many Muslim countries, most future migrants must come from Africa. Africa is demographically the most vital region and simultaneously the poorest. It is hard to imagine that the poorest continent can supply migrants with the education which people need to satisfy the requirements of much richer destination countries and their job markets. Cultural differences will add to the difficulties of successful integration. Moreover, hostility toward migrants seems to have risen in many Western countries at the same time when demography suggests that there should be more immigration. Assuming that current trends in migration and the rising hostility in destination countries continue, we face the question of how to confront the rising ethnic and cultural heterogeneity. Obviously, prosperity helps to mitigate domestic conflict. Contrary to widely shared beliefs, recent econometric research has established that economic freedom or capitalism exerts a pacifying impact within nations by reducing common murders as well as the risk of civil war (de Soysa, 2026). Since economic freedom is in retreat, Western societies face an abundance of economic and social problems at home.

3 EMERGING GREAT POWER RIVALRY INSTEAD OF HEGEMONIC STABILITY

After the end of the Cold War the United States of America was the undisputed hegemon of the world. Most other rich and strong countries were US allies. There had been some tacit cooperation between the US and Communist China against the Soviet Union before the end of the Cold War. But China is simply too big for being permanently satisfied with playing second fiddle to other nations. The Chinese population is about four times as strong as the American. The exploitation of the advantages of backwardness had to give China the opportunity to grow much faster than advanced Western nations could. Western economic freedom could be exploited by the Chinese. They could observe Western models of organizing enterprises and the economy, send students and engineers to Western countries to learn new skills for later application at home. They could invite Western capitalists to invest in Chinese manufacturing and use joint ventures to enter Chinese as well as Western markets. China could integrate itself in global supply chains. It could repeat the export-oriented growth strategy of the four small tigers in

China's neighbourhood, i.e. South Korea, Taiwan, Hong Kong and Singapore, which could benefit from rich and open markets in the West.

During the first decades after Deng Xiaoping's successful reforms China subordinated everything under the goal of promoting economic growth. It succeeded beyond reasonable expectations and delivered a miracle (Coase and Wang, 2013; Lin, 2012; Weede, 2022). Because of the expansion of economic freedom in China, Western observers hoped for a corresponding expansion of political freedom. Some even expected China to become a democracy. Since the Republic of China on Taiwan had overcome autocracy, the cultural heritage of China which both Chinese states shared could hardly be an insurmountable obstacle to democratization. After Xi Jinping's rise to power, however, this hope was slowly lost and replaced by a deepening pessimism about Chinese politics and the future relationship between China and the West.

At least one could hope for a commercial or capitalist peace between China and the West because of the flourishing trade between them and mutual investments in their trading partners. By and large, historical evidence and lots of quantitative analyses of it demonstrate the existence of a capitalist peace (Weede, 2018). The peace based on economic interdependence and trade, however, crucially depends on the widely shared expectation that markets, whether for raw materials or other inputs or for final consumer goods, remain open in future (Copeland, 2015). This expectation must have been shattered by the growing use of economic sanctions. The Chinese must have observed American and Western sanctions against North Korea or Iran in order to prevent these states from acquiring nuclear weapons. They must have seen the escalating sanctions against Russia after its attack on the Ukraine and concluded that access to Western markets is precarious and may easily be denied in future. Because of the disagreement between China and the US over Taiwan, it has been all too easy for the Chinese to imagine what might make them a future target of American or Western sanctions. Thus, the pacifying impact of trade had been blunted for China and the West, even before Trump began his tariff war against friends and foes.

Since the recession of 2008 in the West, the Chinese began to believe that the West is in decline whereas China itself is a rising nation. In the middle of the 2010s the economic size of China began to equal the American size in purchase power parity terms. Given current exchange rates, China has not yet surpassed the US, but its contribution to global manufacturing already is about twice as much as the American contribution and might become its triple in one or two decades (Campbell and Doshi, 2025). Thus, China is by far the most credible challenger to American global dominance. While Russia still commands more nuclear weapons than China, its economic base is far too weak to take this role. Worse still for Russia, its attack on the Ukraine together with Western sanctions have made the Russian economy dependent on trade with China. In the long run, the main geopolitical effect of the war against the Ukraine might be that Russia becomes the junior partner in a vast Chinese sphere of influence extending to the Baltic Sea. The longer the war continues, the more likely such an outcome becomes.

In the past, the integration of China into the global economy and interdependence between China and the West did contribute to a capitalist peace between China and the West. In my view, the capitalist peace is superior to a democratic peace for two reasons. First, economic freedom or capitalism contributes to the avoidance of war in a pair of nations already, if one of them enjoys it. By contrast, democracy reduces the risk of war in a pair of nations only, if the other nation is a democracy, too. In mixed autocracy democracy pairs, the risk of war is even higher than among two autocracies. Second, it is well-known that prosperity contributes to the evolution and survival of democracies (Lipset, 1994).

As argued above, without economic freedom or capitalism one should expect misery and stagnation instead of prosperity.

Unfortunately, free trade and the capitalist peace seem to require hegemonic stability. The rise of China seems to have undercut it. The era of globalization overlaps with a unipolar configuration of power or American hegemony.¹ It began with the decline of the Soviet Union. It has been weakened by the rise of China. Since Trump's second acquisition of the presidency, it is obvious that great power rivalry undermines free trade. Whereas free trade benefits consumers in all nations who take part in it, it does not conserve the dominance of the hegemon or the status ordering of nations. Geopolitical rivalry and concern about one's place in the pecking order promotes interference with free trade. Instead industrial policies and tariffs spread. The freedom of consumers to buy the best product at the cheapest price from domestic or foreign providers is reduced as well as the freedom of entrepreneurs to outsource inputs globally.

But economic freedom suffers from another attack, too. Within nations, it is undercut by the tax and transfer state as well as by excessive regulation and bureaucratization. Within the West, lawyers have a fairly dominant position in the bureaucracy and even in legislative bodies. As Wang (2025) recently suggested, one reason for the rise of China is that its ruling elite has a background in engineering instead of law.

4 EMERGING CONFLICTS OF INTEREST UNDERMINE EXTENDED DETERRENCE, TOO

If the commercial or capitalist peace doesn't apply, the escalation of conflicts of interest to war still may be avoided by deterrence. Although nuclear deterrence is not fail safe or fool proof, it is more likely to work than conventional deterrence. In nuclear war it is easy to imagine that both sides suffer so terribly that meaningful victory becomes unthinkable. The idea of mutual assured destruction pacifies. By contrast, at the beginning of a conventional war both sides can easily imagine a quick victory, as happened in 1914. But deterrence can also cover the relationship between some non-nuclear states, as has happened during the Cold War in Europe. Then, some nations were allied with or subordinated to the American superpower, others to the Soviet superpower, both of which wanted to avoid nuclear war. Fearing escalation, they would not permit their subordinate allies to fight the other side. Extended deterrence did work (Weede, 1983). Trump's criticism of free riding allies², his doubts about the value of NATO allies for the US, and his desire to take control of Greenland against the objection of America's Danish allies must have undercut the value of the American nuclear shield for allied partners. The more questionable extended deterrence becomes, the stronger the incentive for nuclear proliferation becomes. Most experts regard the prospect of proliferation with alarm, because more fingers at nuclear triggers raise the risk of miscalculation and accidental war.

Another reason why extended deterrence suffers an erosion of credibility is the slow emergence of disharmony and conflicts of interest between major Western nations. Before Trump's second presidency it looked, as if the US and Europe together would assist the Ukrainians to defend themselves. Trump insists that only Europeans carry the financial burden of doing so, arguing that Britain, or France, or Germany command larger economies than Russia. Whereas the economic strength of Europe would make the burden shifting feasible, Trump

¹One may argue that unipolarity has not yet ended or that multipolarity is an expectation instead of an established reality (Mohan, 2026). Certainly, the US is still the strongest power. But its status is no longer unchallenged.

²Actually, there is another reason why Americans were disappointed by their major allies. Had the Europeans and the Japanese performed better economically, G7-dominance of the global economy would not have declined as rapidly. The end of unchallenged Western economic supremacy has not been America's fault (Prasad, 2026).

overlooks that it would nevertheless undermine extended deterrence. By contrast, continued cooperation of America and Europe in assisting the Ukraine would strengthen extended deterrence.

Whereas Europeans again feel threatened by Russia, Americans face other concerns. One may even call it a clash of national security interests. Europeans want to deter and contain Russia and therefore are ready to help the Ukraine. The Americans know that Russia no longer is a serious rival – except, of course, for their nuclear weapons – and that a declining great power does not need to be contained. From the American point of view, China is the only serious rival. In order to focus on China, the Americans want to delegate the defence of Europe and the Ukraine to the Europeans. Therefore the Europeans need to rearm themselves. The more important the armaments industry becomes, the stronger necessarily government interference in the economy is, the weaker economic freedom becomes. One should remember that Lenin's model for economic planning was the German war economy during World War I. Without questioning the necessity of Europe taking care of its own defence, it has to be underlined that this requires not only accepting the financial burden, but also some curtailment of economic freedom and the consequences for prosperity, international trade, and peace. Irrespective of strategic needs, European support for the Ukraine may overburden the domestic politics of the greying and deficit-plagued welfare states of Europe.

The emerging conflict of strategic interests between Europe and the US undermines the credibility of extended deterrence. Since the Russians recognize that Trump's relationship to Europe is ambivalent, American readiness to defend Europe with troops and nuclear weapons becomes less credible. One may even detect an emergent harmony of interest between Trump's America and Putin's Russia. The longer the war in the Ukraine lasts, the worse the dependence of Russia on China becomes. In the long run Russia might be destined to become the junior partner of China and even part of its sphere of influence. A Chinese sphere of influence extending all the way to the Baltic Sea is a nightmare for both Russia and America. That is why there might be a reconciliation of America and Russia, at the expense of Europe and the Ukraine.

There is not only a conflict of interest between the Americans and the Europeans, but also one between the Ukraine and its European supporters. If the Ukraine really still wants to re-conquer its lost eastern regions as well as the Crimea, then they must want the Europeans not only to support them financially, but also to support them with troops. Are the Europeans ready to do it? I doubt that politicians in Brussels and London, in Paris or Berlin are sufficiently aware of this conflict of interest.

5 CONCLUSIONS

Economic freedom is a value in itself, but simultaneously a means to become and remain prosperous. Economic freedom has been in retreat during the 20th century because of the growth of government, the establishment and expansion of the welfare state, and a growing preference to pay for public expenses with debt instead of taxation. Demographic trends make this set of preferences and policies worrisome. By and large, Europe is more affected by these disabilities than the United States. The rise of China and its recent change from a minimal deterrence posture to something closer to a counterforce strategy requires the United States to increase its defence spending. The Russian aggression against the Ukraine requires Europe to do so. Emerging conflicts of interest within the West and growing doubts about the effectiveness of extended deterrence by the US against Russia raise the pressure on Europeans to prepare themselves for greater strategic autonomy. Simultaneously, the rise of China has overcome hegemonic

stability and the pacifying effects of free trade. That is why we face the prospect of less economic freedom, less prosperity, and a higher risk of war.

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