

Executive Summary

Economic Freedom of the World

The index published in *Economic Freedom of the World* measures the degree to which the policies and institutions of countries are supportive of economic freedom. The cornerstones of economic freedom are personal choice, voluntary exchange, freedom to compete, and security of privately owned property. Forty-two variables are used to construct a summary index and to measure the degree of economic freedom in five broad areas:

- 1 Size of Government;
- 2 Legal System and Property Rights;
- 3 Sound Money;
- 4 Freedom to Trade Internationally;
- 5 Regulation.

An important anniversary

This year is the 100th anniversary of Milton Friedman's birth. Milton Friedman was the godfather of *Economic Freedom of the World*. He believed that, if economic freedom could be measured with greater accuracy, it would be possible to isolate its impact on the performance of economies and other factors of interest. This led to the Economic Freedom of the World project, headed by Milton and Rose Friedman and Michael Walker, then executive director of the Fraser Institute.

Since our first publication in 1996, numerous studies have used data from *Economic Freedom of the World* to examine the impact of economic freedom on investment, economic growth, income levels, and poverty rates. Virtually without exception, these studies have found that countries with institutions and policies more consistent with economic freedom have higher investment rates, more rapid economic growth, higher income levels, and more rapid reductions in poverty rates.

Economic freedom from around the world

- In the chain-linked index, average economic freedom rose from 5.30 (out of 10) in 1980 to 6.88 in 2007. It then fell for two consecutive years, resulting in a score of 6.79 in 2009 but has risen slightly to 6.83 in 2010, the most recent year available. It appears that responses to the economic crisis have reduced economic freedom in the short term and perhaps prosperity over the long term, but the upward movement this year is encouraging.

- In this year's index, Hong Kong retains the highest rating for economic freedom, 8.90 out of 10. The other top 10 nations are: Singapore, 8.69; New Zealand, 8.36; Switzerland, 8.24; Australia, 7.97; Canada, 7.97; Bahrain, 7.94; Mauritius, 7.90; Finland, 7.88; and Chile, 7.84.
- The rankings (and scores) of other large economies in this year's index are the United Kingdom, 12th (7.75); the United States, 18th (7.69); Japan, 20th (7.64); Germany, 31st (7.52); France, 47th (7.32); Italy, 83rd (6.77); Mexico, 91st, (6.66); Russia, 95th (6.56); Brazil, 105th (6.37); China, 107th (6.35); and India, 111th (6.26).
- The scores of the bottom ten nations in this year's index are: Venezuela, 4.07; Myanmar, 4.29; Zimbabwe, 4.35; Republic of the Congo, 4.86; Angola, 5.12; Democratic Republic of the Congo, 5.18; Guinea-Bissau, 5.23; Algeria, 5.34; Chad, 5.41; and, tied for 10th worst, Mozambique and Burundi, 5.45.
- The United States, long considered the standard bearer for economic freedom among large industrial nations, has experienced a substantial decline in economic freedom during the past decade. From 1980 to 2000, the United States was generally rated the third freest economy in the world, ranking behind only Hong Kong and Singapore. After increasing steadily during the period from 1980 to 2000, the chain-linked EFW rating of the United States fell from 8.65 in 2000 to 8.21 in 2005 and 7.70 in 2010. The chain-linked ranking of the United States has fallen precipitously from second in 2000 to eighth in 2005 and 19th in 2010 (unadjusted ranking of 18th).

Nations that are economically free out-perform non-free nations in indicators of well-being

- Nations in the top quartile of economic freedom had an average per-capita GDP of \$37,691 in 2010, compared to \$5,188 for bottom quartile nations in 2010 current international dollars (Exhibit 1.7).
- In the top quartile, the average income of the poorest 10% was \$11,382, compared to \$1,209 in the bottom in 2010 current international dollars (Exhibit 1.10). Interestingly, the average income of the poorest 10% in the most economically free nations is more than twice the overall average income in the least free nations.
- Life expectancy is 79.5 years in the top quartile compared to 61.6 years in the bottom quartile (Exhibit 1.11).
- Political and civil liberties are considerably higher in economically free nations than in unfree nations (Exhibit 1.12).

Chapter 1: Economic Freedom of the World in 2010

The authors of the report, James Gwartney (Florida State University), Robert Lawson (Southern Methodist University), and Joshua Hall (Beloit College) provide an overview of the report and discuss why economic freedom is important. They also consider the key factors underlying the decline in economic freedom of the United States since 2000.

Chapter 2: Country Data Tables

Detailed historical information is provided for each of the 144 countries and territories in the index.

Chapter 3: Institutions and Economic, Political, and Civil Liberty in Latin America

In this chapter, Alice M. Crisp and James Gwartney take a closer look at the economic, political, and civil institutions of 22 Latin American countries. These institutions are interrelated and they work as a combination to influence economic performance. To a large degree, researchers know the bundle of economic institutions and policies that lead to economic growth and prosperity. But economic institutions are an outgrowth of the political process. Similarly, civil liberties influence the public discourse and thereby have an impact on both economic and political decision-making. The quality of economic and political institutions is generally related. In Latin America, five countries—Chile, Peru, Panama, Trinidad & Tobago, and Uruguay—rank in the top eight in both economic and political institutional quality. Similarly, six countries—Venezuela, Ecuador, Haiti, Bolivia, Guyana, and Honduras—rank in the bottom eight in both the economic and political categories. The chapter provides detailed information on the strengths and weaknesses and changes in the institutional quality of Latin American countries during the past two decades.

Chapter 4: Banking Crises and Economic Freedom

Scott L. Baier, Matthew Clance, and Gerald P. Dwyer examine the connection between banking crises and measures of economic freedom from *Economic Freedom of the World: 2011 Annual Report*. They find that higher economic freedom—more personal choice, freedom of exchange, and protection of private property—is associated with a lower probability of a banking crisis. This is contrary to conventional wisdom that financial “deregulation” contributes to financial and banking crises. This finding appears in estimates from both a linear probability and a probit model and is also unaffected by inclusion of the growth of real Gross Domestic Product (GDP), deposit insurance, time or country dummy variables, or the level of real GDP. The authors also find that economic freedom falls after a financial crisis.

Chapter 5: Does Aid Buy (Economic) Freedom?

In this chapter, Axel Dreher and Kai Gehring survey the literature investigating the effects of development aid on economic freedom. The authors discuss the theoretical channels by which development aid can affect freedom and review the existing empirical literature. Overall, this literature does not establish a final answer to the question of whether aid works. However, multilateral aid seems to be more effective in increasing freedom than bilateral aid, and aid disbursed in the period after the Cold War seems to be more effective as well. This highlights the importance of changes in the prevailing aid paradigm over time when analyzing the effectiveness of aid. Moreover, the authors stress that a unified framework is required to conclusively investigate the effect of aid on freedom, including a common sample and method of estimation, common control variables, and changing one parameter of the empirical setup at a time rather than all of them together.

Chapter 6: How Institutions of Liberty Promote Entrepreneurship and Growth

Christian Bjørnskov and Nicolai J. Foss report on previous research on the links between institutions of freedom, entrepreneurship, and economic growth and add some new findings. Specifically, they discuss how economic policy and institutional design affect entrepreneurship, and how entrepreneurship in turn affects total factor productivity. In a panel of 25 developed countries observed between 1980 and 2005, they find that government size and sound money positively affect entrepreneurial activity while legal quality does so negatively. Further evidence shows that both entrepreneurship and legal quality exert a positive impact on productivity. The main effects of improvements to economic freedom are mediated through entrepreneurship and are substantial.

Data available to researchers

The full data set, including all of the data published in this report as well as data omitted due to limited space, can be downloaded for free at <<http://www.freetheworld.com>>. The data file available there contains the most up-to-date and accurate data for the Economic Freedom of the World index. Some variable names and data sources have evolved over the years since the first publication in 1996; users should consult earlier editions of *Economic Freedom of the World* for details regarding sources and descriptions for those years. All editions of the report are available in PDF and can be downloaded for free at <<http://www.freetheworld.com>>. However, users are always strongly encouraged to use the data from this most recent data file as updates and corrections, even to earlier years' data, do occur. Users doing long-term or longitudinal studies are encouraged to use the chain-linked index as it is the most consistent through time.

If you have problems downloading the data, please contact Jean-François Minardi via e-mail to <freetheworld@fraserinstitute.org> or via telephone +1.514.281.9550 ext. 306. If you have technical questions about the data itself, please contact Robert Lawson via e-mail to Robert Lawson <robert.a.lawson@gmail.com> or via telephone at +1.214.768.1708. Please cite the data set as:

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