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Economic Freedom in the EU

MEDIOCRE TODAY – WORLD LEADER TOMORROW?

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Executive summary

Over five years have passed since the outbreak of the most severe economic crisis of our time. Since then, there has been an ongoing global and European debate on how to restore economic growth. Several years before the outbreak of the crisis, the EU set an ambitious plan with the Lisbon Strategy to become the most dynamic and competitive region in the world. There is widespread consensus that today's levels of unemployment, exclusion, deficit, and debt are undesirable and unsustainable, and need to be addressed.

None of these challenges will be overcome without boosting economic growth. As growth cannot be commanded, the ongoing debate on "austerity measures" vs. "growth" is misleading and false.

Rather, the challenge lies in creating societies where individuals, families, and companies are able to work, trade, consume, save, invent, and invest without tangled regulation, high taxes, or other obstacles. Simply put: the challenge lies in increasing economic freedom.

This memorandum seeks to contribute to the debate by showing that while many EU countries (including Sweden, Poland, Lithuania and Germany) have seen an increase in economic freedom over the last years, much remains to be done. In regards to economic freedom, the EU in total is nowhere near its goal of being a world leader. A weighted ranking for the European Union as a whole would rather bear more resemblance to countries like Brunei, Rwanda, and Uruguay than major competitors such as USA, Canada, Australia, and Taiwan.

Thus, Europe is in need of further reforms. Luckily, the solution is not hard to find. What needs to be done is to use the method of best practices by learning from those EU member states which are freer and more successful than others. As shown in this memorandum, the method of "follow the leader" would rapidly transform the EU into a global leader position, ahead of comparable countries and regions. The example should be used as an illustration of how to reach the goal of the Europe 2020 strategy, which aims to create the world's most dynamic and competitive economy.

First and foremost, the reforms would be an important step in the fight against youth unemployment, deficit, and exclusion. A strategy to increase the economic freedom in the EU as well as in individual member states would tackle both the short term challenges as well as align with the European Union's long term agenda.

Economic freedom fosters wealth

There are clear positive relationships between economic freedom and a vast number of economic and social progress indicators. The strongest and most obvious correlation is the link between a country's economic freedom and its level of prosperity. According to the 2014 *Index of Economic Freedom*, a yearly ranking of economic freedom published by US think tank The Heritage Foundation, issued for the 20th time this year, the income rates in economies regarded as *Free* or *Mostly Free* are more than three times above the average income for all countries. When compared to countries whose economies are *Non-Free*, or *Repressed*, wealth is more than 10 times higher in free or mostly free economies.

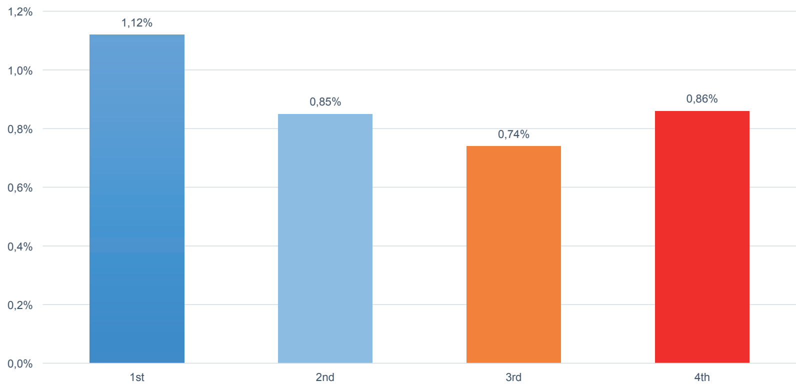
On a country-by-country basis there are also strong correlations between economic freedom and the citizens' overall standard of living. If we divide countries into groups according to their estimated economic freedom and then compare the group's result in the United Nations (UN) *Human Development Index* (measuring e.g. life expectancy, literacy, and level of education), it becomes clear that countries characterised by a high degree of economic freedom are the same countries where citizens enjoy the highest standard of living.

It should be pointed out, the difficulty in comparing different countries and their economies. Each ranking has its own pros and cons, which lead to different results depending on how various factors are weighted. In cooperation with Timbro and a number of other think tanks another index is published by the Canadian think tank, The Fraser Institute: *Economic Freedom of the World*. While different results appear if one compares the indexes by looking at individual countries or factors, the overall picture more or less remains equal. The same holds for other indexes, which look for similar findings, such as the World Bank's Doing Business Index and the World Economic Forum's *Global Competitiveness Index*. However, this paper will be using data—if not stated otherwise—from the Heritage Foundation's *Index of Economic Freedom*.

The case for economic freedom

In their book, *Renaissance for Reforms* (Timbro 2014), scholars Stefan Fölster and Nima Sanandaji show that progress comes not only to already free economies. The countries that are increasing their economic freedom will see the most positive development. This holds good for numerous aspects, including increase in income (per capita) as well as for higher scores in the UN *Human Development Index*.

Fig 1. Improving economic freedom means greater human development. Average annual growth in human development Index 2000–2012.



Change in Economic Freedom (score by quartile).
(1st = most improvement – 4th = least improvement).

Source: The Heritage Foundation "Index of Economic Freedom"

Thankfully, the world seems to desire to move in the right economical direction. The world's freedom in total numbers has increased since measurements started in 1995. During the same period the world economy continued to grow substantially, and at the same time poverty decreased drastically.

The road towards a more decent economic world order seems to be wide open. According to the *Index of Economic Freedom 2014*, published in January 2014, the world economy as a whole reaches 60.3 points, which is the highest score since the index was established 20 years ago. Out of the 178 countries monitored, 114 scored higher points than the year before, whereas 59 scored lower. There were 43 countries that recorded an all-time-high.

Exactly what is being measured when economic freedom on a country level is compared? The index is based on 10 factors divided into four groups:

Rule of Law	• How the country's legal system works. • The extent to which property rights are protected. • How widespread corruption is.
Limited government	• How large an individual's share of profit is from his or her income. • Comparing the size of the private and the governmental spheres of the economy.
Regulatory efficiency	• Presence of functioning freedom of trade and contractual freedom. • What the country's labour market regulation looks like. • Whether or not the country has a stable monetary policy.
Open markets	• The characteristics of the country's financial market and its invest ment environment. • The extent their economy is open in relation to the surrounding world.

The case of Sweden

These factors are in line with literature outlining the fundamental conditions for economic growth. In their book *Varför går det så bra för Sverige?* ("Why is Sweden doing so well?", Fores 2012),[1] economists Andreas Bergh and Magnus Henrekson summarise these conditions as follows:

> *Society's fundamental institutions are key determinants for its wealth. Solid protection of private property rights, a non-corrupt government and international market openness are all examples of growth-enhancing measures, i.e. they are institutions contributing to a high level of economic freedom.*

The 10 economic freedom factors in *Index of Economic Freedom* are set individually on a scale of 0 to 100. The higher the better. A country's total score is calculated by weighing all factors to an average score. Last year's scores for Sweden are presented below:

2014	**Index of Economic Freedom**	Score
Rule of law	Property rights	90.0
	Freedom from corruption	92.3
Government size	Government spending	21.4
	Fiscal freedom	42.9
Regulatory efficiency	Business freedom	91.1
	Labour freedom	52.9
	Monetary freedom	82.5
Market openness	Trade freedom	87.8
	Investment freedom	90.0
	Financial freedom	80.0
Total	Sweden	73.1

Sweden was one of 43 countries recording an all-time-high score. With 73.1 points Sweden ranks as number 20 in the 2014 country rankings. Since the index was introduced in 1995 Sweden has recorded a score improvement by 11.7 points, which is the second best improvement rate amongst the world's developed economies.

Compared to 1996 Sweden has improved considerably in 8 out 10 measuring factors. In categories such as Rule of law and Market openness, Sweden belongs to the *Most Free* countries in the world. However, the picture is more mixed when it comes to Regulatory efficiency and Government size.

1 See also Bergh, A. (2013). What are the policy lessons from Sweden? On the rise, fall and revival of a capitalist welfare state. New Political Economy (forthcoming), <http://berghsbetraktelser.squarespace.com/storage/Bergh-NPE-forthcoming.pdf>.

Sweden has also been more successful than most other EU countries in coping with the current economic crisis. Employment, number of hours worked, and income have all increased in Sweden since 2008. Unlike many other EU countries, Sweden's public finances are in good shape and the country has not been forced to extensive austerity measures or tax increases due to large budget deficits.

In order to further advance within the ranks however, Sweden needs to continue reforming its labour market, in addition to reducing taxation and making prudent choices regarding public spending.

Merkel's European Challenge

Unfortunately, prospects are darker in other parts of the EU; many member countries still have major challenges ahead. Budget deficits remain too large and debts keep growing. Unemployment in Europe is high, especially among the young. Therefore, policy makers need to focus on reforms aimed at creating new jobs as well as promoting economic growth, on EU and national levels alike. Even for the countries that prioritise other issues, such as climate change and crime, economic viability should remain a strict requirement. Failure to provide jobs will make all other challenges even more difficult to resolve.

German Chancellor Angela Merkel is usually given credit for summarizing Europe's challenge in three plain numbers: 7-25-50. The argument is as follows:

> 7: Europe today has around 7% of the world's population; however, low birthrates and an aging population means this number is in decline.
>
> 25: Europe produces around 25% of the world's output, but the share is shrinking as competitiveness falters and growth increases in other parts of the world.
>
> 50: At the same time, Europe accounts for around 50% of the world's public spending on welfare.

While some may say that a large public sector is incompatible with a high degree of economic freedom, scholars Andreas Berg and Magnus Henreksen suggest in their above cited book that "the Nordic countries do well in combining a high degree of economic freedom and an extensive welfare state." A prerequisite is that the welfare state is characterised by an effective, non-corrupt bureaucracy. Another example would be Angela Merkel's Germany.

Provided that the citizens of Europe are willing to maintain high welfare ambitions through relatively heavy taxation, the economy as a whole needs to be given the best of conditions if we want to compete on the international markets.

Creating a single market is a way for Europe to achieve this. The idea is plain and praiseworthy: Replace the current 28, more or less inefficient, regulatory frameworks with a single and competitive EU market framework. This has been the guiding star of the EU since the Single European Act of 1986. Hitherto, how well have we done?

It is beyond doubt that vast progress has been made to embody the EU's vision of free movement of goods, services, capital, and people. However, there is much more to be done, particularly in the services market. Despite the fact that services are a dominating and growing share of Europe's economy, constituting over 70% of its GDP, the sector accounts for only a fifth of the cross-border trade within the EU.

In their report *Kick-starting growth: How to reignite the EU's services sector*, the London-based think tank Open Europe points out how much is yet to be done, and also shows the enormous potential of the single market for services. If EU countries just properly implemented what has already been agreed amongst EU leaders this could boost the EU economy by some €230bn. This is equivalent to the yearly GDP of Denmark!

The idea of the single market is to replace 28 often badly functioning national regulatory frameworks with a single good one. Yet, as the Open Europe report indicates, the single market is not as integrated and common as it could, and should be. Ultimately, if Europe wants to overcome the welfare challenge, a single market alone will not be enough. It also has to be built on freedom, rule of law, efficiency, and openness.

Economic freedom in Europe

What is the current state of economic freedom in Europe? The picture is very mixed. As for geographic Europe, non-EU members included, Switzerland ranks the highest—81.6 points makes it number 4 in the world. In fact, by recording a score above the 80 point mark Switzerland is the only European country qualifying as *Free*.

Free (100–80)	Country	2014 Score	Change since 2013
1	Hong Kong	90.1	0.8
2	Singapore	89.4	1.4
3	Australia	82.0	-0.6
4	Switzerland	81.6	0.6
5	New Zealand	81.2	-0.2
6	Canada	80.2	0.8

Ukraine ranks worst in Europe. With a score of 49.3 points it places as 155th, in the immediate proximity of Belarus in 150th. Failzing to reach the 50 point mark, Ukraine's economy is classified as *Repressed*, whereas Belarus, hovering just above the same boundary, qualifies as *Mostly Unfree*.

None of these top/bottom-rated countries are EU members. Ireland (9th) and Denmark (10th) are the freest economies within the EU, placing them in the *Mostly Free* category. Other EU countries grouping in the same category are Estonia (11th), United Kingdom (14th), The Netherlands (15th), Luxembourg (16th), Germany (18th), Finland (19th), Sweden (20th), Lithuania (21st), Austria (24th), and Czech Republic (26th). These are countries that also arguably have coped better than others with the economic crisis or, as in the case with Ireland, Estonia, and Lithuania; they have taken effective measures in order to meet the crisis and to emerge stronger.

Country "Mostly free"	Economic Freedom Ranking	2014 Score	Change since 2013
Mauritius	8	76,5	-0,4
Ireland	9	76,2	0,5
Denmark	10	76,1	0,0
Estonia	11	75,9	0,6
United States	12	75,5	-0,5
Bahrain	13	75,1	-0,4
United Kingdom	14	74,9	0,1
Netherlands	15	74,2	0,7
Luxembourg	16	74,2	0,0
Taiwan	17	73,9	1,2
Germany	18	73,4	0,6
Finland	19	73,4	-0,6
Sweden	20	73,1	0,2
Lithuania	21	73,0	0,9
Georgia	22	72,6	0,4
Iceland	23	72,4	0,3
Austria	24	72,4	0,6
Japan	25	72,4	0,6
Czech Republic	26	72,2	1,3
Botswana	27	72,0	1,4
United Arab Emirates	28	71,4	0,3
Macau	29	71,3	-0,4
Qatar	30	71,2	-0,1
South Korea	31	71,2	0,9
Norway	32	70,9	0,4
Saint Lucia	33	70,7	0,3
Colombia	34	70,7	1,1

Most EU members (15 out of 28 countries), however, do not qualify as *Free* or even *Mostly Free*, but rather as *Moderately Free*. In this category, one finds Belgium (35th), Latvia (42th), Cyprus (46th), Spain (49th), Poland (50th), Hungary (51st), Slovakia (57th), Malta (58th), Bulgaria (61st), Romania (62nd), and Portugal (69th). Appallingly, France holds the 70th slot on the list. How many Europeans are aware of the fact that the economic freedom of one of the union's largest economies and a key member state such as France is ranked below countries such as Peru (47th) and Rwanda (65th)?

Moderately Free (69, 9–60) Part I	Country	2014 Score	Change since 2013
35	Belgium	69,9	0,7
36	Bahamas	69,8	-0,3
37	Malaysia	69,6	3,5
38	Uruguay	69,3	-0,4
39	Jordan	69,2	-1,2
40	Brunei	69,0	N/A
41	Armenia	68,9	-0,5
42	Latvia	68,7	2,2
43	Macedonia	68,6	0,4
44	Israel	68,4	1,5
45	Barbados	68,3	-1,0
46	Cyprus	67,6	-1,4
47	Peru	67,4	-0,8
48	Oman	67,4	-0,7
49	Spain	67,2	-0,8
50	Poland	67,0	1,0
51	Hungary	67,0	-0,3
52	Saint Vincent Grenadines	67,0	0,3
53	Costa Rica	66,9	-0,1
54	Albania	66,9	1,7
55	Mexico	66,8	-0,2
56	Jamaica	66,7	-0,1
57	Slovakia	66,4	-2,3
58	Malta	66,4	-1,1
59	El Salvador	66,2	-0,5
60	Cape Verde	66,1	2,4
61	Bulgaria	65,7	0,7
62	Romania	65,5	0,4

Italy, the second largest EU economy, also ranks low at 86th place, behind EU colleagues such as Slovenia (74th) and numerous other countries in the world, including Paraguay (78th), Azerbaijan (81th), and Guatemala (83rd).

Moderately Free (69, 9–60) Part II	Country	2014 Score	Change since 2013
63	Dominica	65,2	1,3
64	Turkey	64,9	2,0
65	Rwanda	64,7	0,6
66	Ghana	64,2	2,9
67	Kazakhstan	63,7	0,7
68	Montenegro	63,6	1,0
69	Portugal	63,5	0,4
70	France	63,5	-0,6
71	Panama	63,4	0,9
72	Thailand	63,3	-0,8
73	Trinidad Tobago	62,7	0,4
74	Slovenia	62,7	1,0
75	South Africa	62,5	0,7
76	Kuwait	62,3	-0,8
77	Saudi Arabia	62,2	1,6
78	Paraguay	62,0	0,9
79	Madagascar	61,7	-0,3
80	Dominican Republic	61,3	1,6
81	Azerbaijan	61,3	1,6
82	Swaziland	61,2	4,0
83	Guatemala	61,2	1,2
84	Samoa	61,1	4,0
85	Kyrgyz Republic	61,1	1,5
86	Italy	60,9	0,3
87	Croatia	60,4	-0,9
88	Zambia	60,4	1,7
89	Philippines	60,1	1,9
90	Sri Lanka	60,0	-0,7

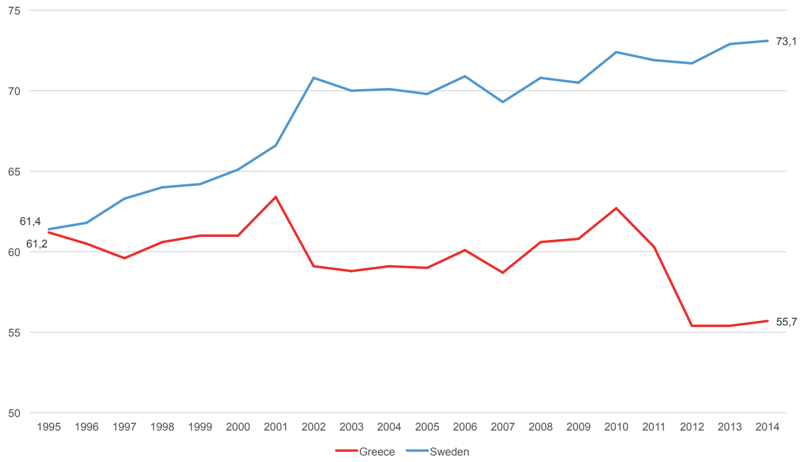
Neither does the most recent EU member, Croatia (2013), help in boosting the average score, ranking a lowly 87th together with Zambia.

Given the strong correlation between economic freedom and prosperity it might not come as a surprise that Greece is found at the very bottom among the EU members. Still suffering from the crisis, Greece's economy is rated *Mostly Unfree* and ranked 119th, lower than countries such as Benin (113th), Belize (115th), and Bhutan (116th).

Unfree (59, 9–50)	Country	2014 Score	Change since 2013
91	Uganda	59,9	-1,2
92	Gambia	59,5	0,7
93	Vanuatu	59,5	2,9
94	Namibia	59,4	-0,9
95	Serbia	59,4	0,8
96	Lebanon	59,4	-0,1
97	Mongolia	58,9	-2,8
98	Burkina Faso	58,9	-1,0
99	Fiji	58,7	1,5
100	Indonesia	58,5	1,6
101	Bosnia Herzegovina	58,4	1,1
102	Nicaragua	58,4	1,8
103	Morocco	58,3	-1,3
104	Tonga	58,2	2,2
105	Gabon	57,8	0,0
106	Tanzania	57,8	-0,1
107	Coe D'Ivoire	57,7	3,6
108	Cambodia	57,4	-1,1
109	Tunisia	57,3	0,3
110	Moldova	57,3	1,8
111	Kenya	57,1	1,2
112	Honduras	57,1	-1,3
113	Benin	57,1	-0,5
114	Brazil	56,9	-0,8
115	Belize	56,7	-0,6
116	Bhutan	56,7	1,7
117	Seychelles	56,2	1,3
118	Djibouti	55,9	2,0
119	Greece	55,7	0,3
120	India	55,7	0,5
121	Guyana	55,7	1,9
122	Mali	55,5	-0,9
123	Yemen	55,5	-0,4
124	Malawi	55,4	0,1
125	Senegal	55,4	-0,1

In 1995, when the *Index of Economic Freedom* was first introduced, Greece and Sweden scored almost identically in points and ranking. Over the last 19 years Sweden has advanced its score from 61.4 to 73.1 points, whereas Greece has fallen from 61.2 to 55.7 points.

Fig 2. Economic freedom. Greece vs Sweden.

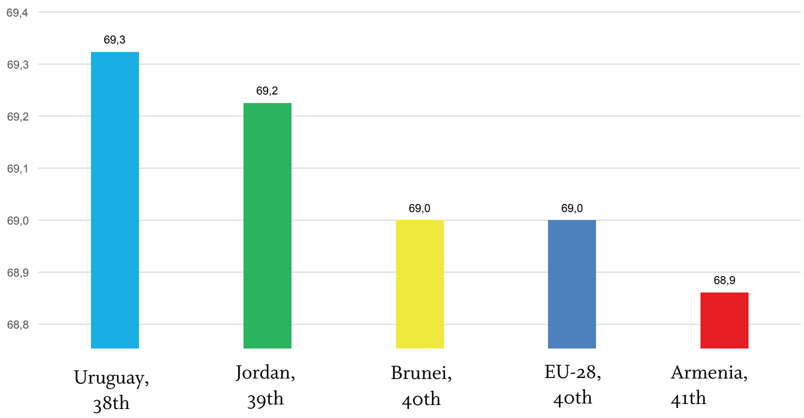


Source: The Heritage Foundation "Index of Economic Freedom"

Economic Freedom in Europe —not as free as people think?

When comparing economic freedom within the EU, the overall picture is quite diverse, reinforcing the picture of a union where there is still no true single market. When the scores from all 28 EU member countries are added up and weighted for GDP, one gets an average EU-28 score of 69.0 points. The EU single market as a whole would rank 40th in the *Index of Economic Freedom 2014*, sharing ranking position with Brunei and behind countries such as Jordan and Uruguay.

Fig 3. Economic freedom in the EU-28 (ranked with comparable countries 2014).



Source: The Heritage Foundation "Index of Economic Freedom"

Opponents against these numbers claim this is due to the EU members' heavy taxation and high social ambitions. While this is partly true, as both taxation and government spending are part of the weighted index, it is only a small part of the total index numbers. As touched on previously, the countries with low index scores in the taxation and government spending categories are often the best rated nations in the overall ranking. That is true for countries such as Sweden, Denmark, and Austria. A reasonable conclusion is that these countries can afford heavy taxes and extensive public spending thanks to high scores in other index factors, which in turn promote economic growth.

Another common objection, also mentioned above, is the methodological difficulty in comparing economies on a country level. An index of this kind is an overall assessment on national levels of freedom of trade, tax policy, bureaucracy, rule of law, and corruption. If factors are assessed separately, the big picture will be lopsided. While other factors outside the index, such as knowledge and capital, obviously are of great importance to the wealth of a nation, Europe still has potential for improvement. Especially when recognising that the EU as a whole, as well as relatively successful countries like Germany and Sweden, are estimated to have a lower degree of economic freedom than important competitors like Australia (3rd), Canada (6th), USA (12th), and Taiwan (17th).

The same observation regarding the union as a whole can be made in other studies. For the past eleven years the World Bank has published their yearly *Doing Business Index*, which shows the degree of market regulation for small and medium sized enterprises (SMEs). In their 2014 ratings Denmark (5th) ranks highest among the EU countries, while Sweden ranks 14th. The United Kingdom ranks 10th, Lithuania 17th, and Germany holds the 21st position, while France ranks 38th, Italy 65th. An overall EU-28 rating, however, would rank 32nd, together with Rwanda.

The above mentioned *Economic Freedom of the World Index*, conducted and published by the Canadian think tank Fraser Institute (in cooperation with several other think tanks, including Timbro), displays similar results. According to the 2013 index, the then 27 EU member states would have ranked 36th in an overall rating, again on the equivalent level as Rwanda. The same index ranks Sweden in a far from flattering 29th place, whereas Finland (7th) is top rated among the EU countries. The United Kingdom ranks 12th and Denmark 14th. France is again behind at place 40, while Italy ranks 83rd and Greece 85th. The data used in the Fraser Rating is a bit older than the Heritage Foundation's Report data, and when taking a look at the long-term graphs for EU members one will again notice that the trend is slightly positive for most member states, as well as for the EU as a whole.

Since 2005, the World Economic Forum (WEF) has published data in the *Global Competitiveness Index*, which evaluates competitiveness in 142 countries in a more comprehensive manner. This ranking rates Finland 3rd, with Sweden not too far behind in 6th place.

EU-28, however, ranks 24th, recording about the same scores as Malaysia.

Potential around the corner

Prosperity in Europe was built by offering world-leading conditions for work, innovation, investment, and progress. These conditions, created by European nations in the interplay between competition and cooperation, were fundamental for both civil liberties and economic growth.

The road to recovery is even shorter than we think: All we need to do is learn from successful neighbours. In virtually all rankings and indexes there is always at least one EU member state with a top position. An approach among member states to learn from best practice would therefore result in significant progress.

Is there any acceptable reason why France and Spain score 79.9 and 77.3 points in Business Freedom respectively, whereas Denmark ranks at the very top with 98.1 points?

As many as ten EU member states score 90 points and above for a top rating position in Property Rights, whereas others score considerably lower, for example Greece (40 points), Italy (50), and Poland (60).

If all EU members were to learn from the best of their neighbours, Europe's economic freedom as well as the individual countries' competitiveness would swiftly improve. Since national governments and parliaments are in their full right to make these policy shifts themselves, coordination from Brussels would not even be necessary.

If we construct a country called "EU-potential" where we take the score from the top EU-country in each category and imagine what the EU could look like if we all just tried to learn from the best – what would happen then? If only the best ranked EU countries in each of the *Index of Economic Freedom* categories are put together, "EU-potential" would score as high as 88.6 points. This experiment ranks the EU as the world's third freest economy, still after Hong Kong and Singapore but ahead of major competitors such as Australia, Canada, Switzerland, Japan, Taiwan, and USA.

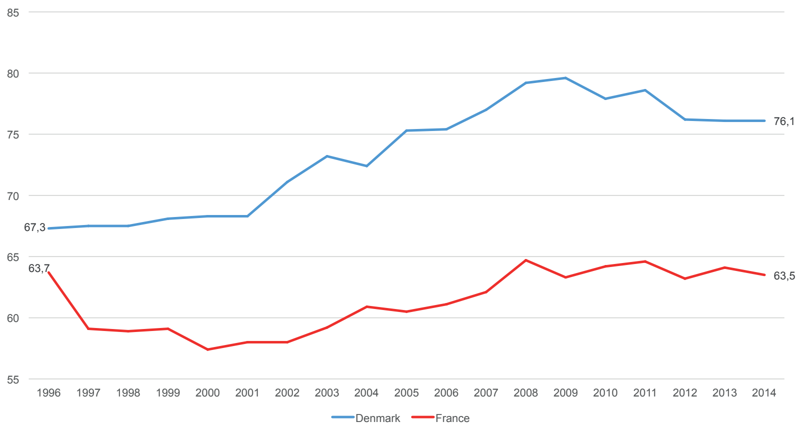
Free (100–80)	Country	2014 Score
1	Hong Kong	90,1
2	Singapore	89,4
3	EU-28 (potential)	88,6
4	Australia	82,0
5	Switzerland	81,6
6	New Zealand	81,2
7	Canada	80,2

We would get similar results if we used data from the other rankings and indexes the same way. Using the World Bank's *Doing Business Index*, "EU-potential" would end up top rated if all countries would learn from the best ranked member state in each category. In the World Economic Forum's *Global Competitiveness Index*, EU-28 would score 5.88 and be equally top rated provided that the best ranked member state becomes all other members' guiding star.

Der er et yndigt land (There is a lovely country)

When increased economic freedom is advocated in Europe one often hears objections like “we don’t want it to be like in the US” or “we are not lowering our standards to the level of poor countries.” Nevertheless, an important point in this memorandum maintains that there are many good examples to follow. The EU, for instance, would gain a great deal if member states began to act more like Denmark, which does well regardless of how one counts and which index one reads.

Fig 4. Economic freedom. Denmark vs France (1996–2014).



Source: The Heritage Foundation "Index of Economic Freedom"

Moreover, in a European context Denmark would be an easier sell. First, Denmark defends high taxes and social ambitions, making it a tougher target for socialists and populists. Second, Danes are the happiest people in the world, according to UN-funded *World Happiness Report 2013*.

Europe is facing many problems and challenges, but also a wide range of solutions and opportunities. By drawing attention to the best policies of each country, and by implementing what has already been agreed amongst member states regarding the single market for services, Europe would take important steps away from the current situation with youth unemployment, budget deficits, and growing debts. It only requires courage and determination. The revolutionizing idea is that our more successful neighbours can provide inspiration and ideas on how to improve ourselves.

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