

Foreword

Thirty years ago, in the otherwise miserable decade of the 1970s, the modern era of free-market economic revival began. The reigning Keynesian economists lacked an explanation, much less a policy answer, for the stagflation of that decade. Free-marketers of various stripes—Chicago-school monetarists, supply-siders, deregulators—stepped into the breach by offering a revival of classical economics. Their prescriptions set the stage for Reaganomics in the U.S. and Margaret Thatcher’s success in the U.K., spreading eventually to China, India, and other once-socialist corners of the world. The result has been an astonishing era of innovation and prosperity, with literally hundreds of millions of people lifted out of poverty.

The daunting question as I write in late 2008 is whether that era is coming to a close. As an optimist by temperament, I like to think not. But there is no denying that the worst financial panic in 70 years has inspired fresh doubts about the utility of free markets and has led to

serious policy setbacks. To prevent the collapse of the world banking system, governments have intervened in financial markets in ways not seen since the 1930s. In the U.S., the mortgage markets have essentially been nationalized. In Europe and the U.S., the government has injected public capital into the banking system.

As distasteful as it is, the need for public capital probably became inevitable once the panic became a global bank run and threatened a collapse of the entire financial system. However, the perils are obvious going forward. Politicians could seek to politicize the allocation of credit even more than they have through the likes of Fannie Mae and Freddie Mac. And with the election of a new Democratic Administration in Washington amid a recession, the political stage is set for even greater government intervention across the entire economy if policymakers ignore the lessons of recent decades.

Our private financial elites certainly made many mistakes, not least in their failure to assess

risk adequately. But the irony of this panic is that its main causes lie in failures of government. The original sin was monetary, in the form of excessive money creation by the U.S. Federal Reserve from 2002 through 2005. This foreword has mentioned that mistake going back to 2004. The Fed created a subsidy for credit that produced asset bubbles in commodity prices and especially in housing. Facilitated by further government subsidies in housing through Fannie and Freddie and other policies, this credit boom produced a bubble in housing prices and mortgage-finance vehicles. When the bubble ultimately burst, the credit mania turned to panic and led to the events we have all been living through this year. Instead of anticipating problems at the most troubled institutions, Treasury and the Fed often moved in an ad hoc, arbitrary fashion that fed the panic.

Rather than admit its own mistakes, the political class in Europe and the U.S. wants to pin the blame on “deregulation.” The reality is that the financial institutions that made mistakes are some of the most regulated in the world. The fault lies with bad or feckless regulation, not the lack of it. Adam Smith in his ruthless fashion has already punished the biggest mistakes, remaking Wall Street without Congress having passed a single reform. Thanks to revived market discipline, the world is already moving to a safer, more stable financial system. Governments are nonetheless set to rewrite their financial rules, and we have to hope they do so in ways that don’t throttle innovation and the free flow of capital.

There are other policy dangers to watch. The Doha global trade round has stalled, and President-elect Barack Obama shows no signs

of wanting to revive it. Taxes and spending in the U.S. are both likely to rise substantially, and the health care and energy industries are in for extensive new regulation or worse. Some European leaders want to use the excuse of the financial meltdown to impose a new global regulatory regime that could stifle competition and, ultimately, growth.

The good news, to the extent there is some, is that the benefits of economic liberty may have spread far enough in the past 30 years to prevent too much of a backlash. The financial panic has done great harm, but we have survived recessions in the past. If the U.S. makes policy mistakes, the rest of the world—especially in Asia—may choose not to follow. Already, the worldwide trend toward lower corporate tax rates means that even an Obama Administration may have no choice but to follow down that particular Laffer Curve. If the U.S. fails to lead on trade, the rest of the world will move to bilateral or regional pacts, as South Korea and Europe are already doing in the wake of Congress’s failure to approve the U.S.–South Korean free-trade agreement.

The abiding lesson of the current panic is that the battle for liberty requires perpetual vigilance. Ostensibly free-market policymakers in the U.S. lost their monetary policy discipline, and we are now paying a terrible price. The *Index of Economic Freedom* exists to chronicle how steep that price will be and to point the way back to policy wisdom.

Paul A. Gigot
Editorial Page Editor
The Wall Street Journal
November 2008

Preface

2008 was an extraordinary year for the global economy, with slowing growth and financial turmoil in many countries, including the United States. Our free-market system was questioned by some as a root cause of the economic woes. An article in *The Washington Post* even declared, “The worst financial crisis since the Great Depression is claiming another casualty: American-style capitalism.” Indeed, populist attacks on the free market, fueled by election-year politics in the United States as well as by actual setbacks to the economy, have gained momentum.

Some of the policy measures undertaken or planned by the governments of the United States and other countries in response to the 2008 financial crisis threaten economic freedom and long-term economic growth and prosperity. Given the rush toward government interventionist measures in late 2008 to shore up—or even buy up—financial institutions or investment equities, there is a real possibility that the economic freedom scores in this edition of the *Index of Economic Freedom*, which ranks countries based on

data and conditions current as of June 30, 2008, might represent the historical high point for economic freedom in the world. Certainly if the U.S. continues on its present course, all things being equal, its economic freedom score will decline significantly next year.

To many of us who have long tracked economic freedom around the world, 2008 was a vivid reminder of the continuing struggle between the state and the free market. In times of uncertainty, it is natural that people will look to their governments for answers. Yet the long-term solutions to our current economic problems do not lie in more government controls and regulations. They lie in a return to free-market principles.

The 2009 *Index of Economic Freedom*, our 15th anniversary edition, offers a good starting point from which to step back from the temptation of short-sighted quick fixes and reflect on the fundamental principles that are responsible for the progress we have achieved.

The *Index* started a few years after the fall of the Berlin Wall and in the years since then has

recorded the worldwide advance of the principles of free exchange, openness, and competition. Over the past 15 years, it has evolved into a powerful tool with which to compare and contrast different approaches to economic growth and well-being.

The *Index* has witnessed profound advances in economic freedom and prosperity around the globe. As its new editor, Ambassador Terry Miller, points out in an introductory chapter, worldwide economic freedom has increased over 8 percent during the 15 years that we have been measuring it. The world economy has grown in that time from about \$30 trillion to well over \$50 trillion, bringing better standards of life to billions of people.

Political authorities find themselves increasingly accountable to the people they govern, and they need tested policies that deliver positive results. Countries that have opened themselves to the productivity-boosting competition of the global marketplace have experienced startling bursts of innovation and economic growth. They have achieved levels of prosperity that are far higher than those found in countries where economic freedoms are constrained. Leaders who have not joined the march of freedom have left their citizens lagging behind and even, in the worst cases, in poverty or destitution. Such failures are inexcusable.

The 2009 *Index* has expanded to include 183 economies from every corner of the globe. In this 15th edition, most of the 20 freest countries from last year are still ranked among the freest, while others in the middle of the pack have experienced some shuffling as a result of varying efforts at reform.

While four Asia-Pacific economies lead the world in economic freedom, every region continues to maintain at least one of the 20 freest economies. Economic freedom can improve the quality of life in any cultural or geographic setting and under any form of government. By allowing the best new ideas of entrepreneurs and innovators to compete freely with established and traditional practices, economic freedom encourages a constant process of change

and improvement. It fosters diversity, ensures fairness, and in the long run promotes equality more surely and sustainably than any government-directed program to redistribute wealth.

In addition to the country pages and regional analyses of economic freedom, the 2009 *Index* contains three special chapters. In chapter 2, Ambassador Miller looks at the 15-year *Index* database and documents long-term trends, both positive and negative, that are shaping economic prospects around the world. Chapter 3 is a collection of noteworthy excerpts from previous *Index* editions that remind us of the first principles of economic freedom and the importance of sticking with them, particularly in challenging times. In chapter 4, Steve Moore, a member of the *Wall Street Journal* editorial board and senior economics writer, highlights the ongoing tax-cutting revolution and the success of supply-side economic policies around the world.

Our confidence in economic freedom is being tested, and now is not the time to waver. The world has experienced ebbs and flows of economic freedom in countries or regions, and the results are plain for all to see. Advances in economic freedom lead to advances in sustainable prosperity.

Economic freedom is a philosophy that encourages entrepreneurship, disperses economic power and decision-making throughout an economy, and—most important—empowers ordinary people with greater opportunity and more choices. Experience teaches that even the best efforts of central planners and bureaucrats are unlikely to lead to sustainable growth. Countries that have tried that approach have failed.

The surer path to prosperity is the path of freedom, letting individuals decide for themselves the way forward that is best to achieve their dreams and aspirations and those of their families. It is that path whose course we map in the *Index of Economic Freedom*.

Edwin J. Feulner, Ph.D., President
The Heritage Foundation
November 2008

Acknowledgments

This year marks the 15th anniversary of the *Index of Economic Freedom*. Countless individuals have contributed to the quality and vitality of the *Index* since 1995, and this year's edition is a product of collaborative effort and ever-growing support from people and organizations around the world.

While it is impossible to mention them all, we wish to express our profound gratitude to the many individuals, especially those at The Heritage Foundation, who have made such valuable contributions to this 15th anniversary edition of the *Index of Economic Freedom*. Under the vision and leadership of Dr. Edwin J. Feulner, President of the Heritage Foundation, the *Index* has truly evolved into a key economic policy guide for various readers.

The Heritage Foundation's Center for International Trade and Economics (CITE) produces the *Index*. The CITE team of Anthony Kim, Daniella Markheim, James Roberts, and Caroline Walsh was responsible for grading the various components of economic freedom, analyzing

the results, and producing the country reports. Major research contributions came from CITE interns James Bezjian, Alexandra Canulli, Peter Kim, Thomas Kraemer, Kate Wouck, Jennifer Zavaleta, and Yifei Zheng.

Others at The Heritage Foundation also made invaluable contributions to this year's edition. In the Kathryn and Shelby Cullom Davis Institute for International Studies, Amber Schwartz, Assistant to the Vice President, and Janice A. Smith, Special Assistant to the Vice President, provided important production assistance. Ariel Cohen, James Phillips, and Ray Walser of the Douglas and Sarah Allison Center for Foreign Policy Studies wrote country backgrounds and contributed their regional expertise, as did Lisa Curtis, Bruce Klingner, John J. Tkacik, Jr., and Director Walter Lohman of the Asian Studies Center and Sally McNamara, Brett Schaefer, and Jordan Pauluhn of the Margaret Thatcher Center for Freedom.

The professionalism of Vice President of Information Technology Michael Spiller and

his team helped enormously. A particular debt is owed to Director of Online Communications Tim McGovern, Maria Sousa, and the incredible IT staff—Jermaine Davis, Martha Galante, and Jim Lawruk—for placing the entire *Index* on the Heritage Web site.

In Publishing Services, Director Therese Pennefather, Elizabeth Brewer, and Ralph Buglass were responsible for all aspects of the production process, including the design and layout that make this 15th edition the most readable and accessible yet published, and for developing the world and country maps and formatting the charts and tables.

Once again, we wish to express our deepest appreciation for the continuing efforts of Senior Editor Richard Odermatt, who is responsible for final review of the completed text, and Senior Copy Editor William T. Poole, who bears the primary responsibility for editing the entire book. Each year, their professionalism, commitment, and attention to detail have been crucial in maintaining consistency of tone and making the *Index* a reality. We are likewise grateful to Senior Data Graphics Editor John Fleming, who carefully reviewed every one of the many charts and tables included in the book.

The continuing support from Phil Truluck, Executive Vice President of The Heritage Foundation; Becky Northern Dunlop, Vice President, External Relations; Mike Franc, Vice President, Government Relations; and Rebecca Hagelin, Vice President, Communications and Marketing, is sincerely appreciated. We also thank

Bridgett Wagner, Director, Coalition Relations, and Center for Data Analysis Director William Beach for their insightful contributions to the *Index*.

Countless individuals serving with various accounting firms, businesses, research organizations, U.S. government agencies, foreign embassies, and other organizations again cooperated by providing us with the data used in the *Index*. Their assistance is much appreciated. As always, we acknowledge our enduring debt to Heritage Trustee Ambassador J. William Middendorf II, who originally encouraged us to undertake such a study of global economic freedom.

Very special thanks go to Paul Gigot and Mary Anastasia O'Grady at *The Wall Street Journal*, whose partnership and support we truly cherish.

Finally, we would like to express our appreciation to the many people who respond so enthusiastically, year after year, to the *Index of Economic Freedom*. The support and encouragement of people in all parts of the world continue to inspire The Heritage Foundation and *The Wall Street Journal* in their ongoing collaboration on this important work. We hope this year's effort meets the expectations of our supporters as well as the thoughtful critics who so often have provided the insights that enable us to continue to improve the *Index*.

Ambassador Terry Miller
Kim R. Holmes, Ph.D.
November 2008

What's New in the 2009 *Index*?

This year, the *Index of Economic Freedom* marks an important milestone with the publication of its 15th edition. Over the past 15 years, The Heritage Foundation and *The Wall Street Journal* have tried to make the *Index* a resource that is credible and relevant to a changing world but faithful to our tradition of objective, data-driven analysis and policy recommendations. Based on the feedback we have received, the *Index* has become an important reference tool and policy guidebook for many leaders and scholars around the world. This evolution has been one of the most rewarding outcomes of our efforts to enhance the substance and overall quality of the book—efforts that continue in this 15th edition.

The robust methodology inaugurated in the 2007 edition of the *Index* and continued last year has been maintained in 2009 with only a single minor modification in the scoring of the labor freedom component. Readers will find an emphasis this year on visual clarity, with a new look for country pages. Worldwide

coverage is enhanced with the inclusion of 21 additional countries, and the countries of the Western Hemisphere are now grouped in two separate regions for analytical purposes.

A more detailed explanation of the changes in the 2009 *Index of Economic Freedom* is provided below:

- **Significant Expansion of Country Coverage.** In response to growing interest in the *Index* from around the world, and consistent with our desire to be as inclusive and comprehensive in our coverage as possible, the 2009 *Index* has been expanded to include 183 economies from every corner of the globe. The 21 newly added economies are Afghanistan, Bhutan, Comoros, Dominica, Eritrea, Timor-Leste, Kiribati, Liberia, Liechtenstein, Macao, Maldives, Micronesia, Papua New Guinea, Saint Lucia, Saint Vincent and the Grenadines, Samoa, São Tomé and Príncipe, Seychelles, Solomon Islands, Tonga, and Vanuatu. Because of the limited availability of data, numerical grading is not provided for

Afghanistan and Liechtenstein.¹

- **New Regional Coverage.** For analytical and ranking purposes, the 2009 *Index* places three countries that formerly were considered part of the Americas region into a newly established regional grouping. The new *North America* region consists of Canada, Mexico, and the United States. The rest of the countries of the Americas are grouped in the *South and Central America/Caribbean* region. These refined regional groupings enable more in-depth analysis of the diverse countries of the Western Hemisphere.

- **Refreshed Country Page Design.** Individual country pages of the *Index* are designed to provide both a quick visual snapshot of a country's overall economic freedom and as much detailed information as space allows about developments and conditions in the various components of that freedom. To enhance user-friendliness, the 2009 *Index* includes two new charts to illustrate a country's overall economic freedom score and its performance over the history of the *Index*. Ranging from 0 to 100, the overall score is displayed on a 180 degree

1. Afghanistan and Liechtenstein join Iraq and Sudan as countries included in the *Index* but not graded because of data limitations.

arc with a pointer indicating the country's 2009 score. A bar chart presents a time series of the country's overall score for each year from the 1995 *Index* (or the earliest year for which a score is available) through the 2009 *Index*, compared to the world average.

- **Fine-Tuned Labor Freedom Component.** For a better balanced assessment of overall employment conditions, the labor freedom component in the 2009 *Index* considers six labor freedom factors rather than the four analyzed in previous editions. Details of the methodological change are provided in the appendix. This minor refinement has been applied to past editions' labor freedom scores so as to ensure comparability.

The editors hope that these changes will make the *Index* an even better research tool and a more accessible policymaking guide. Whatever changes may be made from year to year, however, our goal remains constant: to advance individual freedom, civil society, and prosperity around the world. We hope that this 15th edition of the *Index* will help to make the transition to a better world faster and surer, with many more countries joining the march of freedom.

Executive Summary

In a period of slowing economic growth in many parts of the world, popular pressure for governments to act to fix the situation can be enormous. In responding to such pressure, it is vital that leaders understand the real causes of negative economic developments and undertake actions that will fix them rather than exacerbate them. If intrusive government regulation has contributed to an economic problem, it is unlikely that still more government regulation will cure it. If excessive taxes have stifled investment and entrepreneurship, increasing tax rates is unlikely to spur economic growth. If the monetary supply has been too loose or credit too easily available, lowering interest rates is unlikely to be the magic fix the public demands.

The *Index of Economic Freedom* offers a time-tested formula for sustained economic growth. Grounded in the classical liberal economic theories of Adam Smith and Friedrich Hayek, the *Index* promotes economic policies that:

- Put the individual first and allow people to decide for themselves what is best for their own well-being and that of their families;
- Recognize that the free market is the only reliable predictor of the real prices of goods, labor, and capital;
- Use government to shape a fair and secure environment, protect private property and the value of money, enforce contracts, and promote competition, but not to produce or sell goods and services; and
- Emphasize openness to international trade and investment as the surest paths to increased productivity and economic growth.

A government that limits its involvement in economic activity consistent with these principles maximizes opportunities for individuals to reach their full economic potential and promotes the greatest levels of prosperity and human well-being for society as a whole.

In 2009, the *Index of Economic Freedom* is celebrating its 15th anniversary. The idea of pro-

ducing a user-friendly “index of economic freedom” was first discussed at The Heritage Foundation in the late 1980s. The goal was to develop a systematic, objective, and empirical measurement of economic freedom in economies around the world.

The methodology for measuring economic freedom has been gradually enhanced as the availability of data has grown. The *2009 Index of Economic Freedom* covers 183 countries¹ and measures 10 separate components of economic freedom. (See text box, “The 10 Components of Economic Freedom.”) Chapter 1 and the methodological appendix explain these components and how to assess them in detail.

Taken together, these 10 components of economic freedom provide a portrait of a country’s economic policies and establish benchmarks by which to gauge strengths and weaknesses. A systematic analysis of the 10 freedoms over the 15-year history of the *Index* demonstrates that economic freedom is the key to creating an environment in which entrepreneurship and innovation flourish, with rapid economic growth and sustainable development as the happy results.

HIGHLIGHTS FROM THE 2009 INDEX

• **Despite the progress made over the past 15 years, the struggle between the state and the free market continues.** Many governments are maintaining a strong commitment to economic freedom, but others are regressing. Regrettably, populist attacks on the free

The 10 Components of Economic Freedom

- Business Freedom
- Trade Freedom
- Fiscal Freedom
- Government Size
- Monetary Freedom
- Investment Freedom
- Financial Freedom
- Property Rights
- Freedom from Corruption
- Labor Freedom

market, fueled by the economic slowdown and the political temptation of quick interventionist remedies, have gained momentum. Even so, however, for countries included in last year’s *Index*, economic freedom advanced, from an average score of 60.2 to an average score of 60.3. The overall average score this year for all ranked countries, including the 21 appearing for the first time in the *Index*, is 59.5.²

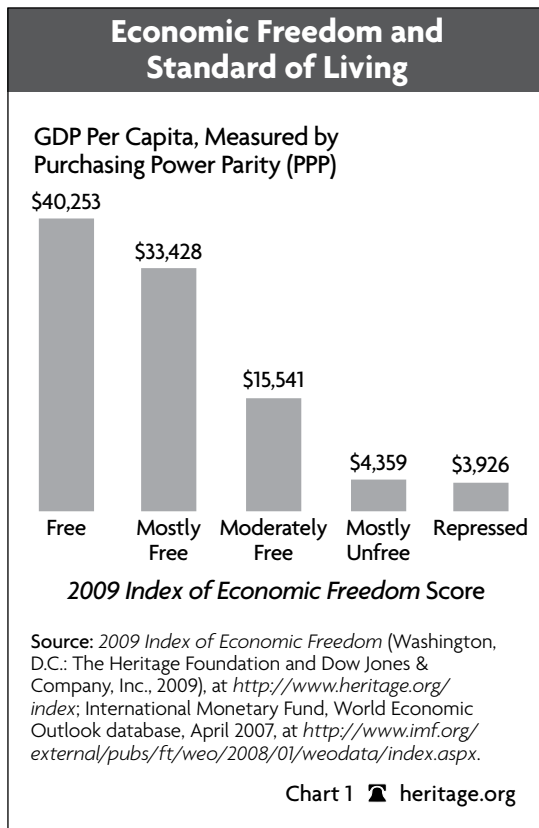
• **Four Asia-Pacific economies lead the world in economic freedom.** Hong Kong maintains its status as the world’s freest economy, a position it has held for 15 consecutive years. It was the only economy to score at least 90 on the 100-point economic freedom scale. Singapore remains close, ranked as the world’s second freest economy. Australia has climbed to third place in the *2009 Index*, with New Zealand only 0.4 point back in fifth place.

• **Every region continues to maintain at least one of the top 20 freest economies.** Ten of the 20 freest economies are European, led by Ireland, Denmark, Switzerland, and the United Kingdom. Five are in the Asia-Pacific region, and two (the United States and Canada) are from North America. The other regions are represented by one country each: Chile (South and Central America/Caribbean region); Mauritius (Sub-Saharan Africa region); and Bahrain (Middle East/North Africa region).

• **Economic freedom is strongly related to good economic performance.** Per capita

1. The *2009 Index* has expanded its coverage to include for the first time Afghanistan, Bhutan, Comoros, Dominica, Eritrea, Kiribati, Liberia, Liechtenstein, Macau, Maldives, Micronesia, Papua New Guinea, Saint Lucia, Saint Vincent and the Grenadines, Samoa, São Tomé and Príncipe, Seychelles, Solomon Islands, Timor-Leste, Tonga, and Vanuatu.

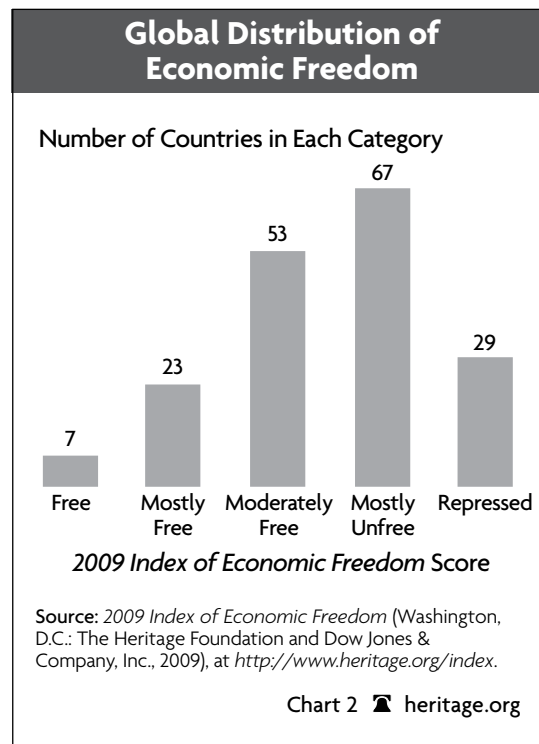
2. For countries graded in both the 2008 and 2009 editions of the *Index of Economic Freedom*, average scores increased from 60.2 to 60.3. However, the average economic freedom score for all countries in the *2009 Index* is only 59.5 because of the addition to the Index rankings of 21 previously unranked economies, most of which score below the world average.



incomes are much higher in countries that are economically free. Economies rated “free” or “mostly free” in the 2009 *Index* enjoy incomes that are more than double the average levels in all other countries and more than eight times higher than the incomes of “repressed” economies.

- **Overall human development, political openness, and environmental sustainability thrive in an environment that is economically free.** Economic freedom is about more than a business environment in which entrepreneurship and prosperity can flourish. With its far-reaching impacts on various aspects of human development, economic freedom empowers people, unleashes powerful forces of choice and opportunity, gives nourishment to other liberties, and improves the overall quality of life. (See below, “Economic Freedom Matters.”)

- **A sustained commitment to economic freedom is critical to fostering economic development and prosperity.** The *Index* findings reveal that sustained commitment



to policies that promote economic freedom is critical to achieving development and lasting prosperity. Countries that are too quick to abandon their efforts at policy reform often find their economic freedom fading away, along with their prosperity. We have seen ebbs and flows of economic freedom in specific countries or regions. The erosion of economic freedom in South America, for example, reflects reversals of free-market policies in some countries and a lack of perseverance in pursuing economic freedom in others. Venezuela, in particular, is tempting long-run decline as President Hugo Chávez takes the country further down an anti-democratic and anti-free market path.

As shown in Chart 2, of the 179 economies that are numerically graded in the 2009 *Index*,³ only seven have very high freedom scores of 80 or more, putting them in the “free” category (the highest). The next 23 countries have scores

3. Numerical grading was not possible for Afghanistan, Iraq, Liechtenstein, and Sudan due to the limited availability of relevant data.

between 70 and 80, placing them in the “mostly free” category. Thus, a total of only 30 countries, or about one-sixth of all countries graded, have economic systems in which individuals enjoy substantial levels of freedom. The largest portion of the countries graded—119 economies—have freedom scores between 50 and 70. Of those, 53 economies are “moderately free” (scores of 60–70), and 67 economies are “mostly unfree” (scores of 50–60). This year, 29 countries have “repressed economies” with scores below 50.

ECONOMIC FREEDOM MATTERS

There are clear relationships between economic freedom and numerous other positive economic and social indicators, the most prominent being the strong relationship between the level of economic freedom and the level of prosperity in a given country. (See Chart 3.)

Previous editions of the *Index* have confirmed the tangible benefits of living in freer societies. Not only are higher levels of economic freedom associated with higher per capita incomes and higher GDP growth rates, but those higher growth rates seem to create a virtuous cycle, triggering further improvements in economic freedom.

Greater economic freedom can also provide more fertile ground for effective and democratic governance. It empowers people to exercise greater control of their daily lives. By increasing options, economic freedom ultimately nurtures political reform as well. Economic freedom makes it possible for individuals to gain the economic resources necessary to challenge entrenched interests or compete for political power, thereby encouraging the creation of more pluralistic societies.

Debate has occasionally arisen over the direction of causality between economic freedom and democracy because of the complex interplay between them. However, the positive relationship is undeniable. Chart 4 shows the relationship between economic freedom and democratic governance as measured by the Economist Intelligence Unit’s Democ-

cracy Index.⁴ They are clearly interrelated and together form a coherent philosophy of governance.

Higher economic freedom is also strongly correlated with overall human development as measured by the United Nations Human Development Index,⁵ which measures life expectancy, literacy, education, and the standard of living in countries worldwide. (See Chart 5.)

The prosperity that flows from economic freedom results in greater access to education, reduced illiteracy, increased access to higher quality health care and food supplies, and longer life expectancy.

In addition, economically free countries do a better job of protecting the environment. In January 2008, the World Economic Forum, the Center for International Earth Science Information Network (CIESIN), and the Yale Center for Environmental Law and Policy published an Environmental Performance Index (EPI).⁶ The EPI shows a country’s performance in coping with environmental challenges, providing “a composite index of current national environmental protection efforts.”⁷

Chart 6 illustrates the relationship between economic freedom scores and the EPI. The chart shows a strong relationship between economic freedom and environmental performance: The freer the economy, the better the level of environmental protection or sustainability.

The lesson is clear: Economic freedom is good not only for growth and individual economic advancement, but also for the progres-

4. For more information on the EIU Democracy Index, see Laza Kekic, “The Economist Intelligence Unit’s Index of Democracy,” *The World in 2007: Democracy Index*, at http://www.economist.com/media/pdf/Democracy_Index_2007_v3.pdf.

5. For more information on the United Nations Human Development Index, see United Nations Development Programme, *Human Development Reports*, at <http://hdr.undp.org/en/statistics>.

6. See Daniel C. Esty, M. A. Levy, C. H. Kim, A. de Sherbinin, T. Srebotnjak, and V. Mara, *2008 Environmental Performance Index* (New Haven: Yale Center for Environmental Law and Policy, 2008), at <http://epi.yale.edu/Framework>.

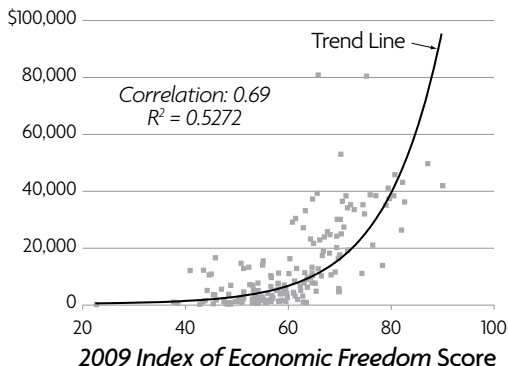
7. *Ibid.*

Economic Freedom Improves Lives

Economic Freedom and Prosperity

Each dot represents a country in the Index of Economic Freedom.

GDP Per Capita, Measured by Purchasing Power Parity (PPP)



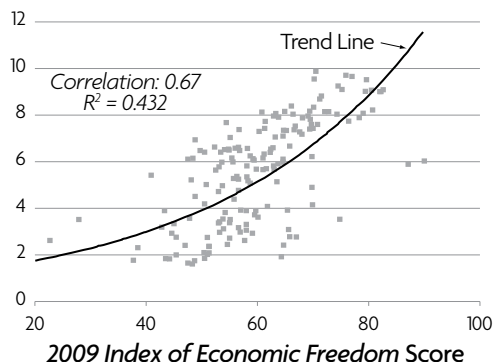
Source: 2009 Index of Economic Freedom (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2009), at <http://www.heritage.org/index>; International Monetary Fund, World Economic Outlook database, April 2007, at <http://www.imf.org/external/pubs/ft/weo/2008/01/weodata/index.aspx>.

Chart 3 heritage.org

Economic Freedom and Democratic Governance

Each dot represents a country in the Index of Economic Freedom.

Economist Intelligence Unit's Index of Democracy

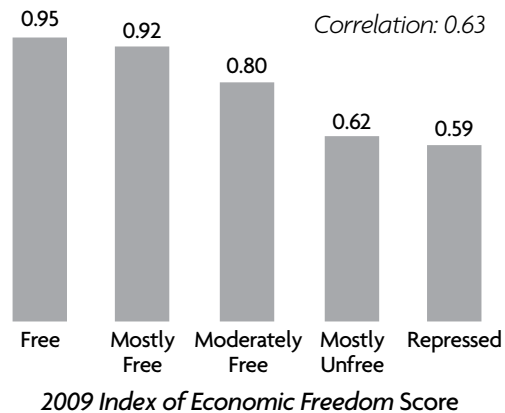


Source: 2009 Index of Economic Freedom (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2009), at <http://www.heritage.org/index>; The Economist Intelligence Unit's Index of Democracy, Country Forecasting Services, Economist Intelligence Unit, at http://www.economist.com/media/pdf/Democracy_Index_2007_v3.pdf.

Chart 4 heritage.org

Economic Freedom and Human Development

U.N. Human Development Index

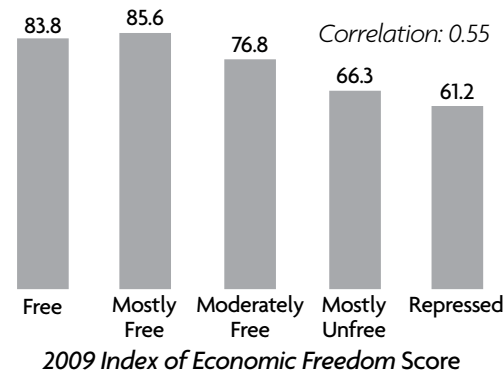


Source: 2009 Index of Economic Freedom (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2009), at <http://www.heritage.org/index>; Human Development Reports 2007/2008, United Nations Human Development Programme, at <http://hdr.undp.org/en/statistics>.

Chart 5 heritage.org

Economic Freedom and the Environment

Environmental Performance Index



Source: 2009 Index of Economic Freedom (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2009), at <http://www.heritage.org/index>; Daniel C. Esty, M. A. Levy, C. H. Kim, A. de Sherbinin, T. Srebotnjak, and V. Mara, 2008 Environmental Performance Index (New Haven: Yale Center for Environmental Law and Policy, 2008), at <http://epi.yale.edu/Framework>.

Chart 6 heritage.org

sive values and public goods that people seek for society as a whole.

In economically free societies, children go to school rather than to work, trees are valued for their shade rather than as fuel, workers worry about job safety rather than unemployment, and hospitals are places of hope rather than despair.

Economic freedom is the revolutionary economic counterpart to democratic pluralism.

It empowers the poor and builds the middle class. It is a philosophy that encourages entrepreneurship and disperses economic power and decision-making throughout an economy. Governments that embrace the desires of their citizens for growing and sustainable prosperity will find the surest path to be that which is also the widest and most open, offering each individual the chance to walk freely in their own way toward a better future.

Index of Economic Freedom World Rankings

World Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
1	Hong Kong	90.0	0.3	92.7	95	93.4	93.1	86.2	90	90	90	83	86.3
2	Singapore	87.1	-0.2	98.3	90	91.1	93.8	86.8	80	50	90	93	98.1
3	Australia	82.6	0.4	90.5	84.8	61.4	64.3	84.7	80	90	90	86	94.7
4	Ireland	82.2	-0.3	93.0	85.8	69.2	64.9	84.3	90	90	90	75	79.7
5	New Zealand	82.0	1.2	99.9	84.6	62.5	49.6	84.6	80	80	95	94	89.6
6	United States	80.7	-0.3	91.9	86.8	67.5	59.6	84	80	80	90	72	95.1
7	Canada	80.5	0.3	96.5	88.2	76.6	53.7	80.8	70	80	90	87	81.9
8	Denmark	79.6	0.4	99.9	85.8	35.4	20.4	86.6	90	90	95	94	99.4
9	Switzerland	79.4	-0.1	82.9	85.4	67.5	65.3	83.9	70	80	90	90	79.2
10	United Kingdom	79.0	-0.5	89.8	85.8	61.0	40.3	80.4	90	90	90	84	78.5
11	Chile	78.3	-0.3	66.3	85.8	78.2	90.1	77.3	80	70	90	70	75.0
12	Netherlands	77.0	-0.4	86.5	85.8	50.9	36.2	87.0	90	90	90	90	63.3
13	Estonia	76.4	-1.5	75.9	85.8	81.5	67.3	79.7	90	80	90	65	48.5
14	Iceland	75.9	0.1	93.6	88	76.2	44.0	75.3	70	70	90	92	59.9
15	Luxembourg	75.2	0.5	76.2	85.8	66.3	54.4	80.2	90	80	90	84	45.1
16	Bahrain	74.8	2.6	79.6	80	99.9	79.4	74.0	60	80	60	50	85.1
17	Finland	74.5	-0.1	95.1	85.8	64.3	28.6	87.4	70	80	95	94	44.8
18	Mauritius	74.3	1.7	83.3	86.8	92.2	80.8	71.1	80	70	60	47	71.5
19	Japan	72.8	-0.2	85.8	82	67.5	61.1	93.6	60	50	70	75	82.5
20	Belgium	72.1	0.5	93.2	85.8	41.5	28.3	81.0	90	80	80	71	70.5
21	Macau	72.0	n/a	60.0	90	79.3	93.3	80.3	70	70	60	57	60.0
22	Barbados	71.5	0.2	90.0	64.6	70.9	66.3	74.5	50	60	90	69	80.0
23	Austria	71.2	-0.2	78.6	85.8	49.9	27.1	80.9	70	70	90	81	78.7
24	Cyprus	70.8	-0.5	70.0	80.8	76.6	42.2	85.7	70	70	90	53	70.0
25	Germany	70.5	-0.1	90.3	85.8	58.5	38.2	80.8	80	60	90	78	43.4
26	Sweden	70.5	-0.4	95.9	85.8	35.0	7.3	82.1	80	80	90	93	55.5
27	The Bahamas	70.3	-0.8	74.7	56	96.5	84.4	75.5	40	70	75	50	80.4
28	Norway	70.2	1.6	88.1	89.2	50.3	50.5	78.1	60	60	90	87	48.6
29	Spain	70.1	1.0	76.8	85.8	58.6	55.3	78.9	80	80	70	67	48.3

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World Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
30	Lithuania	70.0	-1.0	82.4	85.8	87.6	65.3	75.8	70	80	50	48	54.6
31	Armenia	69.9	0.0	83.7	86.4	90.0	89.7	77.8	70	70	35	30	66.3
32	Georgia	69.8	0.5	86.6	80.6	86.8	74.6	70.9	70	60	35	34	99.4
33	El Salvador	69.8	1.3	67.3	81.8	85.7	87.9	77.4	70	70	50	40	67.5
34	Botswana	69.7	1.5	71.2	69	75.1	70.6	71.8	70	70	75	54	70.0
35	Taiwan	69.5	-0.7	69.5	85.2	76.2	89.4	82.1	70	50	70	57	45.7
36	Slovak Republic	69.4	-0.6	73.4	85.8	84.1	57.4	78.7	70	70	50	49	75.3
37	Czech Republic	69.4	1.2	65.1	85.8	80.2	43.0	79.7	70	80	70	52	67.8
38	Uruguay	69.1	1.2	65.6	83.4	82.2	76.5	72.8	70	30	70	67	73.7
39	Saint Lucia	68.8	n/a	87.7	72	74.0	68.5	85.1	40	40	70	68	82.8
40	South Korea	68.1	-0.5	90.4	70.2	70.4	72.5	80.0	70	60	70	51	46.4
41	Trinidad and Tobago	68.0	-1.6	60.1	79.8	79.7	75.6	72.2	70	70	60	34	78.3
42	Israel	67.6	1.3	67.8	86	57.1	35.1	83.7	80	70	70	61	64.9
43	Oman	67.0	-0.3	63.3	83.6	98.5	61.1	71.4	60	60	50	47	75.0
44	Hungary	66.8	-0.8	77.4	85.8	70.6	19.2	73.8	80	70	70	53	68.4
45	Latvia	66.6	-1.7	73.8	85.8	82.3	58.5	71.1	70	60	55	48	61.6
46	Costa Rica	66.4	2.2	60.3	81.8	82.8	88.4	69.7	70	50	50	50	61.2
47	Malta	66.1	0.1	70.0	85.8	63.1	41.7	82.7	50	60	90	58	60.0
48	Qatar	65.8	3.6	75.7	81.6	99.9	69.1	67.3	40	50	50	60	64.7
49	Mexico	65.8	-0.3	80.3	80.2	83.4	81.8	77.5	50	60	50	35	59.8
50	Kuwait	65.6	-2.5	67.4	81	99.9	63.7	71.7	50	50	50	43	79.3
51	Jordan	65.4	1.3	68.9	78.8	83.0	56.9	80.3	50	60	55	47	74.1
52	Jamaica	65.2	-0.5	87.8	70.6	75.3	62.2	75.4	80	50	50	33	67.4
53	Portugal	64.9	1.0	81.1	85.8	61.6	35.4	79.9	70	60	70	65	40.3
54	United Arab Emirates	64.7	2.2	57.4	80.8	99.9	86.3	69.8	30	50	40	57	76.2
55	Panama	64.7	0.0	74.5	76.2	82.6	89.8	77.9	70	70	30	32	44.1
56	Bulgaria	64.6	0.9	73.5	85.8	86.2	58.7	72.8	60	60	30	41	78.4
57	Peru	64.6	0.9	65.1	79.4	79.7	91.8	86.5	60	60	40	35	48.7
58	Malaysia	64.6	0.7	70.8	78.2	83.0	81.4	79.9	40	40	50	51	71.5
59	Saudi Arabia	64.3	1.8	79.6	81.8	99.6	73.4	68.4	40	50	40	34	76.4
60	Saint Vincent and the Grenadines	64.3	n/a	78.2	73.6	64.7	60.9	75.6	40	40	70	61	78.5
61	South Africa	63.8	0.4	74.6	74.8	68.9	77.6	74.3	50	60	50	51	56.8
62	Albania	63.7	1.3	67.0	75.8	92.8	75.6	79.6	70	70	30	29	47.2
63	Uganda	63.5	-0.3	58.7	75.2	80.4	86.9	78.4	50	60	30	28	87.9
64	France	63.3	-1.4	87.4	80.8	50.9	14.5	71.7	60	70	70	73	54.5
65	Romania	63.2	1.5	74.9	85.8	87.0	70.0	75.0	60	50	35	37	57.1
66	Belize	63.0	0.0	75.5	69.6	68.8	77.6	78.4	50	50	50	30	80.6
67	Thailand	63.0	0.7	71.1	75.6	74.4	90.6	69	30	60	50	33	76.5
68	Slovenia	62.9	2.7	84.5	85.8	62.9	38.4	78.6	60	50	60	66	42.8
69	Mongolia	62.8	-0.8	71.0	81.2	81.3	69.9	76.7	60	60	30	30	67.7

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70	Dominica	62.6	n/a	76.4	74.2	67.4	52.2	79.8	60	30	60	56	70.0
71	Namibia	62.4	1.0	74.4	88.4	67.2	69.7	74.6	40	50	30	45	85.0
72	Colombia	62.3	0.2	77.4	72.4	72.9	65.9	70.6	60	60	40	38	66.0
73	Madagascar	62.2	-0.2	60.5	72.6	80.9	86.3	73.9	70	50	50	32	46.0
74	Kyrgyz Republic	61.8	0.7	75.3	87.6	93.4	74.9	71.5	50	50	25	21	69.5
75	Turkey	61.6	1.6	69.9	86.6	73.2	83.4	71.1	50	50	50	41	40.3
76	Italy	61.4	-1.2	78.7	80.8	55.8	24.7	80.8	70	60	50	52	61.3
77	Cape Verde	61.3	3.4	57.1	65.4	65.5	62.2	76.9	60	60	70	49	46.9
78	Macedonia	61.2	0.2	58.2	81.6	89.4	65.1	85.4	50	60	30	33	59.8
79	Paraguay	61.0	1.0	61.7	83.6	96.6	90.4	76.7	60	60	30	24	27.0
80	Fiji	61.0	-0.8	66.0	69.6	76.0	76.0	77.3	30	60	30	40	84.8
81	Greece	60.8	0.2	78.7	80.8	66.5	46.3	78.8	50	50	50	46	61.2
82	Poland	60.3	0.0	53.7	85.8	69.0	42.2	80.8	60	60	50	42	59.8
83	Kazakhstan	60.1	-1.0	57.9	86.2	82.8	87.5	70.0	30	60	25	21	80.5
84	Nicaragua	59.8	-1.0	57.6	79.2	78.8	71.0	69.5	70	50	25	26	70.6
85	Burkina Faso	59.5	3.8	58.7	70.4	80.7	83.7	83.7	40	50	30	29	69.0
86	Samoa	59.5	n/a	61.5	70	86.2	56.2	75.7	30	30	60	45	80.2
87	Guatemala	59.4	-0.4	54.1	78.4	79.4	93.5	73.3	50	50	30	28	57.3
88	Dominican Republic	59.2	1.5	63.7	73	85.3	91.1	74.1	50	40	30	30	55.1
89	Swaziland	59.1	0.6	68.6	71.6	64.3	70.6	73.1	50	40	50	33	69.6
90	Kenya	58.7	-0.6	66.9	71.8	78.6	81.5	74.0	50	50	30	21	63.1
91	Honduras	58.7	-0.2	64.4	78	85.1	79.7	73.5	50	60	30	25	40.9
92	Vanuatu	58.4	n/a	69.0	63	95.3	84.0	78.7	30	40	40	31	52.6
93	Tanzania	58.3	1.8	48.1	75.6	80.6	83.4	73.4	60	50	30	32	49.9
94	Montenegro	58.2	n/a	68.7	80.2	89.1	45.3	78.9	40	50	40	33	57.2
95	Lebanon	58.1	-1.9	60.0	80.8	91.7	64.1	77.3	30	60	30	30	57.4
96	Ghana	58.1	1.0	56.7	63	83.2	65.7	69.6	50	60	50	37	45.3
97	Egypt	58.0	-0.5	64.7	63.4	89.5	66.1	65.9	50	50	40	29	61.3
98	Tunisia	58.0	-2.1	81.6	53	76.5	78.3	78.4	30	30	50	42	60.1
99	Azerbaijan	58.0	2.6	74.6	78.4	79.7	77.5	66.3	30	40	25	21	87.0
100	Bhutan	57.7	n/a	61.7	42	83.6	58.3	75.9	30	30	60	50	85.8
101	Morocco	57.7	2.1	76.2	68	65.1	76.5	80.5	60	50	35	35	30.8
102	Pakistan	57.0	1.4	72.5	65.6	80.4	90.7	72.2	40	40	30	24	54.5
103	Yemen	56.9	3.1	74.9	76.2	83.2	57.1	66.5	50	30	30	25	75.8
104	The Philippines	56.8	0.8	49.3	78.6	75.4	90.8	77.2	40	50	30	25	51.4
105	Brazil	56.7	0.5	54.4	71.6	65.8	50.3	77.2	50	50	50	35	62.7
106	Cambodia	56.6	0.8	42.7	63.4	91.4	94.5	80.0	50	50	30	20	44.5
107	Algeria	56.6	0.4	72.5	68.6	77.2	74.1	78.6	50	30	30	30	55.5
108	Zambia	56.6	0.4	68.8	71.2	72.9	82.1	64.1	50	50	30	26	51.0
109	Serbia	56.6	n/a	56.0	78	85.9	46.3	65.8	40	50	40	34	70.0
110	Senegal	56.3	-2.0	65.0	71.2	65.1	77.0	76.5	40	40	50	36	42.5

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111	Sri Lanka	56.0	-2.4	73.7	71	73.2	80.5	59.4	20	40	40	32	70.8
112	The Gambia	55.8	-1.1	59.9	59.6	71.9	74.4	71.9	50	50	30	23	67.0
113	Mozambique	55.7	0.2	54.2	73.4	77.7	76.5	75.9	50	50	30	28	41.1
114	Mali	55.6	0.1	42.2	73	69.4	81.4	79.6	50	40	30	27	63.8
115	Benin	55.4	0.1	43.8	67.4	67.2	88.5	79.6	40	60	30	27	50.3
116	Croatia	55.1	1.0	59.9	87.6	68.7	31.7	79.0	50	60	30	41	43.4
117	Nigeria	55.1	0.0	55.1	61.8	84.4	64.3	77.9	30	40	30	22	85.8
118	Gabon	55.0	0.9	59.9	57	61.7	84.8	73.8	40	40	40	33	60.0
119	Côte d'Ivoire	55.0	1.0	45.8	70.4	58.1	87.6	79.1	40	60	30	21	57.8
120	Moldova	54.9	-3.0	70.1	81.6	85.3	51.3	67.6	30	50	40	28	45.1
121	Papua New Guinea	54.8	n/a	60.1	87.2	67.4	71.0	81.4	30	30	20	20	81.1
122	Tajikistan	54.6	0.2	45.1	82.6	89.3	85.9	63.2	30	40	30	21	58.7
123	India	54.4	0.3	54.4	51	73.8	77.8	69.3	30	40	50	35	62.3
124	Rwanda	54.2	0.0	58.9	61.2	76.8	76.8	70.8	40	40	30	28	59.5
125	Suriname	54.1	-0.2	41.5	64.2	67.7	75.5	72.2	30	30	40	35	84.8
126	Tonga	54.1	n/a	79.0	56	82.5	58.0	68.9	40	20	20	17	99.4
127	Mauritania	53.9	-1.2	53.6	75.6	75.4	65.9	77.7	50	40	25	26	50.2
128	Niger	53.8	1.0	36.9	70.4	66.3	88.8	89.5	50	40	30	26	40.6
129	Malawi	53.7	1.1	45.2	68.8	70.7	48.6	69.8	50	50	50	27	57.2
130	Bolivia	53.6	0.5	58.5	81.8	84.8	71.9	67.9	20	60	20	29	41.9
131	Indonesia	53.4	0.2	46.7	76.4	77.5	88.0	71.6	30	40	30	23	50.9
132	China	53.2	0.1	51.6	71.4	70.6	88.9	72.9	30	30	20	35	61.8
133	Nepal	53.2	-0.9	60.5	63.2	86.3	91.0	78.7	20	30	30	25	46.9
134	Bosnia and Herzegovina	53.1	-0.8	59.9	77.2	71.8	37.6	79.0	50	60	10	33	52.1
135	Ethiopia	53.0	0.5	62.6	68.6	77.4	82.7	65.5	40	20	30	24	59.4
136	Cameroon	53.0	-1.3	39.3	56	69.6	93.6	76.0	40	50	30	24	51.5
137	Ecuador	52.5	-2.8	54.0	72.6	85.8	83.1	75.0	30	40	25	21	38.3
138	Argentina	52.3	-1.8	62.1	70	70.3	75.6	60.6	50	40	20	29	45.6
139	Micronesia	51.7	n/a	59.8	81	97.4	0.0	76.7	30	30	30	30	82.3
140	Djibouti	51.3	0.1	38.1	31.8	80.8	59.4	76.6	50	60	30	29	57.9
141	Syria	51.3	4.2	61.4	54	87.0	74.9	67.2	40	20	30	24	54.9
142	Equatorial Guinea	51.3	-0.3	45.7	59.4	75.5	86.3	81.4	30	40	30	19	46.1
143	Maldives	51.3	n/a	83.2	44	95.8	0.0	76.5	30	30	30	33	90.1
144	Guinea	51.0	-1.8	45.2	59.6	71.1	91.9	57.4	40	40	20	19	66.3
145	Vietnam	51.0	0.6	61.7	63.4	74.3	77.3	67	30	30	10	26	70.0
146	Russia	50.8	1.0	54.0	60.8	78.9	70.6	65.5	30	40	25	23	60.0
147	Haiti	50.5	1.5	37.7	79.4	77.9	93.8	69.0	30	30	10	16	61.2
148	Uzbekistan	50.5	-1.4	68.4	65.4	88.3	68.1	62.6	30	20	20	17	64.9
149	Timor-Leste	50.5	n/a	47.0	73	64.7	84.0	74.1	30	20	20	26	66.0
150	Laos	50.4	0.1	59.5	66.4	70.6	89.7	75.4	30	20	10	19	63.5

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151	Lesotho	49.7	-2.5	61.7	57	63.1	36.2	73.1	30	40	40	33	62.7
152	Ukraine	48.8	-2.2	40.5	84	77.0	39.0	68.1	30	40	30	27	52.4
153	Burundi	48.8	2.6	34.4	63	72.5	55.8	72.7	40	30	30	25	64.3
154	Togo	48.7	-0.2	36.6	70.6	53.7	86.6	81.5	30	30	30	23	44.7
155	Guyana	48.4	-0.4	60.9	72.6	66.5	3.2	69.6	40	40	40	26	65.2
156	Central African Republic	48.3	-0.3	39.5	50.4	65.4	94.0	75.0	40	30	20	20	48.7
157	Liberia	48.1	n/a	40.2	53.8	73.8	97.2	70.1	30	20	25	21	49.8
158	Sierra Leone	47.8	-0.5	57.0	66	80.9	86.3	73.8	30	20	10	21	33.4
159	Seychelles	47.8	n/a	65.5	28.4	73.8	0.0	78.1	50	30	50	45	57.1
160	Bangladesh	47.5	3.3	62.9	40.2	72.8	94.2	67.3	20	20	25	20	52.3
161	Chad	47.5	-0.4	35.7	58.4	50.5	90.8	78.6	40	40	20	18	42.6
162	Angola	47.0	0.1	43.6	72	85.2	62.2	61.8	20	40	20	22	43.5
163	Solomon Islands	46.0	n/a	67.2	66.4	68.9	0.0	73.5	20	30	30	28	76.3
164	Kiribati	45.7	n/a	62.5	55	42.2	0.0	88.7	30	30	30	33	85.6
165	Guinea-Bissau	45.4	1.1	24.2	66.8	88.4	49.1	73.5	30	30	20	22	50.5
166	Republic of Congo	45.4	0.0	50.1	55.4	60.2	77.6	73.9	30	30	10	21	45.6
167	Belarus	45.0	-0.4	63.7	67.2	79.4	30.9	66.8	20	10	20	21	70.8
168	Iran	44.6	-0.4	60.6	57.4	81.0	79.7	60.1	10	10	10	25	52.4
169	Turkmenistan	44.2	0.8	30.0	79.2	90.9	93.6	68	10	10	10	20	30.0
170	São Tomé and Príncipe	43.8	n/a	45.1	60	75.0	22.0	61.4	40	30	30	27	48.0
171	Libya	43.5	4.8	20.0	90	81.7	68.1	70.3	30	20	10	25	20.0
172	Comoros	43.3	n/a	46.5	27.2	64.6	88.1	78.9	20	20	30	26	31.8
173	Democratic Republic of Congo	42.8	n/a	34.3	62.2	73.3	85.3	59.5	30	20	10	19	34.5
174	Venezuela	39.9	-4.8	50.8	59.6	70.6	69.3	53.7	10	30	5	20	30.1
175	Eritrea	38.5	n/a	18.3	69.2	86.4	9.9	59.0	10	20	10	28	73.9
176	Burma	37.7	-1.8	20.0	72.2	81.8	98.5	45.3	10	10	5	14	20.0
177	Cuba	27.9	0.4	10.0	64.4	45.9	0.0	67.0	10	10	10	42	20.0
178	Zimbabwe	22.7	-6.7	30.8	50.4	44.1	4.6	0	10	10	5	21	51.2
179	North Korea	2.0	-1.0	0.0	0.0	0.0	0.0	0.0	10	0	5	5	0.0
n/a	Afghanistan	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
n/a	Iraq	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
n/a	Liechtenstein	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
n/a	Sudan	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Methodology for the 10 Economic Freedoms

The *Index of Economic Freedom* is built upon analysis of 10 specific components of economic freedom, some of which are themselves composites of additional quantifiable measures. The 10 component scores are equally weighted and averaged to get an overall economic freedom score for each country.

The following paragraphs provide detailed descriptions of the methodology used to determine the scores for each of the 10 components of economic freedom.

FREEDOM #1: BUSINESS FREEDOM

Business freedom is a quantitative measure of the ability to start, operate, and close a business that represents the overall burden of regulation, as well as the efficiency of government in the regulatory process. The business freedom score for each country is a number between 0 and 100, with 100 equaling the freest business environment. The score is based on 10 factors, all weighted equally, using data from the World Bank's *Doing Business* study:

- Starting a business—procedures (number);
- Starting a business—time (days);
- Starting a business—cost (% of income per capita);
- Starting a business—minimum capital (% of income per capita);
- Obtaining a license—procedures (number);
- Obtaining a license—time (days);
- Obtaining a license—cost (% of income per capita);
- Closing a business—time (years);

- Closing a business—cost (% of estate); and
- Closing a business—recovery rate (cents on the dollar).¹

Each of these raw factors is converted to a scale of 0 to 100, after which the average of the converted values is computed. The result represents the country's business freedom score. For example, even if a country requires the highest number of procedures for starting a business, which yields a score of zero in that factor, it could still receive a score as high as 90 based on scores in the other nine factors.

Singapore, for instance, receives scores of 100 in nine of the 10 factors, the exception being the 11 licensing procedures required by the government, which equates to a score of 83.1 for that factor.

Each factor is converted to a 0 to 100 scale using the following equation:

$$\text{Factor Score}_i = 50 \times \text{factor}_{\text{average}} / \text{factor}_i$$

which is based on the ratio of the country data for each factor relative to the world average, multiplied by 50. For example, on average worldwide, it takes 18.3 procedures to get necessary licenses. Singapore's 11 licensing procedures is a factor value better than the average, resulting in a ratio of 1.66. That ratio multiplied by 50 equals the final factor score of 83.

For the nine countries that are not covered by the World Bank's *Doing Business* study, business freedom is scored by looking into business regulations based on qualitative information from reliable and internationally recognized sources.²

Sources. Unless otherwise noted, the authors used the following sources in determining business freedom scores, in order of priority: World Bank, *Doing Business 2009*; Economist Intelligence Unit, *Country Report, Country Commerce, and Country Profile, 2005–2008*; U.S. Department of Commerce, *Country Commercial Guide, 2005–2008*; and official government publications of each country.

FREEDOM #2: TRADE FREEDOM

Trade freedom is a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services. The trade freedom score is based on two inputs:

- The trade-weighted average tariff rate and
- Non-tariff barriers (NTBs).

Different imports entering a country can, and often do, face different tariffs. The weighted average tariff uses weights for each tariff based on the share of imports for each good. Weighted average tariffs are a purely quantitative measure and account for the basic calculation of the score using the following equation:

$$\text{Trade Freedom}_i = (((\text{Tariff}_{\text{max}} - \text{Tariff}_i) / (\text{Tariff}_{\text{max}} - \text{Tariff}_{\text{min}})) * 100) - \text{NTB}_i$$

where Trade Freedom_i represents the trade freedom in country i , $\text{Tariff}_{\text{max}}$ and $\text{Tariff}_{\text{min}}$ represent the upper and lower bounds for tariff rates (%), and Tariff_i represents the weighted average tariff rate (%) in country i . The minimum tariff is naturally zero percent, and the upper bound was set

1. The recovery rate is a function of time and cost. However, the business freedom component uses all three subvariables to emphasize closing a business, starting a business, and dealing with licenses equally.

2. Nine countries are not covered by the World Bank's *Doing Business* study: Barbados, Burma, Cuba, Cyprus, North Korea, Libya, Macao, Malta, and Turkmenistan. The methodology for business freedom dates to the 2006 *Index* because of the limited availability of quantitative data. For the 1995 through 2005 editions, we used a subjective assessment with a score of 1–5. Those earlier scores have been converted by means of a simple formula to make them comparable. Observations with the top score were converted to 100, the next best to 85, and so on. This conversion formula is different from the one used for other subjective factors, but it is unique because those other factors are not bridging to a new, data-driven methodology.

as 50 percent. An NTB penalty is then subtracted from the base score. The penalty of 5, 10, 15, or 20 points is assigned according to the following scale:

- **20**—NTBs are used extensively across many goods and services and/or act to effectively impede a significant amount of international trade.
- **15**—NTBs are widespread across many goods and services and/or act to impede a majority of potential international trade.
- **10**—NTBs are used to protect certain goods and services and impede some international trade.
- **5**—NTBs are uncommon, protecting few goods and services, and/or have very limited impact on international trade.
- **0**—NTBs are not used to limit international trade.

We determine the extent of NTBs in a country's trade policy regime using both qualitative and quantitative information. Restrictive rules that hinder trade vary widely, and their overlapping and shifting nature makes their complexity difficult to gauge. The categories of NTBs considered in our penalty include:

- **Quantity restrictions**—import quotas; export limitations; voluntary export restraints; import–export embargoes and bans; countertrade, etc.
- **Price restrictions**—antidumping duties; countervailing duties; border tax adjustments; variable levies/tariff rate quotas.
- **Regulatory restrictions**—licensing; domestic content and mixing requirements; sanitary and phytosanitary standards (SPSs); safety and industrial standards regulations; packaging, labeling, and trademark regulations; advertising and media regulations.
- **Investment restrictions**—exchange and other financial controls.
- **Customs restrictions**—advance deposit requirements; customs valuation procedures; customs classification procedures; customs clearance procedures.
- **Direct government intervention**—subsidies and other aid; government industrial policy and regional development measures; government-financed research and other technology policies; national taxes and social insurance; competition policies; immigration policies; government procurement policies; state trading, government monopolies, and exclusive franchises.

As an example, China received a trade freedom score of 71.4. China's weighted average tariff of 4.3 percent would have yielded a score by itself of 91.4, but the existence of significant NTBs in China reduced the score by 20 points.

Gathering data on tariffs to make a consistent cross-country comparison can be a challenging task. Unlike data on inflation, for instance, countries do not report their weighted average tariff rate or simple average tariff rate every year; in some cases, the most recent time a country reported its tariff data could have been as far back as 1999. To preserve consistency in grading the trade policy component, the authors have decided to use the most recently reported weighted average tariff rate for a country from our primary source. If another reliable source reports more updated information on the country's tariff rate, the authors note this fact and may review the grading of this component if there is strong evidence that the most recently reported weighted average tariff rate is outdated.

The World Bank produces the most comprehensive and consistent information on weighted average applied tariff rates. When the weighted average applied tariff rate is not available, the authors use the country's average applied tariff rate; and when the country's average applied tariff rate is not available, the authors use the weighted average or the simple average of most favored nation (MFN) tariff rates.³ In the very few cases where data on duties and customs rev-

3. MFN is now referred to as permanent normal trade relations (PNTR).

enues are not available, the authors use data on international trade taxes instead. In all cases, the authors clarify the type of data used and the different sources for those data in the corresponding write-up for the trade policy component. Sometimes, when none of this information is available, the authors simply analyze the overall tariff structure and estimate an effective tariff rate.

Sources. Unless otherwise noted, the authors used the following sources to determine scores for trade policy, in order of priority: World Bank, *World Development Indicators 2008* and *Data on Trade and Import Barriers: Trends in Average Applied Tariff Rates in Developing and Industrial Countries, 1981–2006*; World Trade Organization, *Trade Policy Review, 1995–2008*; Office of the U.S. Trade Representative, *2008 National Trade Estimate Report on Foreign Trade Barriers*; World Bank, *Doing Business 2008* and *Doing Business 2009*; U.S. Department of Commerce, *Country Commercial Guide, 2004–2008*; Economist Intelligence Unit, *Country Report, Country Profile, and Country Commerce, 2004–2008*; and official government publications of each country.

FREEDOM #3: FISCAL FREEDOM

Fiscal freedom is a measure of the burden of government from the revenue side. It includes both the tax burden in terms of the top tax rate on incomes (individual and corporate separately) and the overall amount of tax revenue as a percentage of GDP. Thus, the fiscal freedom component is composed of three quantitative factors:

- The top tax rate on individual income,
- The top tax rate on corporate income, and
- Total tax revenue as a percentage of GDP.

In scoring the fiscal freedom component, each of these numerical variables is weighted equally as one-third of the factor. This equal weighting allows a country to achieve a score as high as 67 based on two of the factors even if it receives a score of 0 on the third.

The economics of public finance is unambiguous about the effect of taxation, using simple supply and demand. A doubling of the tax rate quadruples lost economic activity's economic cost to society. This is known as deadweight loss because it is not value gained by government, but simply prosperity that is destroyed. This happens because the price wedge created by taxation separates optimal supply and demand and diminishes the quantity of goods exchanged. In the extreme, raising tax rates will decrease tax revenue itself, as famously demonstrated by the Laffer curve. Therefore, the scoring of fiscal freedom is calculated with a quadratic cost function. The data for each factor are converted to a 100-point scale using this quadratic equation:

$$\text{Fiscal Freedom}_{ij} = 100 - \alpha \times (\text{Factor}_{ij})^2$$

where $\text{Fiscal Freedom}_{ij}$ represents the fiscal freedom in country i for factor j ; Factor_{ij} represents the value (based on a scale of 0 to 100) in country i for factor j ; and α is a coefficient set equal to 0.03. The minimum score for each factor is zero, which is not represented in the printed equation but was utilized because it means that no single high tax burden will make the other two factors irrelevant.

As an example, in the 2008 *Index*, Bulgaria has a flat rate of 10 percent for both individual and corporate tax rates, which yields a score of 97 for each of the two factors. Bulgaria's overall tax revenue as a portion of GDP is 34.4 percent, yielding a revenue factor score of 64.5. When the three factors are averaged together, Bulgaria's overall fiscal freedom score becomes 86.2.

Sources. Unless otherwise noted, the authors used the following sources for information on taxation, in order of priority: Deloitte, *Country Snapshot, Corporate Tax Rates at a Glance*, and *International Tax and Business Guide, 2008*; International Monetary Fund, *Staff Country Report, "Selected Issues and Statistical Appendix," 2005–2008*; Ernst & Young, *The Global Executive and Worldwide Corporate Tax Guide, 2007–2008*; PricewaterhouseCoopers, *Worldwide Tax Summaries, 2006–2008*; countries' investment agencies; other governmental authorities (embassy confirmations and/

or the country's treasury or tax authority); and Economist Intelligence Unit, *Country Report* and *Country Profile*, 2006–2008.

For information on tax revenue as a percentage of GDP, the authors' primary sources (in order of priority) were Organisation for Economic Co-operation and Development data; Eurostat; African Development Bank and Organisation for Economic Co-operation and Development, *African Economic Outlook 2008*; International Monetary Fund, *Staff Country Report*, "Selected Issues and Statistical Appendix," 2005–2008; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2007–2008*; World Trade Organization, *Trade Policy Reviews*, 2007–2008; official government publications of each country; and individual contacts from government agencies and multinational organizations such as the IMF and World Bank.

FREEDOM #4: GOVERNMENT SIZE

This component considers the level of government expenditures as a percentage of GDP. Government expenditures—including consumption and transfers—account for the entire score.

Some level of government expenditures represents true public goods, implying an ideal level greater than zero. However, identifying that ideal level seems too arbitrary, static, and difficult to apply universally. For these reasons, the methodology treats zero government spending as the benchmark. Moreover, governments that have no public goods will be penalized by lower scores in the other factors (such as property rights and financial freedom).

The scale for scoring government size is non-linear, which means that government spending that is close to zero is lightly penalized, while levels of government exceeding 30 percent of GDP receive much worse scores in a quadratic fashion (e.g., doubling spending yields four times less freedom), so that only really large governments receive very low scores.

The expenditure equation used is:

$$GE_i = 100 - \alpha \times (\text{Expenditures}_i)^2$$

where GE_i represents the government expenditure score in country i ; Expenditures_i represents the total amount of government spending at all levels as a portion of GDP (between 0 and 100); and α is a coefficient to control for variation among scores (set at 0.03). The minimum component score is zero.

In most cases, general government expenditure data include all levels of government such as federal, state, and local. In cases where general government spending data are not available, data on central government expenditure are used instead.

Sources. Unless otherwise noted, the authors used the following sources for information on government intervention in the economy, in order of priority: Official government publications of each country; Economist Intelligence Unit, *Country Report* and *Country Profile*, 2004–2007; Organisation for Economic Co-operation and Development data; Eurostat; African Development Bank and Organisation for Economic Co-operation and Development, *African Economic Outlook 2008*; African Development Bank, *Selected Statistics on African Countries 2008*; International Monetary Fund, *Staff Country Report*, "Selected Issues and Statistical Appendix," 2004–2008; and Asian Development Bank, *Key Indicators 2007–2008*.

FREEDOM #5: MONETARY FREEDOM

Monetary freedom combines a measure of price stability with an assessment of price controls. Both inflation and price controls distort market activity. Price stability without microeconomic intervention is the ideal state for the free market.

The score for the monetary freedom factor is based on two factors:

- The weighted average inflation rate for the most recent three years and
- Price controls.

The weighted average inflation rate for the most recent three years serves as the primary input into an equation that generates the base score for monetary freedom. The extent of price controls is then assessed as a penalty of up to 20 points subtracted from the base score. The two equations used to convert inflation rates into the monetary freedom score are:

$$\text{Weighted Avg. Inflation}_i = \theta_1 \times \text{Inflation}_{it} + \theta_2 \times \text{Inflation}_{it-1} + \theta_3 \times \text{Inflation}_{it-2}$$

$$\text{Monetary Freedom}_i = 100 - \alpha \times \sqrt{\text{Weighted Avg. Inflation}_i} - \text{PC penalty}_i$$

where θ_1 through θ_3 (thetas 1–3) represent three numbers that sum to 1 and are exponentially smaller in sequence (in this case, values of 0.665, 0.245, and 0.090, respectively); Inflation_{it} is the absolute value of the annual inflation rate in country i during year t as measured by the consumer price index; α represents a coefficient that stabilizes the variance of scores; and the price control (PC) penalty is an assigned value of 0–20 points based on the extent of price controls. The convex (square root) functional form was chosen to create separation among countries with low inflation rates. A concave functional form would essentially treat all hyperinflations as equally bad, whether they were 100 percent price increases annually or 100,000 percent, whereas the square root provides much more gradation. The α coefficient is set to equal 6.333, which converts a 10 percent inflation rate into a freedom score of 80.0 and a 2 percent inflation rate into a score of 91.0.

Sources. Unless otherwise noted, the authors used the following sources for data on monetary policy, in order of priority: International Monetary Fund, *International Financial Statistics Online*; International Monetary Fund, *2008 World Economic Outlook*; and Economist Intelligence Unit, *Country Report*, 1999–2008, and *Country Profile*, 2004–2008.

FREEDOM #6: INVESTMENT FREEDOM

This component scrutinizes each country’s policies toward the free flow of investment capital (foreign investment as well as internal capital flows) in order to determine its overall investment climate. The authors assess all countries using the same rubric.

Questions examined include whether there is a foreign investment code that defines the country’s investment laws and procedures; whether the government encourages foreign investment through fair and equitable treatment of investors; whether there are restrictions on access to foreign exchange; whether foreign firms are treated the same as domestic firms under the law; whether the government imposes restrictions on payments, transfers, and capital transactions; and whether specific industries are closed to foreign investment.

The following criteria are used in determining a country’s score for this component:

- **100**—Foreign investment (FI) is encouraged and treated the same as domestic investment, with a simple and transparent FI code and a professional, efficient bureaucracy. There are no restrictions in sectors related to national security or real estate. No expropriation is allowed. Both residents and non-residents have access to foreign exchange and may conduct international payments. Transfers or capital transactions face no restrictions.
- **90**—Same as above with the following exceptions: There are very few restrictions on FI in sectors related to national security. There are legal guarantees against expropriation of property. Transfers or capital transactions are subject to virtually no restrictions.
- **80**—Same as above with the following exceptions: A transparent FI code is subject to minimal bureaucratic or other informal impediments. There are very few restrictions on foreign exchange. Transfers or capital transactions are subject to very few restrictions.
- **70**—Same as above with the following exceptions: There are some restrictions on FI through general rules or in a few sectors such as utilities, natural resources, or national security. There are a few restrictions on access to foreign exchange or the ability to conduct international payments.

- **60**—Same as above with the following exceptions: FI is generally encouraged but may not receive equal treatment in a few sectors. The FI code is somewhat non-transparent, and/or FI faces bureaucratic impediments. Expropriation of property is highly unlikely, and the government guarantees compensation. Transfers or capital transactions are subject to some restrictions.
- **50**—Same as above with the following exceptions: Foreign investors face restrictions on their ability to purchase real estate. All investors face bureaucratic impediments and corruption. Residents and/or non-residents face some restrictions on access to foreign exchange or their ability to conduct international payments. Transfers or capital transactions are subject to obvious restrictions.
- **40**—Same as above with the following exceptions: FI is somewhat restricted, the FI code is somewhat discriminatory, and FI is restricted outright in some sectors. Expropriation of property is rare. Transfers and capital transactions are subject to significant restrictions.
- **30**—Same as above with the following exceptions: FI is significantly restricted, the FI code is discriminatory, and foreign investors may purchase real estate only in limited circumstances. All investors face significant bureaucratic impediments and corruption. Residents and non-residents face strict restrictions on access to foreign exchange, and the government imposes many controls on international payments.
- **20**—Same as above with the following exceptions: FI is discouraged and prohibited in many sectors, the FI code is discriminatory, and the approval process is opaque and subject to widespread corruption. Few sectors are open to FI. Expropriation of property is common. The government imposes extensive controls on international payments, transfers, and capital transactions.
- **10**—Same as above with the following exceptions: Foreign investors may not purchase real estate. The government controls or prohibits most international payments, transfers, and capital transactions.
- **0**—Same as above with the following exceptions: FI is prohibited, foreigners may not own real estate, and the government prohibits international payments, transfers, and capital transactions.

Sources. Unless otherwise noted, the authors used the following sources for data on capital flows and foreign investment, in order of priority: Official government publications of each country; Economist Intelligence Unit, *Country Commerce, Country Profile, and Country Report*, 2005–2008; Office of the U.S. Trade Representative, *2008 National Trade Estimate Report on Foreign Trade Barriers*; and U.S. Department of Commerce, *Country Commercial Guide*, 2005–2008.

FREEDOM #7: FINANCIAL FREEDOM

Financial freedom is a measure of banking security as well as a measure of independence from government control. State ownership of banks and other financial institutions such as insurers and capital markets is an inefficient burden that reduces competition and generally lowers the level of available services.

The authors score this component by determining the extent of government regulation of financial services; the extent of state intervention in banks and other financial services; the difficulty of opening and operating financial services firms (for both domestic and foreign individuals); and government influence on the allocation of credit. The authors use this analysis to develop a description of the country's financial climate and assign it an overall score on a scale of 0 to 100.

The following criteria are used in determining a country's score for this component of economic freedom:

- **100—Negligible government influence.** Independent central bank supervision and regulation of financial institutions are limited to enforcing contractual obligations and prevent-

ing fraud. Credit is allocated on market terms. The government does not own financial institutions. Financial institutions may engage in all types of financial services. Banks are free to issue competitive notes, extend credit and accept deposits, and conduct operations in foreign currencies. Foreign financial institutions operate freely and are treated the same as domestic institutions.

- **90—Minimal government influence.** Same as above with the following exceptions: Independent central bank supervision and regulation of financial institutions are minimal but may extend beyond enforcing contractual obligations and preventing fraud.
- **80—Nominal government influence.** Same as above with the following exceptions: Independent central bank supervision and regulation are straightforward and transparent but extend beyond enforcing contractual obligations and preventing fraud. Government ownership of financial institutions is a small share of overall sector assets. Financial institutions face almost no restrictions on their ability to offer financial services.
- **70—Limited government influence.** Same as above with the following exceptions: Credit allocation is slightly influenced by the government, and private allocation of credit faces almost no restrictions. Foreign financial institutions are subject to few restrictions.
- **60—Significant government influence.** Same as above with the following exceptions: The central bank is not fully independent, its supervision and regulation of financial institutions are somewhat burdensome, and its ability to enforce contracts and prevent fraud is insufficient. The government exercises active ownership and control of financial institutions with a significant share of overall sector assets. The ability of financial institutions to offer financial services is subject to some restrictions.
- **50—Considerable government influence.** Same as above with the following exceptions: Credit allocation is significantly influenced by the government, and private allocation of credit faces significant barriers. The ability of financial institutions to offer financial services is subject to significant restrictions. Foreign financial institutions are subject to some restrictions.
- **40—Strong government influence.** Same as above with the following exceptions: The central bank is subject to government influence, its supervision and regulation of financial institutions are heavy, and its ability to enforce contracts and prevent fraud is weak. The government exercises active ownership and control of financial institutions with a large minority share of overall sector assets.
- **30—Extensive government influence.** Same as above with the following exceptions: Credit allocation is extensively influenced by the government. The government owns or controls a majority of financial institutions or is in a dominant position. Financial institutions are heavily restricted, and bank formation faces significant barriers. Foreign financial institutions are subject to significant restrictions.
- **20—Heavy government influence.** Same as above with the following exceptions: The central bank is not independent, and its supervision and regulation of financial institutions are repressive. Foreign financial institutions are discouraged or highly constrained.
- **10—Near repressive.** Same as above with the following exceptions: Credit allocation is controlled by the government. Bank formation is restricted. Foreign financial institutions are prohibited.
- **0—Repressive.** Same as above with the following exceptions: Supervision and regulation are designed to prevent private financial institutions. Private financial institutions are prohibited.

Sources. Unless otherwise noted, the authors used the following sources for data on banking and finance, in order of priority: Economist Intelligence Unit, *Country Commerce*, *Country Profile*, and *Country Report*, 2005–2008; Deloitte, *Country Snapshot*; Organisation for Economic Co-oper-

ation and Development; official government publications of each country; U.S. Department of Commerce, *Country Commercial Guide*, 2005–2008; Office of the U.S. Trade Representative, *2008 National Trade Estimate Report on Foreign Trade Barriers*; U.S. Department of State, *Investment Climate Statements 2008*; World Bank, *World Development Indicators 2008*; and various news and magazine articles on banking and finance.

FREEDOM #8: PROPERTY RIGHTS

The property rights component is an assessment of the ability of individuals to accumulate private property, secured by clear laws that are fully enforced by the state. It measures the degree to which a country's laws protect private property rights and the degree to which its government enforces those laws. It also assesses the likelihood that private property will be expropriated and analyzes the independence of the judiciary, the existence of corruption within the judiciary, and the ability of individuals and businesses to enforce contracts. The more certain the legal protection of property, the higher a country's score; similarly, the greater the chances of government expropriation of property, the lower a country's score. Countries that fall between two categories may receive an intermediate score.

The authors grade each country according to the following criteria:

- **100**—Private property is guaranteed by the government. The court system enforces contracts efficiently and quickly. The justice system punishes those who unlawfully confiscate private property. There is no corruption or expropriation.
- **90**—Private property is guaranteed by the government. The court system enforces contracts efficiently. The justice system punishes those who unlawfully confiscate private property. Corruption is nearly nonexistent, and expropriation is highly unlikely.
- **80**—Private property is guaranteed by the government. The court system enforces contracts efficiently but with some delays. Corruption is minimal, and expropriation is highly unlikely.
- **70**—Private property is guaranteed by the government. The court system is subject to delays and is lax in enforcing contracts. Corruption is possible but rare, and expropriation is unlikely.
- **60**—Enforcement of property rights is lax and subject to delays. Corruption is possible but rare, and the judiciary may be influenced by other branches of government. Expropriation is unlikely.
- **50**—The court system is inefficient and subject to delays. Corruption may be present, and the judiciary may be influenced by other branches of government. Expropriation is possible but rare.
- **40**—The court system is highly inefficient, and delays are so long that they deter the use of the court system. Corruption is present, and the judiciary is influenced by other branches of government. Expropriation is possible.
- **30**—Property ownership is weakly protected. The court system is highly inefficient. Corruption is extensive, and the judiciary is strongly influenced by other branches of government. Expropriation is possible.
- **20**—Private property is weakly protected. The court system is so inefficient and corrupt that outside settlement and arbitration is the norm. Property rights are difficult to enforce. Judicial corruption is extensive. Expropriation is common.
- **10**—Private property is rarely protected, and almost all property belongs to the state. The country is in such chaos (for example, because of ongoing war) that protection of property is almost impossible to enforce. The judiciary is so corrupt that property is not protected effectively. Expropriation is common.

- 0—Private property is outlawed, and all property belongs to the state. People do not have the right to sue others and do not have access to the courts. Corruption is endemic.

Sources. Unless otherwise noted, the authors used the following sources for information on property rights, in order of priority: Economist Intelligence Unit, *Country Profile, Country Report, and Country Commerce*, 2005–2008; U.S. Department of Commerce, *Country Commercial Guide*, 2005–2008; and U.S. Department of State, *Country Reports on Human Rights Practices*, 2005–2008.

FREEDOM #9: FREEDOM FROM CORRUPTION

Corruption erodes economic freedom by introducing insecurity and uncertainty into economic relationships. The score for this component is derived primarily from Transparency International’s Corruption Perceptions Index (CPI) for 2007, which measures the level of corruption in 179 countries.

The CPI is based on a 10-point scale in which a score of 10 indicates very little corruption and a score of 0 indicates a very corrupt government. In scoring freedom from corruption, the authors convert the raw CPI data to a scale of 0 to 100 by multiplying the CPI score by 10. For example, if a country’s raw CPI data score is 5.5, its overall freedom from corruption score is 55.

For countries that are not covered in the CPI, the freedom from corruption score is determined by using the qualitative information from internationally recognized and reliable sources.⁴ This procedure considers the extent to which corruption prevails in a country. The higher the level of corruption, the lower the level of overall economic freedom and the lower a country’s score.

Sources. Unless otherwise noted, the authors used the following sources for information on informal market activities, in order of priority: Transparency International, *Corruption Perceptions Index*, 2007; U.S. Department of Commerce, *Country Commercial Guide*, 2005–2008; Economist Intelligence Unit, *Country Commerce, Country Profile, and Country Report*, 2005–2008; Office of the U.S. Trade Representative, *2008 National Trade Estimate Report on Foreign Trade Barriers*; and official government publications of each country.

FREEDOM #10: LABOR FREEDOM

The labor freedom component is a quantitative measure that looks into various aspects of the legal and regulatory framework of a country’s labor market. It provides cross-country data on regulations concerning minimum wages; laws inhibiting layoffs; severance requirements; and measurable regulatory burdens on hiring, hours, and so on.

Six quantitative factors are equally weighted as one-sixth of the labor freedom component:⁵

- Ratio of minimum wage to the average value added per worker,
- Hindrance to hiring additional workers,
- Rigidity of hours,
- Difficulty of firing redundant employees,
- Legally mandated notice period, and
- Mandatory severance pay.

Based on data from the World Bank’s *Doing Business* study, these factors specifically examine “the difficulty of hiring, nonstandard work schedules and paid annual leave, and the costs and rules governing redundancy termination.”⁶

4. The following three countries are not covered by the CPI: Bahamas, Liechtenstein, and North Korea.

5. The labor freedom assessment in the 2009 *Index* expanded its factors to six from four in previous editions of the *Index*. This refinement was applied equally to past editions’ labor freedom scores so as to maintain consistency. The method for labor freedom assessment dates to the 2005 *Index* due to the limited availability of the quantitative data.

6. For more detailed information on the data, see “Employing Workers,” in World Bank, *Doing Business*, at <http://www.doingbusiness.org/MethodologySurveys/EmployingWorkers.aspx>.

In constructing the labor freedom score, each of the six factors is converted to a scale of 0 to 100 based on the following equation:

$$\text{Factor Score}_i = 50 \times \text{factor}_{\text{average}} / \text{factor}_i$$

where country i data are calculated relative to the world average and then multiplied by 50. The six factor scores are then averaged for each country, yielding a labor freedom score.

The simple average of the converted values for the six factors is computed for the country's overall labor freedom score. For example, even if a country has the worst rigidity of hours in the world with a zero score for that factor, it could still get a score as high as 83.3 based on the other five factors.

For the nine countries that are not covered by the World Bank's *Doing Business* study, the labor freedom component is scored by looking into labor market flexibility based on qualitative information from other reliable and internationally recognized sources.⁷

Sources. Unless otherwise noted, the authors relied on the following sources for data on labor freedom, in order of priority: World Bank, *Doing Business 2009*; Economist Intelligence Unit, *Country Report* and *Country Profile*, 2004–2008; U.S. Department of Commerce, *Country Commercial Guide*, 2006, 2007, and 2008; and official government publications of each country.

CONTINUITY AND CHANGE

With over a decade of experience measuring economic freedom in over a hundred nations annually, two issues regularly challenge our methodology.

The first challenge has to do with outdated data. Country data in the most up-to-date sources are often behind by years. Also, countries often make policy changes during the year of grading. Sometimes the policy changes are not reflected in official data, and sometimes the changes are proposed but not made law, or made law but not enforced. Additionally, a country can experience a violent conflict or catastrophe that interrupts all efforts to measure the economy.

The second challenge is the balance between quality and consistency of the *Index* itself. The authors aim for methodological consistency from one year to the next, balanced against opportunities to incorporate new data and methods that improve the quality of the current year's scores.

Using the Most Currently Available Information. Analyzing economic freedom annually permits the authors of the *Index* to include the most recent information as it becomes available country by country. A cutoff date is utilized so that all countries are treated fairly. As described above, the period of study for the current year's *Index* considers all information as of the last day of June of the previous year (June 30, 2008). Any new legislative changes or policy actions effective after that date have no positive or negative impact.

Occasionally, because the *Index* is published several months after the cutoff date for evaluation, recent economic events cannot be factored into the scores. In the past, such occurrences have been uncommon and isolated to one region of the world. The Asian financial crisis, for example, erupted at the end of 1997 just as the 1998 *Index* was going to print. The policy changes in response to that crisis, therefore, were not considered in that year's scoring, but they were included in the next year's scores. Similarly this year, the convulsions in global financial markets that occurred in the second half of 2008 have not affected the rankings for 2009, but will almost certainly show up in scores for 2010.

Changes in government policy are occurring at a rapid rate in many less-developed countries. The *Index*, because it is published each year, enables readers around the world to see how recent changes in government policy affect economic freedom in specific countries. Each country page includes a time series graph of the country's overall score for each year from the present back either to 1995 or to the first year when a country's economic freedom began to be scored.

7. See note 2.

In the 2009 *Index of Economic Freedom*, 21 new countries were added to expand the reach of the *Index's* economic analysis. The 21 newly added countries are Afghanistan, Bhutan, Comoros, Dominica, Eritrea, Kiribati, Liberia, Liechtenstein, Macao, Maldives, Micronesia, Papua New Guinea, Saint Lucia, Saint Vincent and the Grenadines, Samoa, São Tomé and Príncipe, Seychelles, Solomon Islands, Timor-Leste, Tonga, and Vanuatu. Because of data constraints for Afghanistan, Iraq, Sudan, and Liechtenstein, however, only 179 countries are fully scored and ranked.

Quality and Continuity. Ideally, the methodology used for the *Index* should not change over time. Instead, the scores for various countries would improve as the institutions of freedom improved as measured against a constant standard of measurable liberty. However, the increased quality of the data available allows researchers to create more detailed measures of institutions as well as economic performance. The positive consequence of statistical progress is an enhanced ability to measure progress.

Over time, therefore, the *Index* methodology has been continually revised and improved; but we also aim for continuity, so each time a methodology change is implemented, we also attempt to make the scores continuous back to 1995. In this way, country performance is comparable from one year to the next.

Nevertheless, there are still some cases for which new data are not available going back to the first year, at least not in the same level of detail. There is a natural tension between the quality of the *Index* and the continuity of the *Index*. It would be easy to maintain perfect continuity if no changes were ever made, or *vice versa*, but we are committed to incorporating innovations into the methodology to optimize both the quality and continuity of the *Index* rather than simply maximizing one at the expense of the other.

Chapter 1

The 10 Economic Freedoms

The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the “rules of the game” and as an umpire to interpret and enforce the rules decided on. What the market does is to reduce greatly the range of issues that must be decided through political means, and thereby to minimize the extent to which government need participate directly in the game.

Milton Friedman, *Capitalism and Freedom*

Economic freedom is that aspect of human liberty that is concerned with the material autonomy of the individual in relation to the state and other organized groups. Individuals are economically free if they can fully control their own labor and property. Economic freedom is related to—and is perhaps a necessary condition for—political freedom, but it is also valuable as an end in itself.¹

DEFINING ECONOMIC FREEDOM

The authors of the *Index of Economic Freedom* perceive economic freedom as a positive concept, recognizing that its traditional definition as an absence of government coercion or constraint must also include a sense of liberty as distinct from anarchy. Governments are instituted to create basic protections against

the ravages of nature or the predations of one citizen over another so that positive economic rights such as property and contract are given social as well as individual defense against the destructive tendencies of others.

A comprehensive definition of economic freedom should *encompass all liberties and rights of production, distribution, or consumption of goods and services. The highest form of economic freedom should provide an absolute right of property ownership; fully realized freedoms of movement for labor, capital, and goods; and an absolute absence of coercion or constraint of economic liberty beyond the extent necessary for citizens to protect and maintain liberty itself.* In other words, individuals in an economically free society would be free and entitled to work, produce, consume, and invest in any way they please under a rule of law, with their freedom at once both protected and respected by the state.

All government action involves coercion. Some minimal coercion is necessary for the citizens of a community or nation to defend them-

1. Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), esp. Chapter 1, “The Relation Between Economic Freedom and Political Freedom,” pp. 7–17.

selves, promote the evolution of civil society, and enjoy the fruits of their labor. This Lockean idea is embodied in the U.S. Constitution. For example, citizens are taxed to provide revenue for the protection of person and property as well as for the common defense. Most political theorists also accept that certain goods—what economists call “public goods”—can be supplied more efficiently by government than through private means. Of particular interest are those economic freedoms that are also public goods, such as the maintenance of a police force to protect property rights, a monetary authority to maintain a sound currency, and an impartial judiciary to enforce contracts among parties.

When government coercion rises beyond the minimal level, however, it becomes corrosive to freedom—and the first freedom affected is economic freedom. Logically, an expansion of state power requires enforcement and therefore funding, which is extracted from the people. Exactly where that line is crossed is open to reasoned debate.

Throughout history, governments have imposed a wide array of constraints on economic activity. Constraining economic choice distorts and diminishes the production, distribution, and consumption of goods and services (including, of course, labor services).² The establishment of price controls is perhaps the clearest example of the distortionary effect of state coercion because of its well-known disruption of the equilibrium of supply and demand.

MEASURING ECONOMIC FREEDOM

As the first comprehensive study of economic freedom ever published, the 1995 *Index of Economic Freedom* defined a method of measuring and ranking freedom in such vastly different places as Hong Kong and North Korea.

The *Index* looks at economic freedom from 10 different viewpoints. Some aspects of eco-

nommic freedom are external in nature, measuring the extent of an economy’s openness to investment or trade. Most are internal in nature, assessing the liberty of individuals to use their labor or finances without restraint and government interference. Each is vital to the development of personal and national prosperity. The fundamental right of property, for example, has been recognized for centuries by the great philosophers of liberty, such as Locke and Montesquieu, as a bulwark of free people. Over time, scholars and practitioners have recognized many other pillars of economic liberty, including free trade, stable money, the right to work, control of government spending, and lower taxation. Over the past 15 years, the *Index* has grown and improved its measurement of countries’ capacity to create environments that allow economic opportunity to flourish.

The 10 specific economic freedoms measured in the *Index of Economic Freedom* are discussed below. Each of the freedoms is individually scored. A country’s overall economic freedom score is a simple average of its scores on the 10 individual freedoms. Detailed information about the methodology used to score each component is contained in the appendix.

Freedom #1: Business Freedom

Business freedom is about an individual’s right to create, operate, and close an enterprise without interference from the state. Burdensome, redundant regulatory rules are the most common barriers to the free conduct of entrepreneurial activities.

Regulations are a form of taxation that makes it difficult for entrepreneurs to create value. Although many regulations hinder businesses, the most important are associated with licensing new companies and businesses. In some countries, as well as many states in the United States, the procedure for obtaining a business license can be as simple as mailing in a registration form with a minimal fee. In Hong Kong, for example, obtaining a business license requires filling out a single form, and the process can be completed in a few hours. In other countries, such as India and countries in parts of South America, the process involved

2. “The property which every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable.” Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: The Modern Library, 1937), pp. 121–122; first published in 1776.

in obtaining a business license requires endless trips to government offices and can take a year or more.

Once a business is open, government regulation does not always subsidize; in some cases, it increases. Interestingly, two countries with the same set of regulations can impose different regulatory burdens. If one country, for instance, applies its regulations evenly and transparently, it lowers the regulatory burden by enabling businesses to make long-term plans more easily. If the other applies regulations inconsistently, it raises the regulatory burden by creating an unpredictable business environment. Finally, regulations that make it difficult and expensive to close business are disincentives for entrepreneurs to start them in the first place.

Freedom #2: Trade Freedom

Trade freedom reflects the openness of an economy to imports of goods and services from around the world and the ability of citizens to interact freely as buyers and sellers in the international marketplace.

Trade restrictions can take the form of taxes on imports and exports, quotas or outright bans on trade, and regulatory barriers. The degree to which government hinders the free flow of foreign commerce has a direct bearing on the ability of individuals to pursue their economic goals.

Tariffs directly increase the prices that local consumers pay for foreign imports, but they also distort production incentives for local producers, causing them to produce either a good in which they lack a comparative advantage or more of a protected good than is economically efficient. This impedes economic growth. In many cases, trade limitations also put advanced-technology products and services beyond the reach of local people, limiting their own productive development.

Freedom #3: Fiscal Freedom

Fiscal freedom is the freedom of individuals and businesses to keep and control their income and wealth for their own benefit and use. A government can impose fiscal burdens on economic activity by generating revenue for itself, primarily through taxation but also from

debt that ultimately must be paid off through taxation.

The marginal tax rate confronting an individual is, in effect, the government's cut of the profit from his or her next unit of work or engagement in a new entrepreneurial venture; whatever remains after the tax is subtracted is the individual's actual reward for this effort. The higher the government's cut, the lower the individual's reward—and the lower the incentive to undertake the work at all. Higher tax rates both interfere with the ability of individuals and firms to pursue their goals in the marketplace and reduce, on average, their willingness to work or invest.

While individual and corporate income tax rates are important to economic freedom, they are not a comprehensive measure of the tax burden. Governments impose many other taxes, including payroll, sales, and excise taxes, tariffs, and the value-added tax (VAT). One way to capture all taxation is to measure total government revenues from all forms of taxation as a percentage of total GDP.

Freedom #4: Government Size

The burden of excessive government is a central issue in economic freedom, both in terms of generating revenue (see fiscal freedom) and in terms of expenditure.

Government expenditures are often justified in terms of "public goods" that are provided efficiently by the state rather than by the market. There is also a justification for correcting market failures through government action. Unfortunately, a government's insulation from market discipline leads to inefficiency, bureaucracy, and lowered productivity. Government expenditures necessarily compete with private agents and interfere in market prices by overstimulating demand and potentially diverting resources through a crowding-out effect. In extreme cases, governments can coerce goods and capital out of markets altogether, driving up interest rates and inflation.

The government's appetite for private resources affects both economic freedom and economic growth. Even if a state-managed economy achieves fast growth through heavy

expenditure, it diminishes freedom in the process and can create long-term damage to a country's growth potential.

Freedom #5: Monetary Freedom

Monetary freedom, reflected in a stable currency and market-determined prices, is to an economy what free speech is to democracy. Free people need a steady and reliable currency as a medium of exchange and store of value. Without monetary freedom, it is difficult to create long-term value.

The value of a country's currency is controlled largely by the monetary policy of its government. With a monetary policy that endeavors to maintain stability, people can rely on market prices for the foreseeable future. Investment, savings, and other longer-term plans are easier to make, and individuals enjoy greater economic freedom. Inflation not only confiscates wealth like an invisible tax, but also distorts pricing, misallocates resources, raises the cost of doing business, and undermines a free society.

There is no singularly accepted theory of the right monetary institutions for a free society. At one time, the gold standard enjoyed widespread support, but this is no longer the case. What characterizes almost all monetary theories today, however, is support for low inflation and an independent central bank. There is also now widespread recognition that price controls corrupt market efficiency and lead to shortages or surpluses.

Freedom #6: Investment Freedom

Restrictions on foreign investment can limit both inflows and outflows of capital. In a free environment, capital will flow to its best use where it is most needed and the returns are greatest. State action to redirect the flow of capital is an imposition on both the freedom of the investor and the freedom of the people seeking capital. The more restrictions a country imposes on investment, the lower its level of entrepreneurial activity and economic growth.

Freedom #7: Financial Freedom

Virtually all countries provide some type of prudential supervision of banks and other

financial services. This supervision serves two major purposes: ensuring the safety and soundness of the financial system and ensuring that financial services firms meet basic fiduciary responsibilities.

Excessive banking and financial regulation by the state, however, limits competition, impedes efficiency, and increases the costs of financing entrepreneurial activity. In a free banking environment, the marketplace should be the primary source of protection through such institutions as independent auditors and information services. Such oversight is distinguished from burdensome or intrusive government regulation or government ownership of banks, both of which interfere with market provision of financial services to consumers.

Increasingly, the central role played by banks is being complemented by other financial services that offer alternative means for raising capital or diversifying risk. As with the banking system, aside from basic provisions to enforce contractual obligations and prevent fraud, increased government intervention in these areas undermines economic freedom and inhibits the ability of non-banking financial services to contribute to economic growth. If the government intervenes in the stock market, it contravenes the choices of millions of individuals by interfering with the pricing of capital—the most critical function of a market economy. Equity markets measure, on a continual basis, the expected profits and losses in publicly held companies. This measurement is essential in allocating capital resources to their highest-valued uses and thereby satisfying consumers' most urgent requirements. Similarly, government ownership or intervention in the insurance sector undermines the ability of providers to make available those services at prices that are based on risk and market conditions.

Freedom #8: Property Rights

The ability to accumulate private property is the main motivating force in a market economy, and the rule of law is vital to a fully functioning free-market economy. Secure property rights give citizens the confidence to undertake commercial activities, save their income, and make

long-term plans because they know that their income and savings are safe from expropriation or theft. The protection of private property requires an effective and honest judicial system that is available to all, equally and without discrimination.

Freedom #9: Freedom from Corruption

Corruption is defined as dishonesty or decay. In the context of governance, it can be defined as the failure of integrity in the system, a distortion by which individuals are able to gain personally at the expense of the whole. Political corruption is a sad part of human history and manifests itself in many forms such as bribery, extortion, nepotism, cronyism, patronage, embezzlement, and (most commonly) graft, whereby public officials steal or profit illegitimately from public funds.

Many societies, of course, outlaw such activities as the traffic in illicit drugs, but others frequently limit individual liberty by outlawing such activities as private transportation and construction services. Corruption infects all parts of an economy unless the market is allowed to develop transparency and effective policing. A government regulation or restriction in one area may create an informal market in another. For example, a country with high barriers to trade may have laws that protect its domestic market and prevent the import of foreign goods, but these barriers create incentives for smuggling and an informal market for the barred products.

Freedom #10: Labor Freedom

The ability of individuals to work as much as they want and wherever they want is a key component of economic freedom. By the same token, the ability of businesses to contract freely for labor and to fire workers when they are no longer needed is a vital mechanism for increasing productivity and sustaining economic growth. The core principle of any market is free, voluntary exchange. That principle has several components such as voluntary choice and free competition. The labor market is no exception.

The free market is also an efficient institution for labor, yielding the best results for soci-

ety and workers, just as the free market has proven superior for virtually all other fields. Furthermore, state intervention generates the same problems in the labor market that it produces in any other markets.

Government regulations take a variety of forms, including wage controls, hiring and firing restrictions, and health and safety restrictions. In many countries, unions play an important role in regulating labor freedom and, depending on the nature of their activity, may be either a force for greater freedom or an impediment to the efficient functioning of labor markets. In general, the greater the degree of labor freedom, the lower the rate of unemployment in an economy.

Equal Weight. In the *Index of Economic Freedom*, the 10 components of economic freedom are equally weighted so that the overall score will not be biased toward any one component or policy direction. It is clear that the 10 economic freedoms interact, but the exact mechanisms of this interaction are not easily definable. Is a minimum threshold for each one essential? Is it possible for one to maximize if others are minimized? Are they dependent or exclusive, complements or supplements?

These are valid questions, but they are beyond the scope of our fundamental mission. The purpose of the *Index* is to reflect the economic environment in every country surveyed in as balanced a way as possible. The *Index* has never been designed specifically to explain economic growth or any other dependent variable; that is ably done by empirical econometricians elsewhere. The raw data for each component are provided so that others can study and weight and integrate as they see fit.

The Grading Scale. Each one of the 10 economic freedoms is graded using a scale from 0 to 100, with 100 representing the maximum freedom. A score of 100 signifies an economic environment or set of policies that is most conducive to economic freedom. The grading scale is continuous, meaning that scores with decimals are possible. For example, a country could have a trade freedom score of

50.3. Many of the 10 freedoms are based on quantitative data that are converted directly into a score. In the case of trade, a country with zero tariffs and zero non-tariff barriers will have a trade freedom score of 100.³

Period of Study. For the current *Index of Economic Freedom*, the authors generally examined data for the period covering the second half of 2007 through the first half of 2008. To the extent possible, the information considered for each factor was current as of June 30,

3. For detailed guidance on how the data in the *Index* can be used in statistical research, see <http://www.heritage.org/research/features/index/downloads.cfm#methodology>.

2008. It is important to understand, however, that some component scores are based on historical information. For example, the monetary freedom component is a three-year weighted average rate of inflation from January 1, 2005, to December 31, 2007.

Sources. In evaluating the criteria for each component, the authors have used a range of authoritative sources that are internationally recognized. All sources are indicated in the narrative where appropriate. Because it would be unnecessarily cumbersome to cite all of the sources used in scoring every single variable of each factor, unless otherwise noted, the major sources used in preparing the country summaries may be found in the appendix.

Chapter 2

Fifteen Years of Advancing Freedom

Ambassador Terry Miller

The *Index of Economic Freedom* is a book of statistics. Behind those statistics are stories of human progress and the achievements of real people—literally billions of people around the world whose lives have improved profoundly. Sadly, there are also some stories of backsliding, regression, and even failure.

The link between economic freedom and economic growth and development is strong. Countries that allow their citizens more economic freedom enjoy higher incomes and better standards of life. People in economically free societies live longer. They have better health. They are able to be better stewards of the environment, and they push forward the frontiers of human achievement in science, technology, and culture.

By a great many measures, the 15 years during which the *Index* has been charting the advance of economic freedom have been the most prosperous in the history of the world. More people have lived better lives than ever

before. Some, unfortunately, have not. That not all of the world's people have participated in our era's explosion of prosperity is a human tragedy—an appalling, *avoidable* human tragedy.

At the beginning of the 21st century, we know the economic policies and systems that promote economic growth and well-being.

- We know that those countries that practice some version of free-market capitalism, with economies open to trade and investment, do better than those that are protectionist or that shun economic linkages with others.

- We know that competition promotes greater productivity and a better allocation of resources than central planning.

- We know that private ownership and the protection of individuals and enterprises by the rule of law encourages effort and initiative more than collectivism and socialism.

- We know that governments that dominate their countries' economies impoverish their populations.

- And we know that excessive taxation stifles business activity and entrepreneurship.

The great economic debates of the past two centuries have centered on a profound moral question: the nature of fairness. The great political revolution of the 18th century that led to the founding of the United States of America was based on a belief in the primacy and freedom of the individual. The power of the collective, which finds its most forceful expression in actions by governments, was sharply and deliberately restricted by the U.S. Constitution. Fairness was defined by the U.S. Founding Fathers as equality of opportunity. The most fundamental right was the pursuit of happiness, not its achievement.

Over two centuries later, the economy built in the United States on equality of opportunity has grown and prospered to a degree unimagined in human history, providing even its poorest citizens with standards of living that exceed those of the world's wealthiest only a few generations before.

By contrast, the Russian revolution of the 20th century took as its guiding principles the Communist ideology of Karl Marx that extolled collective ownership and the abolition of class or economic distinction and declared that everyone was entitled not to the same opportunity to pursue happiness, but rather to the same degree of happiness, an outcome to be achieved at first through the redistributive power of government and eventually through the enlightened beneficence of the population. It was a powerful and seductive idea that failed ultimately because of the tendency of the powerful, redistributionist state to grow continuously rather than wither away. Unfortunately, to the extent that those who have followed the Marxist path have created equal societies, it has been an equality of misery rather than prosperity.

MEASURING FREEDOM FOR A DECADE AND A HALF

The *Index of Economic Freedom* is an attempt to measure those factors that contribute to individual freedom and a fair and equal opportuni-

ty for all to strive for happiness and prosperity. The authors and researchers hope that by identifying and quantifying what countries actually do, they can give governments and their citizens an important tool with which to identify policy changes that will promote increased well-being.

The *Index* has evolved over time, and its methodology has been significantly refined. The basic scale on which scores are registered shifted in 2007 from a ranking of 1 to 5, with lower scores reflecting more freedom, to a scale of 0 to 100, with higher scores reflecting more freedom. The availability of relevant data has improved greatly over the 15 years during which the *Index* has been measuring economic freedom, and coverage has grown from 101 countries in 1995 to 183 countries in 2009.

Over the past 15 years, the average economic freedom score for the 155 countries for which we have solid multi-year data has increased by 4.5 points.¹ Since the average starting score for these countries was 56.4, this represents an 8 percent increase in global economic freedom between 1995 and 2009—a meaningful gain in a short time and even more impressive in light of the fact that the fall of the Soviet Union and the rejection of Communism by its European satellites was five years in the past when the *Index* was first produced. The period since 1995 has been one of relative political stability worldwide, and the significant growth in economic freedom has been steady and purposeful rather than

1. Because the *Index* has grown significantly in coverage over the years, there are not 15 years of data for every country. The 21 countries added to the *Index* in 2009 are not included in multi-year score comparisons in this chapter. Unless otherwise specified, global comparisons described as “over the life of the *Index*” or “over the 15 years of the *Index*” or with similar phrases compare average scores of countries for which we have multiple years of data, using as a starting point either 1995 or their first year of coverage in the *Index*. The 2009 average economic freedom score for the 155 countries used in most of these comparisons is 60.9.

revolutionary or convulsive.

The average improvement in economic freedom scores hides significant differences among countries and regions. Economic freedom has increased in 115 countries and declined in 40.

The country that has gained the most economic freedom over the life of the *Index* is Azerbaijan: Its score has increased an impressive 28 points. Other big gainers are Armenia, Georgia, Bosnia and Herzegovina, Moldova, Lithuania, and Romania, all up more than 20 points in the *Index*. Per capita GDP has been growing in these countries over the past decade at an average annual rate of 7.4 percent. The 10-year average annual per capita GDP growth of the 36 countries that gained at least 10 points of economic freedom was just over 4.6 percent.

For the citizens of these countries, the gains in economic freedom have translated into real improvements in their lives. In Azerbaijan, an additional 750,000 people have gained access to clean water, 2.2 million have escaped hunger and undernourishment, and 200,000 have learned to read and write.²

At the other end of the scale, Zimbabwe, Venezuela, Argentina, and the Central African Republic all lost at least 10 points on the economic freedom scale. Zimbabwe's drop was over 25 points. The average annual per capita GDP growth rate for these countries in which economic freedom was significantly curtailed was actually negative: -0.42 percent.

The human costs of the loss of economic freedom can be terrible. Almost 2 million Venezuelans have lost their access to adequate nourishment. In the Central African Republic, 15,000 more mothers die in childbirth each year. In Zimbabwe, average life expectancy has dropped by 13 years.³

2. Estimates derived from data reported in United Nations Development Programme, *Human Development Report 1995*, at <http://hdr.undp.org/en/reports/global/hdr1995/chapters>, and *Human Development Report 2007/2008*, at <http://hdr.undp.org/en/reports/global/hdr2007-2008>.

3. *Ibid.*

CHANGES IN ECONOMIC FREEDOM MATTER

Both the absolute level of economic freedom and changes in the level of economic freedom are important predictors of economic growth. A comparison of GDP growth rates between countries in which economic freedom advanced and those in which it fell is revealing. Those countries that lost economic freedom saw their per capita GDP increase at an average annual rate of 1.9 percent.⁴ Countries that increased economic freedom grew more than a full percentage point faster, with an average per capita GDP growth rate of 3.3 percent.

A comparison between the countries that gained or lost substantial amounts of economic freedom is even more striking. Countries whose economic freedom scores improved at least 5 points over the life of the *Index* had average yearly per capita GDP growth of almost 4 percent. By contrast, countries whose economic freedom scores declined by 5 points or more averaged only 1.7 percent in per capita GDP growth. Table 1 shows how dramatically GDP growth rates improve with increases in economic freedom.

REDUCING POVERTY

We can also tell from looking at the data that countries that are freer economically do a better job of eliminating poverty. The United Nations Human Poverty Index (HPI) gives an approximation of the percentage of a population living in poverty and deprivation.⁵ A lower score indicates a society or economic system that is relatively better at taking care of a larger percentage of its population.

There are 70 countries that are ranked over the life of both the HPI and the *Index of Economic Freedom*. Countries that gained economic freedom, on average, lifted 5.0 percent of their people out of poverty. Countries that lost economic freedom performed less well, with only

4. Compound average growth rate of per capita GDP from 1996 to 2006.

5. See U.N. Development Programme, *Human Development Report 2007/2008*, pp. 238-240.

Increasing Economic Freedom Boosts Incomes

AVERAGE OF SCORE CHANGES

Change in Economic Freedom Score (1995*-2009)	10 Year GDP Per Capita Growth Rate (1996-2006)	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom**
Over 5	3.99	4.8	20.1	15.6	9.6	28.9	3.8	11.9	-0.5	10.3	0.0
0 to 5	2.39	-0.9	17.8	8.1	1.9	8.1	-4.3	0.0	-8.1	-2.3	-0.8
-5 to 0	1.96	-5.9	15.0	4.9	2.8	2.5	-8.1	-3.0	-20.6	-7.6	0.2
Below -5	1.70	-14.8	7.6	-0.6	-1.7	-6.0	-22.3	-16.2	-30.8	-7.8	-0.3

* Or earliest year in which a country was ranked in the *Index*.

** Data to permit scoring of an independent labor freedom component became available only as of 2005.

Table 1  heritage.org

3.9 percent of their people escaping poverty on average. (See Table 2.)

The differences were even more telling for countries that gained or lost significant amounts of economic freedom. Countries that gained at least 5 points of economic freedom lifted 5.8 percent of their people out of poverty on average. For countries that lost at least 5 points of economic freedom, the picture was bleak. On average, an additional 0.4 percent of their people fell into poverty.

THE CHANGING COMPOSITION OF ECONOMIC FREEDOM

Advances in economic freedom have not occurred evenly across all of the factors measured in the *Index*. Table 3 shows the changes in average scores over the life of the *Index* for the various components of economic freedom.

It is clear that the growth in overall economic freedom has been driven primarily by advances in trade freedom, monetary freedom, and fiscal freedom. The success of the World

Trade Organization and the advancement of regional trading blocs like the European Union and NAFTA no doubt have driven major gains in trade freedom. Monetary freedom advanced significantly following the Asian financial crisis, which inspired major reforms, the professionalization of finance ministries, and an increasing focus worldwide on the importance of controlling inflation. Tax competition and the adoption of flat taxes in a

Economic Freedom Reduces Poverty


Human Poverty Index (HPI)	1997	2007/2008	Change in the Percentage of the Population in Poverty
All countries	31.3	26.6	-4.7
Countries that <i>gained</i> economic freedom	33.0	28.0	-5.0
Countries that <i>lost</i> economic freedom	27.3	23.4	-3.9
Countries that <i>gained</i> at least 5 points of economic freedom	35.5	29.7	-5.8
Countries that <i>lost</i> at least 5 points of economic freedom	23.3	23.7	0.4

* A negative change reflects a decrease in poverty.

Table 2  heritage.org

Component Score Changes	
Score Changes Over the Life of the <i>Index</i>	
Overall Score	+4.5
Trade Freedom	+17.4
Monetary Freedom	+15.1
Fiscal Freedom	+10.1
Government Size	+5.1
Financial Freedom	+3.4
Freedom from Corruption	+1.8
Labor Freedom*	-0.2
Business Freedom	-0.4
Investment Freedom	-2.8
Property Rights	-8.8

* Data to permit scoring of an independent labor freedom component became available only as of 2005.

Table 3  heritage.org

number of countries encouraged entrepreneurship and promoted private enterprise.

The declining scores in several of the components of economic freedom are cause for concern. Business freedom is a measure of the effect of regulatory policies that are entirely under the control of governments. The costs of inefficient and ineffective regulation are a dead-weight loss to an economy. This is an area in which the knowledge and expertise to fix government policies are available, but the political will seems to be lacking.

The drop in investment freedom stands in stark contrast to the average gains in trade freedom. Restrictions on investment freedom often derive from the same protectionist impulses that have been overcome with respect to trade in goods, and the lack of progress in freeing investment is comparable to the lack of progress in freeing trade in services. Investment restrictions preserve the status quo and privileges or monopoly positions that are enjoyed by elites and existing producers, and they slow innovation and productivity increases. Since the explosive growth in the availability of capital for international investment is a relatively recent phenomenon, it is possible that investment restrictions are merely becoming increasingly apparent and relevant as opposed

to increasing in absolute terms. Their significance in retarding economic growth, however, is unassailable.

The large drop in average scores for the economic freedom component measuring property rights and respect for the rule of law is alarming. A majority of the world's countries score below 50 on property rights. Better performers cluster around a score of 70, and the best economic performers score 90 or above on this component. The 20 countries whose scores on this component have improved over the life of the *Index* have seen their per capita GDPs grow almost twice as fast, at over 3.5 percent per year, as the countries whose property rights scores fell.

COUNTRIES ADVANCING AND RETREATING

Another way to compare countries over time and despite methodological changes is to look at changes in countries' rankings relative to each other. Table 4 shows the earliest and most recent *Index* scores for countries, expressed as percentiles that reflect relative positions in the rankings rather than absolute levels of economic freedom. The percentile score for a country is derived by dividing the number of countries that it outranks by the total number of countries ranked in a given year. Albania, for example, outranks 117 of the 179 countries ranked in the 2009 *Index*. Its percentile score is 117 divided by 179, or 65 percent. In other words, Albania is freer than 65 percent of the other countries ranked in 2009.

Percentile scores provide only a relative ranking: that is, how a country scored compared to others. They do not provide an absolute measure of economic freedom, which is something that a country's economic freedom score in the *Index* does provide.

Specifically, percentile scores provide a way to measure whether countries are moving up or falling behind in terms of economic freedom compared with others, and they minimize the effects of methodological changes or changes in the number of countries covered by the *Index*. It is important to bear in mind that a country's percentile ranking will be affected as much by

Moving Ahead or Falling Behind

Country	Percentile Rank 2009	Percentile Rank 1995*	Change in Percentile Ranking	Country	Percentile Rank 2009	Percentile Rank 1995*	Change in Percentile Ranking
Armenia	83	12	71	Kenya	50	33	17
Georgia	82	13	69	Nigeria	35	18	17
Lithuania	83	27	56	Uruguay	79	63	16
Romania	64	12	52	Belgium	89	75	14
Bulgaria	69	24	45	Canada	96	82	14
Albania	65	21	44	Ethiopia	25	11	14
Nicaragua	53	10	43	Mauritania	29	15	14
Mongolia	61	19	42	Brazil	41	28	13
Azerbaijan	45	4	41	Uzbekistan	17	4	13
Kazakhstan	54	13	41	Croatia	35	23	12
Botswana	81	44	37	Macedonia	56	44	12
Hungary	75	39	36	Niger	28	16	12
Latvia	75	39	36	Qatar	73	61	12
Montenegro	47	12	35	Norway	84	73	11
Slovenia	62	30	32	Cambodia	41	31	10
Malta	74	43	31	Laos	16	6	10
Madagascar	59	29	30	South Africa	66	56	10
Moldova	33	3	30	Vietnam	19	9	10
Samoa	52	22	30	Dominican Republic	51	42	9
Cape Verde	57	28	29	Mauritius	90	81	9
Egypt	46	17	29	Ukraine	15	6	9
Kyrgyz Republic	59	30	29	Angola	9	1	8
Poland	54	25	29	Chile	94	86	8
Burkina Faso	53	25	28	Jordan	72	64	8
Serbia	39	12	27	Netherlands	93	85	8
Sweden	85	59	26	Portugal	70	62	8
Barbados	88	63	25	Syria	21	13	8
Slovak Republic	80	55	25	Bangladesh	11	4	7
Finland	91	67	24	Cyprus	87	80	7
Rwanda	31	7	24	Australia	98	92	6
Suriname	30	6	24	Ghana	46	40	6
Bosnia and Herzegovina	25	3	22	Turkey	58	52	6
Mozambique	37	15	22	Equatorial Guinea	21	16	5
Peru	68	46	22	The Gambia	37	32	5
Fiji	55	35	20	Haiti	18	13	5
Tajikistan	32	12	20	Mali	36	31	5
Yemen	42	23	19	The Philippines	42	37	5
Estonia	93	75	18	Guinea-Bissau	8	4	4
Ireland	98	80	18	Iceland	92	88	4
Spain	84	66	18	Mexico	73	69	4
Denmark	96	79	17	Austria	87	84	3
India	31	14	17	Germany	86	83	3
Israel	77	60	17	Luxembourg	92	89	3
				Czech Republic	79	77	2
				Honduras	49	47	2

* Or earliest year of entry into the *Index*.

** For Montenegro and Serbia, their earliest year scores were taken from Serbia and Montenegro prior to their independence in 2006.

(continued on next page)

Table 4  heritage.org

Moving Ahead or Falling Behind (continued)

Country	Percentile Rank 2009	Percentile Rank 1995*	Change in Percentile Ranking	Country	Percentile Rank 2009	Percentile Rank 1995*	Change in Percentile Ranking
Côte d'Ivoire	34	32	2	Bahrain	91	95	-4
Zambia	40	38	2	Chad	10	14	-4
El Salvador	82	81	1	China	26	30	-4
Iran	6	5	1	Dominica	61	65	-4
Namibia	60	59	1	Nepal	26	30	-4
Singapore	99	98	1	Belize	63	68	-5
United States	97	96	1	Dem. Rep. of Congo	3	8	-5
Belarus	7	7	0	Costa Rica	74	79	-5
Bhutan	44	44	0	Japan	89	94	-5
Burundi	15	15	0	Malawi	28	34	-6
Comoros	4	4	0	Pakistan	43	50	-7
Eritrea	2	2	0	Trinidad and Tobago	77	84	-7
Hong Kong	99	99	0	France	64	72	-8
Italy	58	58	0	Kiribati	8	16	-8
Liberia	12	12	0	Russia	18	26	-8
Libya	4	4	0	Togo	14	22	-8
Macau	88	88	0	Indonesia	27	36	-9
Maldives	20	20	0	Oman	76	85	-9
Micronesia	22	22	0	Guatemala	51	61	-10
North Korea	0	0	0	Sierra Leone	12	22	-10
Saint Lucia	78	78	0	Senegal	39	50	-11
Saint Vincent and the Grenadines	66	66	0	Burma	2	14	-12
São Tomé and Príncipe	5	5	0	South Korea	78	91	-13
Seychelles	11	11	0	Taiwan	80	93	-13
Solomon Islands	9	9	0	Colombia	60	74	-14
Tanzania	48	48	0	Saudi Arabia	67	81	-14
Timor-Leste	17	17	0	Gabon	34	49	-15
Tonga	30	30	0	Djibouti	22	39	-17
Turkmenistan	6	6	0	Sri Lanka	38	55	-17
Vanuatu	49	49	0	Bolivia	27	45	-18
Algeria	40	41	-1	United Arab Emirates	70	88	-18
Cuba	1	2	-1	Lebanon	47	66	-19
New Zealand	97	98	-1	Panama	69	88	-19
Benin	36	38	-2	Zimbabwe	1	20	-19
Greece	55	57	-2	Paraguay	56	76	-20
Jamaica	71	73	-2	Swaziland	50	70	-20
Switzerland	95	97	-2	Morocco	44	65	-21
Uganda	65	67	-2	Papua New Guinea	32	53	-21
Cameroon	24	27	-3	Malaysia	68	90	-22
Republic of Congo	7	10	-3	Thailand	63	87	-24
Guyana	13	16	-3	Tunisia	45	71	-26
Kuwait	72	75	-3	Ecuador	23	51	-28
Lesotho	16	19	-3	Guinea	20	53	-33
United Kingdom	94	97	-3	Central African Rep.	13	52	-39
The Bahamas	85	89	-4	Venezuela	3	54	-51
				Argentina	23	78	-55

Table 4  heritage.org

other countries' progress as by its own performance. If a country stagnates in promoting economic freedom while others reform, its percentile score and degree of freedom relative to others will drop.

The percentile ranking data give a different perspective on the stories of economic achievement and failure that are told in the *Index of Economic Freedom*.

The most dramatic picture that emerges is the amazing progress in economic freedom among the countries that emerged from the breakup of the Soviet Union. Seven of the 20 countries that improved their relative position in the rankings the most are nations that were formerly republics of the Soviet Union. Armenia, Georgia, Lithuania, Kazakhstan, Azerbaijan, Latvia, and Moldova all moved up at least 30 percentage points in the percentile rankings, which means that they each leapfrogged at least 30 percent of the world's countries in economic freedom. Armenia, Georgia, and Lithuania advanced over more than half of the world's countries. Per capita GDP growth was very strong in these countries, averaging 8.0 percent between 1996 and 2006.

Of all the former Soviet republics, only Russia itself has lost ground relative to other countries, and only Russia has suffered an absolute loss in economic freedom since 1995.

The countries of Eastern Europe also rose rapidly in the rankings of economic freedom once the heavy yoke of Soviet domination was removed. Following the dissolution of the Soviet Union, most of these countries moved quickly to establish market economies that were mostly free rather than mostly repressed. The relative advance in economic freedom in the seven Eastern European former members of the Soviet Bloc is truly astounding, with the average percentile rank going up over 33 points despite virtually no movement at all after 1995 on the part of the Czech Republic. Annual average per capita GDP growth in these countries was over 4 percent over the past decade.

Mongolia, a non-European country in a similar situation vis-à-vis the former Soviet Union, improved its relative ranking by 42 points, the

eighth highest increase of all. Its per capita GDP grew at an annual average rate of 3.9 percent over the decade.

In Sub-Saharan Africa, Botswana, Madagascar, Cape Verde, Burkina Faso, Rwanda, Mozambique, Nigeria, Kenya, Ethiopia, Niger, Mauritania, and South Africa all improved their percentile rankings by at least 10 percentage points. Their average per capita GDP growth over 10 years was more than 3.0 percent. By contrast, the Central African Republic, Guinea, Swaziland, Zimbabwe, Djibouti, Gabon, Senegal, and Sierra Leone all moved down in the percentile rankings by at least 10 percentage points. These countries averaged no per capita GDP growth at all over the past 10 years, and four of them actually saw their per capita GDP fall.

Asia's diversity showed through in long-term trends. About half of the Asian countries gained in relative economic freedom, and about half lost ground. This region includes the highest ranking countries over the entire span of the *Index* (Hong Kong and Singapore) and the lowest (North Korea). Besides Mongolia, Asian countries that moved significantly ahead of other nations (gaining at least 10 percentile places on the list) included Samoa, Fiji, India, Laos, and Vietnam. Per capita GDP growth averaged 3.7 percent in these countries. By contrast, Thailand, Malaysia, Papua New Guinea, Sri Lanka, South Korea, Burma, and Taiwan all lost significant ground relative to other countries. Their average per capita GDP growth (excluding Burma, for which reliable GDP data are not available) was only 2.8 percent.

The two countries that slipped farthest down the rankings over the 15 years were both from Latin America. Argentina and Venezuela were surpassed by more than half of the world's countries in terms of economic freedom. Ecuador was the fifth worst performer in relative terms, surpassed by 28 percent of the world's countries. What these three countries share is a commitment to a brand of populist socialism that had lost favor for a time in Latin America but has resurfaced in recent years. The effects on the people of these countries are dev-

astating, with average per capita GDP growth of less than 1.5 percent per year.

In fact, the countries of Latin America are lagging significantly behind the rest of the world in the promotion of economic freedom. Eight Latin countries (Argentina, Venezuela, Ecuador, Paraguay, Panama, Bolivia, Colombia, and Guatemala) dropped 10 percentage points or more on the percentile rankings. Only Nicaragua, Barbados, Suriname, and Brazil advanced ahead of at least 10 percent of the world's countries.

There was significant slippage in the Middle East and North Africa region as well, with former good performers Saudi Arabia and the United Arab Emirates slipping toward the middle ranks of countries and Tunisia and Morocco both dropping at least 20 percentage points in the percentile rankings.

MOVING FORWARD

The 15 years of data measured in the *Index of Economic Freedom* should encourage economic reformers everywhere. It is clear that steps to improve economic performance are available to countries at all stages of development. It starts with the basics: freedom from corruption and respect for property rights. The poorest countries score far below the world average in these two categories.

The richest countries need to pay particular attention to government size and tax rates; the redistributionist temptations of utopian socialism kill economic growth.

All countries need to ensure a regulatory environment in which businesses and work-

ers have the right to compete freely on a level playing field. They need to maintain realistic and stable currency levels and low inflation to preserve the value of assets and income. They need to keep their economies open to flows of trade and investment to ensure productivity growth and innovation.

A PROVEN PATH TO PROSPERITY

Economic freedom is not a plan or an ideology. Indeed, it is the antithesis of centralized planning and government control.

Economic freedom is a threat only to elite privilege and special interests. It is the revolutionary economic counterpart to democratic political pluralism. It empowers the poor and builds the middle class. It is a philosophy that encourages entrepreneurship and disperses economic power and decision-making throughout an economy. It is not the only way to organize an economy, nor a perfect way, but it is a good way and far better on average than other systems that have been tried.

For 15 years, the *Index of Economic Freedom* has held up a mirror to countries undergoing profound economic and social change. The data in the *Index* can help countries guide their economic evolution along proven paths of prosperity. Much has been accomplished. Much remains to be done. The challenge of economic freedom is the challenge of economic growth and prosperity. Those countries that have been brave enough to accept the challenge have reaped great rewards and, in doing so, have set a powerful example for others to follow.

Chapter 3

The *Index* at Fifteen: Standing Firm for First Principles

The publication of the 2009 *Index of Economic Freedom*—the 15th anniversary edition—is a good point at which to step back and reflect on the principles and themes that have been highlighted and emphasized in the *Index* over the years. These have been articulated not only in the methodology of the rankings, but also through many outstanding contributions, both by experts from within The Heritage Foundation and *The Wall Street Journal* and by guest authors. Excerpts from some of these contributions appear below.

With the perspective of 15 years, it is obvious that some of the principles and themes of economic freedom have been widely understood, accepted, and implemented by many countries. Their progress is seen in the rankings. The poorer performing countries, by contrast, have tried only some of the ideas, adulterated others, or even, in a few cases, rejected them outright. The negative consequences are also apparent in the rankings. Especially during times of global financial uncertainty, it is important to remember these first principles and stick with them.

THE 1995 INDEX

[When the Index of Economic Freedom debuted in 1995, Dr. Edwin J. Feulner, President of The Heritage Foundation, described in his foreword the policy context and economic environment in which the first edition was produced. He noted in particular the hesitancy of many countries to embrace fully the basic tenets of capitalism. Feulner also highlighted one of the key areas of focus in early editions of the Index—the failure of donor governments’ foreign aid programs to achieve the sought-after impact in developing countries. The reality of this failure has been confirmed by a significant body of peer-reviewed research in the ensuing years and remains a subject of interest today.]

Much has been made of the collapse of state socialism and the post-Cold War global march toward free markets. In reality, however, progress has been slow—and in some parts of the

world nonexistent. Even today, as the authors show in the study that follows, only a relative handful of countries—and we [in the United States] are blessed to be among them—have truly free economies. And some of them, our own included, are backsliding.

U.S. development assistance should have one priority, and one priority only: to promote the kind of free market growth that will enable the recipient country to prosper *without* foreign aid. If U.S. aid does not promote free market capitalism and self-sufficiency, we need to ask the question: Why are we giving it?

The Heritage Foundation's *Index of Economic Freedom* provides compelling evidence that economic prosperity and economic freedom go hand in hand. Lasting prosperity cannot exist in the absence of economic freedom; and a free economy inevitably results in economic growth and rising living standards. Well-intentioned programs that fail to accomplish their goals—and in some cases make matters worse—can no longer be tolerated. The U.S. foreign aid program is a classic example of this: good intentions gone awry.

THE 1996 INDEX

[In a chapter on "Foreign Aid and Economic Development," Bryan T. Johnson and Thomas P. Sheehy of The Heritage Foundation looked at U.S. foreign aid in even greater depth, and the results were not pretty.]

The facts show that poverty is largely a condition imposed on people by ill-conceived and repressive economic policies. Other factors such as history, culture, war, and climate influence a country's development, but none is as important as economic freedom. The facts also show that no amount of foreign aid can make up for the conditions that result from economically "unfree" economies. Some countries have received U.S. foreign aid for over 50 years and still are no better off than they were before such aid. A close look at recipients of U.S. foreign aid and their economic performance over the last several decades proves the point:

- Of the 76 countries ranked as "mostly unfree" or "repressed" on the *Index*, 34 have

received U.S. foreign aid for over 35 years, many for as long as 51 years.

- Of these 34 countries, 14 are poorer today than they were in 1965.

- Twelve more have essentially the same amount of wealth as they did some 30 years ago.

- Of the 34 long-term recipients of U.S. foreign aid ranked by the *Index* as lacking economic freedom, 26 are no better off than they were over three decades ago.

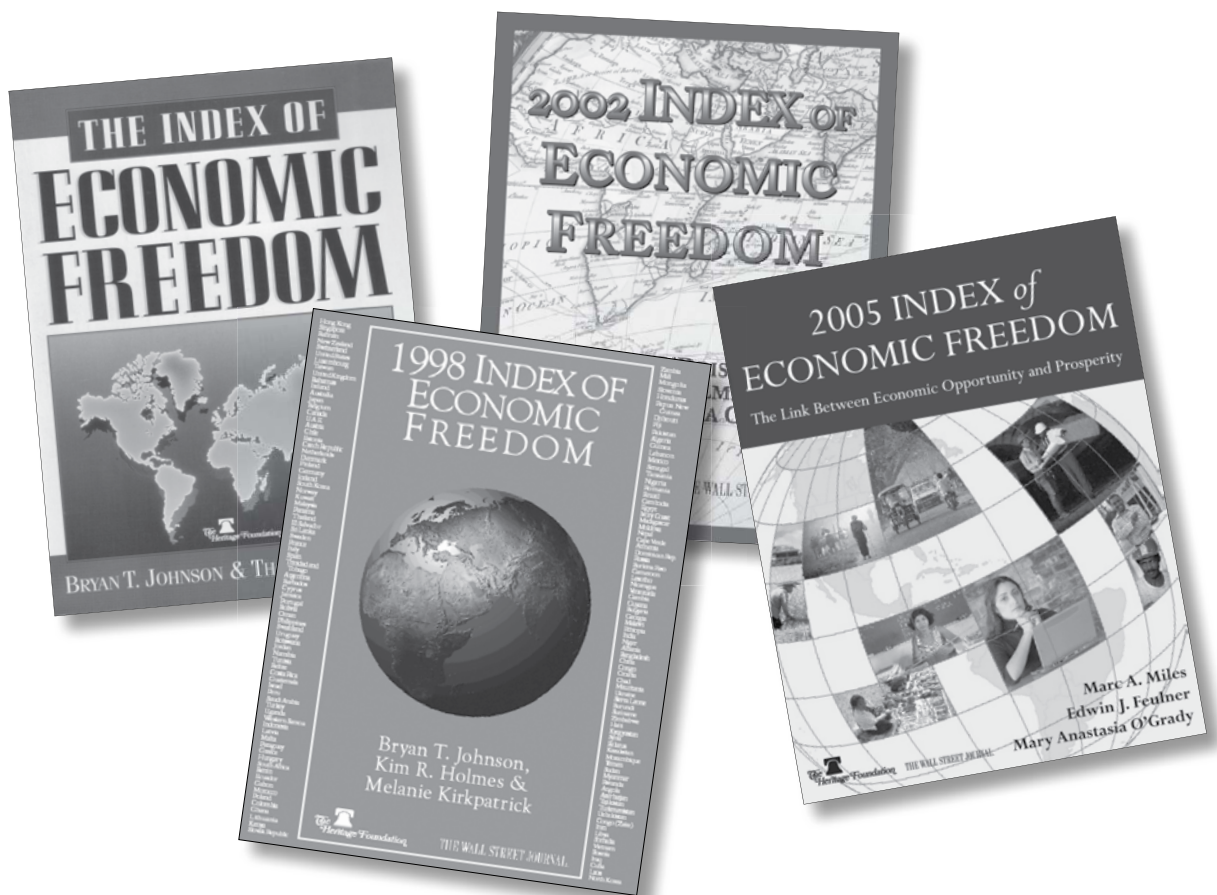
While many countries dependent on foreign aid have remained poor, the few that have eschewed foreign aid have achieved impressive levels of economic growth and wealth. They have done so because they have maximized economic freedom. The key to economic growth is a set of policies that minimize government control of the economy.

THE 1997 INDEX

[Sticking with the subject of development assistance, in 1997, William W. Beach, Director of The Heritage Foundation's Center for Data Analysis, and Gareth Davis, also of Heritage, discussed competing academic theories in "The Index of Economic Freedom and Economic Growth."]

Why do some countries prosper while others do not? For Adam Smith, the answer was obvious: All economic growth flourishes from the single root of creatively dividing labor in the production of desirable goods and blossoms in a political environment that protects private property and the justly deserved fruits of labor. Nations will experience opulence and peace, Smith argued, once they create the institutions that encourage entrepreneurship and savings (the stock of capital upon which all production takes place). On the other hand, nations reap only poverty and despair when they discourage business and thrift.

From the 1960s to the mid-1980s, the dominant academic theory of what causes economic growth was named after Nobel Laureate Robert Solow. From a factual or a policy viewpoint, this theory has performed poorly. First, the theory offered meager advice to



policymakers on to how to generate economic growth. Solow argued that the only way a nation could boost its level of growth was to save more and therefore accumulate physical capital. Even an increase in the rate of capital accumulation, however, would bring only a one-time boost in income and have only a short-term or medium-term increase in economic growth rates.

The long-run rate of economic growth (the “steady state” level) was determined by “technological innovation.” This technological innovation was a mysterious force within Solow’s model that neither could be analyzed by economists nor influenced by government policy. In the Solow model, to paraphrase the famous Cambridge economist Joan Robinson, technology and growth fall like manna from heaven. Second, the major factual prediction of traditional growth theory (that poorer countries generally would grow faster and “converge” to the economic status of richer countries) clearly is not coming true in the real world.

In 1983, Professor Paul Romer, then at the University of Rochester, published a paper entitled “Increasing Returns and Long Run Growth.” Romer argued that an initial increase in a society’s productive capacity can feed on itself (because of what are known technically as *increasing returns*) to produce permanently higher rates of growth. This feedback effect stands in sharp contrast to the *decreasing returns* contained in the old theory, under which the growth effects of an increase in a society’s capacity are only temporary.

In other words, under the old theory of decreasing returns, policy changes would produce only a one-time boost to economic activity, after which the economy would return to its long-term growth path. Under the new theory of increasing returns, however, it is possible to affect the long-term growth path itself.

The old growth theory predicted that establishing sound policies would lead only to a one-time boost in income (and therefore

only a transitory increase in economic growth rates). The theory of increasing returns implies that instituting sensible policies can result in a GDP growth rate that is permanently higher.

[Also in 1997, Bryan T. Johnson of The Heritage Foundation wrote about the USAID bureaucracy's efforts to resist market-based reforms in "Economic Freedom, Foreign Aid, and Economic Development."]

U.S. foreign aid bureaucrats have argued for years that foreign assistance is vital to the economic well-being of less developed countries. J. Brian Atwood, administrator of the U.S. Agency for International Development (USAID), the agency responsible for handing out most of America's \$12 billion foreign aid budget, has further stretched such claims by suggesting that the overall economic prosperity of the post-World War II era can be attributed largely to the Marshall Plan and successive foreign aid efforts. This grossly exaggerates the benefits of development aid while ignoring its many harmful effects. Not only has the U.S. foreign aid program failed to promote economic growth in less developed countries, but many recipient countries are worse off because of it.

The *Index of Economic Freedom* demonstrates that economic freedom is the single most important factor in creating the conditions for economic growth and prosperity. The data in this chapter further demonstrate that instead of helping poor countries lift themselves out of poverty, development aid often impedes their economic growth while damaging their fragile economies. Economic freedom, not aid, is what matters most in achieving economic development.

The *Index* also shows that many long-term U.S. foreign aid recipients have unfree or repressed economies. No matter how much money the United States and other donors spend on foreign aid recipients like Tanzania, Sudan, and Ethiopia, economic development and wealth will not be forthcoming.

THE 1998 INDEX

[In 1998, William W. Beach and Gareth Davis of The Heritage Foundation continued to explore the academic debate in "The Institutional Setting of Economic Growth."]

From Alfred Marshall and Karl Marx to John Maynard Keynes and Friedrich Hayek—all have emphasized the critical relationship between economic activity and its institutional setting when explaining the phenomenon of economic growth. Perhaps more important, much of the policymaking community and intellectually active public already recognizes that sustainable, long-term growth stems in some fashion from the synergy between free-wheeling capitalism and the institutions that sustain the civil society.

The *Index*, of course, speaks for those who understand that free markets produce steadier and fairer economic progress than markets shaped by government edict. Not only does history show the central role of economic freedom in producing superior economic well-being and growing economies, [but] it also shows that state intervention in private economic decision making nearly always reduces long-term well-being. [It is simply wrong to argue] that the *Index* ignores the state. The *Index* does recognize government's role in protecting free markets, principally through its judicial, monetary, and international functions. In fact, the *Index* may be viewed correctly as singularly devoted to examining government's role in economic affairs.

THE 1999 INDEX

[Long before her tenacious investigative reporting uncovered the massive "Oil-for-Food" scandal at the United Nations, journalist Claudia Rosett put a human face on the theory of economic freedom in "Mapping the New World Markets."]

One of the most poignant questions I have heard about economic development came from a North Korean refugee I interviewed in Moscow for *The Wall Street Journal* back in 1994. This

man had come to Russia under official auspices from North Korea to work in a lumber camp in the Far East. From there, he had defected into post-communist Russia. When I met him, he was staying in a dingy Moscow apartment, hiding out from North Korean agents and hoping for asylum. To him, after the repression and hopeless poverty of North Korea, newly liberalizing Russia seemed a land of promise and opportunity—worth risking his life for a chance to stay. But he had a question: “Is it true,” he asked, “that America is even better than this?”

THE 2000 INDEX

[Harvard University Professor of Economics Robert J. Barro found a surprisingly weak link between democracy and the promotion of development in “Rule of Law, Democracy, and Economic Performance.”]

The problem in having the United States recommend democracy to a country such as Zaire (now the Democratic Republic of Congo) is not that democracy would harm economic performance but, rather, that it would have little impact. If there is a limited amount of energy that can be used to accomplish institutional reforms, then it is much better spent in a poor country by attempting to implement the rule of law—or, more generally, property rights and free markets. These are the institutional features that matter most for economic growth, and these features are not the same thing as democracy. Moreover, in the long run, the rule of law tends to generate sustainable democracy by first promoting economic development. Thus, even if democracy is the principal objective in the end, the best way to proceed is to encourage the rule of law in the short run. U.S. advice to poor countries should focus more on the rule of law, property rights, and free markets, and less on the romance of democracy.

[Guest contributors Alejandro A. Chafuen of the Atlas Economic Research Foundation and Eugenio Guzmán of the Heritage-affiliated Institute for Liberty and Development in Santiago, Chile, wrote about the

greatest threat to the rule of law in “Economic Freedom and Corruption.”]

True economic freedom is possible only under a system of limited government with a strong rule of law. Economic freedom has little value if corruption in government means that only a few will enjoy it. Therefore, the rule of law, under limited government, is the essence of a just society—one in which the rights of persons are respected and individuals are free to improve their personal and social lives through their own efforts and according to just laws, unencumbered by corrupt government actions.

The fewer resources (including assets and regulatory power) a government controls, the fewer the opportunities for corruption. Both the number and amount of resources controlled by a government and the ability of its officials to grant privileges can influence the level of corruption.

THE 2001 INDEX

[Mary Anastasia O’Grady, Editor of The Wall Street Journal’s weekly “Americas” column (and now a member of the Journal’s Editorial Board), explored the link between economic freedom and political change in “First, Open Markets.”]

The North American Free Trade Agreement’s (NAFTA’s) most important effect on Mexico was not more choice for consumers or a larger market for producers—although these are certainly significant—but rather a change in the ownership and control of the political economy. In a very real sense, it was NAFTA that brought Vicente Fox to power because it weakened the grip of the Institutional Revolutionary Party (PRI).

Recognizing the connection between Mexico’s opening to trade and its gains in political and economic rights is key to understanding what is going on in the rest of Latin America, where (Chile excepted) economic modernization is lagging.

Along with price stability, the highest reform priority for the region ought to be trade liberalization. The competition engendered by free

trade not only provides direct gains in productivity and lowers prices for consumers, but also produces less tangible but perhaps more powerful side effects. As NAFTA proved in Mexico, foreign competition and contact with the outside world weaken the very pillars of statism.

THE 2002 INDEX

[Lee Hoskins, former President of the Federal Reserve Bank of Cleveland, and Ana I. Eiras of The Heritage Foundation touched upon another crucial ingredient of economic freedom in "Property Rights: The Key to Economic Growth."]

The more government policy facilitates the use of private property, the more prosperity it helps bring. In contrast, when governments infringe on citizens' property rights, implementing policies that restrict access to markets and interfere with the use of private property, they bring poverty to their countries. Accordingly, the extent to which governments carry out their responsibility to respect and protect property rights does much to determine the extent to which economic growth is possible and individuals can use freely what is theirs and enjoy the things that science, technology, and innovation can deliver to improve their lives.

When government policy interferes with economic activity, the economy suffers and people's living standards decrease. Governments can infringe on property rights directly by enabling a weak judiciary or indirectly by raising taxes, enacting burdensome regulations, consuming scarce resources, and mandating that business implement social programs. Government infringement of property rights subtly confiscates wealth, decreases the value of economic activity, and prevents resources from flowing to their most valuable use. At the same time, it helps to concentrate wealth in the hands of the few at the expense of the poorest.

THE 2003 INDEX

[Mart Laar, who served as Prime Minister of newly independent Estonia from 1992 through 1994 and then again from 1999

until January 2002, delivered a lecture entitled "How Estonia Did It" during the 25th Annual Meeting of The Heritage Foundation's Resource Bank in Philadelphia, Pennsylvania, on April 11–12, 2002. The text of the lecture was adapted as a guest chapter in the next edition of the Index.]

After 50 years of Soviet occupation, Estonia was in ruins. Our economy was a shambles, the spirit of our people spoiled by the socialist heritage. Within 10 years, Estonia has changed beyond recognition. Sometimes it is hard even for us to remember how this country looked under the socialist system. Estonia is now a modern and vibrant young country, integrating with Western structures like the European Union and NATO with astonishing speed.

In planning our "jump to nowhere," we tried to learn from the experiences of other countries that had undertaken a transition from left-wing socialist utopia to free-market economy. Some key lessons emerged. One is to take care of politics first and then to proceed with economic reform. Don't underestimate the importance of a new, modern constitution and democratic legislature with free elections.

There can be no market economy and democracy without laws, clear property rights, and a functioning justice system.

The flat-rate tax has been an important part of the Estonian success story. It is easy to collect and easy to control. The only losers...were the tax lawyers.

We realized quickly the danger of extensive reliance on aid. Shipments of outdated computers to any transition country can secure them a permanent seat in the Third World.

THE 2004 INDEX

[Daniel J. Mitchell of The Heritage Foundation discussed desirable models for tax reform in "The Economics of Tax Competition: Harmonization vs. Liberalization."]

Like other forms of competition, fiscal rivalry generates positive results. People get to keep more of the money they earn, and economic performance is enhanced because of lower tax

rates on work, saving, and investment.

The thought of losing sources of tax revenue scares government officials from high-tax nations, who vociferously condemn tax competition and would like to see it reduced or eliminated. Working through international bureaucracies like the European Union, the United Nations, and the Organisation for Economic Co-operation and Development, high-tax governments are promoting various tax harmonization schemes to inhibit the flow of jobs and capital from high-tax jurisdictions to low-tax jurisdictions.

Tax competition should be celebrated, not persecuted. It is a powerful force for economic liberalization that has helped promote good tax policy in countries around the world.

[The same year, The Wall Street Journal's Brian M. Carney attacked a roadblock to successful completion of the Doha trade round in "The Common Agricultural Policy: How the European Union Distorts Trade with Non-EU Nations."]

The European Union (EU)—or, more precisely, its predecessor, the European Economic Community (EEC)—was founded on the idea that war in Europe could be stopped through free trade and open borders. It is a cruel irony, therefore, that the EU in its various forms has spent most of its 46-year history waging economic war on others, and most particularly on the world's developing nations.

The predominant form that this warfare has taken is known as the Common Agricultural Policy, an anti-competitive combination of subsidies designed to give the European farmer an edge. Written into the EEC's founding documents in 1957, CAP was the price French President Charles de Gaulle exacted for France's membership. It has grown inexorably ever since and now eats up approximately half of the EU's 90 billion euro annual budget.

It may be surprising to learn that fully half of the funds spent each year by Brussels takes the form of handouts to farmers—that is, sup-

ports the CAP. Yet, apart from the direct costs of the EU subsidies, there is another cost that exacts a terrible toll on world economic prosperity and development. That is the cycle of global protectionism that EU agricultural policy perpetuates. CAP is harming European consumers and taxpayers, Europe's manufacturers and service providers, and—just as important—consumers in the developing world because it is a major stumbling block to further world trade liberalization, as was vividly demonstrated at the [World Trade Organization] ministerial meeting in Cancun in September 2003.

THE 2005 INDEX

[James Jay Carafano of The Heritage Foundation found a role for free trade in combating terrorism in "Global Terrorism and the Global Economy: Unpeaceful Coexistence."]

In the long term, the best way to engage emerging economies in the battle against terrorism is to promote free trade. Free trade is the handmaiden of security. It makes more inhabitants stakeholders in their national economy and the international economy. Economic growth also provides the capacity to implement effective security regimes. In short, there are few better weapons in the war against terrorism than free trade.

Developed nations can help speed the process in two ways.

First, they can negotiate and implement free trade agreements with emerging economies.

Second, they can promote policies that combat corruption; encourage good governance, the rule of law, and transparency; aim to establish strong institutions; and advance economic and political freedom.

Developed nations can start by rethinking their foreign assistance programs. Traditional aid programs are just not getting the job done, either in promoting economic growth or in enhancing security.

[With the Doha round continuing to founder, John C. Hulsman, Brett D. Schaefer, and Anthony B. Kim of The Heritage Founda-

tion examined “*The Benefits of a Global Free Trade Alliance.*”¹]

Liberal trade policy is a key component of economic freedom and contributes to long-term, stable economic growth by increasing efficiency and reducing costs for producers and consumers. Yet resistance to trade liberalization remains strong in both developed and developing countries. The struggle in the World Trade Organization during the current Doha round of trade negotiations clearly demonstrates that many governments continue to see trade as a zero-sum game in which their goal is to lower barriers in other countries while seeking to keep their own barriers as high as possible. The slow pace of WTO negotiations does not mean that they are without merit, but countries that grasp the value of free trade should not hold themselves hostage to glacial progress in that body.

Instead, countries eager to take advantage of free trade should consider forming a Global Free Trade Alliance (GFTA). Because the GFTA would be a free trade coalition of the willing, membership would be based on existing policies, not negotiated concessions. It would secure the benefits of increased trade and investment without forcing members to undergo any new major policy reforms. With the potential to encompass every nation—provided only that they meet the criteria and wish to open their markets to goods and services from other GFTA members—the GFTA offers an intriguing alternative means for advancing global free trade that does not force unwilling countries to liberalize more quickly than they desire.

[Mary Anastasia O’Grady, a member of the Editorial Board of The Wall Street Journal and Editor of the Journal’s weekly “Americas” column, looked at another problem in the WTO in “Antidumping Abuses Threaten the Gains in Global Free Trade.”]

1. For a more updated discussion of this concept, see Kim R. Holmes, *Liberty’s Best Hope: American Leadership for the 21st Century* (Washington, D.C.: The Heritage Foundation, 2008).

World trade expansion is critical to finding new markets for U.S. agriculture, manufactures, and information technology. It is also critical to the war on terrorism because economic engagement is among the best tools available to America in its efforts to combat the isolationism that breeds radical Islamic militancy.

The World Trade Organization’s limits on tariff hikes and restrictive quotas have brought about tremendous gains in trade liberalization in the past 25 years. Because rising global competition is challenging the status quo, however, antidumping law has picked up where tariffs and quotas left off as a favored tool for winning protection.

Envisioned in theory as a legitimate mechanism for combating “predatory” pricing, antidumping action gains its potency from broad interpretations by trade authorities of what constitutes “predatory.” Its widening use is a modern-day example of Adam Smith’s classic warning about business and government getting together and conspiring to cheat the people. Domestic producers use it as their last bastion for survival; politicians, despite knowing full well that protection is bad for the majority of their constituents, are using it as a political safety valve to release pressure from special interests.

THE 2006 INDEX

[Three chapters in the 2006 Index were devoted to microeconomic conditions in developing countries. In “The Failures of State Schooling in Developing Countries and the People’s Response,” Professors James Tooley and Pauline Dixon from the University of Newcastle in the United Kingdom painted a vivid example of the benefits of competition in education in the Third World.]

Drive across the low highway viaduct toward Victoria Island in the bustling city of Lagos, Nigeria, and you see the shantytown of Makoko, home to an estimated 50,000 people, sprawling out into the black waters below. Wooden huts on stilts stretch out into the lagoon; young men punt and women paddle dug-out canoes down into narrow canals weaving between the raised

homes; teenage boys stand on rocks in the water and cast their fishing nets; large wooden boats, some with noisy outboard motors, carry fishermen out to below the highway and into the ocean beyond. Across the top of the shantytown, there is a veneer of drifting smog created by the open fires used for cooking.

It is possibly the last place where you would expect to witness an educational revolution taking place, but that is precisely what is happening. In Makoko—as in other poor communities around the developing world—parents are abandoning public education *en masse*, disturbed by its low quality, and educational entrepreneurs are setting up private schools to cater to this demand. These private schools, it turns out, whatever their appearances might suggest, are of higher quality than the public alternative, achieving higher standards at a fraction of the cost of public education. Their existence provides a neat grassroots solution to the problem that so perplexes development experts: how to achieve universal basic education—the United Nations Millennium Development Goal of “education for all”—by 2015.

[Barun S. Mitra, Director of the Liberty Institute in New Delhi, extolled the revolutionary potential of the informal economy in the Third World in “Grassroots Capitalism Thrives in India.”]

India remains a poor country, with a per capita income of around USD\$550 (around USD\$3,100 in purchasing power parity). At the same time, however, it is rich in potential—a potential that is fueled by the real stars of the Indian economy, the ordinary Indians who have survived the heavy hand of government that has sought to control almost every aspect of economic activity since the 1950s.

Notwithstanding the ideological fervor of the intelligentsia and the rhetoric of the political class, there is a point beyond which the government cannot impose rigid economic regulations. Where such regulations are indeed laid down, there is a point beyond which enforcement agencies cannot implement laws on the ground.

That is the way it has always been. While the dominant political party adopted the doctrine of a “socialist pattern of development” in the mid-1950s and sought to implement Soviet-style five-year plans, a large part of the Indian economy continued to function virtually outside the scope of the law. Today, 15 years after economic liberalization, experts estimate that 30 percent–40 percent of the Indian economy continues to be in the informal sector. This informal economy reflects India’s true economic potential.

[Michael Gonzalez of The Asian Wall Street Journal, in “Informal Finance: Encouraging the Entrepreneurial Spirit in Post-Mao China,” explained how economic freedom can triumph even in Third World countries still under the heavy hand of the state.]

In China, back-alley banks do most of the intermediation between savers and private businesses. In 2000, only 0.5 percent of loans extended by the state banks went to the private sector. It is estimated that, even today, this number is not much larger than 1 percent.

Economists such as Hernando de Soto have rightly put an emphasis on the need to legalize underground activity. And in a sense, the important role that informal finance plays in China shows how dysfunctional the place remains. I prefer to think the glass is half full, however, and see the informal phenomenon as proof of how the entrepreneurial spirit of the Chinese people shines through any crack in the great wall of repressive government.

The dead hand of the state continues to restrain people’s economic freedom in China more than it does in France or Germany—countries that are commonly thought of as socialist infernos. The reason China seems to have a more exciting future is perhaps that the government and its writ suffer from a deficit of legitimacy unknown in democracies and that the people are used to bypassing the law.

As the growing phenomenon of informal finance reveals, the Chinese are quick to open shop in any nook or cranny abandoned by the state. China is a fascinating study in the eco-

conomic truths advanced by Adam Smith, Frederick Hayek, and Hernando de Soto, illustrating that its recent communist past continues to feed many serious policy distortions.

THE 2007 INDEX

[Xavier Sala-i-Martin, Professor of Economics at Columbia University and a renowned expert on economic growth, in "Global Inequality Fades as the Global Economy Grows," rebutted criticisms from the left that market-based policies do not benefit the poor. He noted that the confusion about growing global inequality among individuals is based on a logical misunderstanding. Comparing countries and comparing individuals within those countries is akin to the classic problem of mixing apples and oranges. Professor Sala-i-Martin corrected that analysis by integrating the apples with the apple trees.]

Looking at the planet as a whole, never in history has poverty been eradicated as rapidly as it has been during our lifetimes. Moreover, individual income inequalities have been falling, and this is the first time they have fallen since the eve of the Industrial Revolution. The aggregate numbers have never looked better. Looking at the world distribution of income, the world is a better place.

Using the original World Bank definition (\$495 annual income), the poverty rate declined from 15.4 percent of the world population in 1970 to 5.7 percent in 2000, a decline of a factor of almost three. This is especially impressive given that, during the same period, world population increased by almost 50 percent, from 3.5 billion to 5.5 billion. The implication is that the total number of poor citizens went from 534 million to 322 million, a decline of 50 percent.

Our analysis shows that, after having stagnated during the 1970s, global income inequality started a two-decades-long process of decline. The main reason is that incomes of some of the world's poorest and most populated countries (most notably China and India, but also many other countries in Asia) converged rapidly with the incomes of OECD citizens. This force has been larger than the divergence effect caused by the dismal performance of African countries.

THE 2008 INDEX

[Last year, Dr. Carl J. Schramm of the Ewing Marion Kauffman Foundation stressed the importance of entrepreneurship in "Economic Fluidity: A Crucial Dimension of Economic Freedom."]

Without entrepreneurship—what Joseph Schumpeter called the "fundamental impulse" of a free-market system—an economy will stagnate, and without the requisite labor mobility, a society's workers will not feel secure enough to launch an entrepreneurial venture. Economist William Baumol has helped to bring the entrepreneur back into economic analysis, and some economic historians have highlighted the role of entrepreneurs in continuously renewing economic growth and freedom.

The degree of economic freedom (and, thus, of economic growth) in any society will reflect the amount of fluidity in the institutional, organizational, and individual elements of the economy. Every economy evolves based on the interactions within and between these elements, but the *rate* of evolution is determined by the level of fluidity and corresponding degree of interaction, which allows the mixing of ideas and generation of innovation.

Chapter 4

The World Discovers the Laffer Curve

Stephen Moore

For 15 years, the *Index of Economic Freedom* has provided an indispensable road map for countries that want to achieve prosperity. The rules aren't complicated. As the *Index* has revealed, lasting prosperity is a result of a persistent commitment to low tax rates, a stable currency, limited government, strong private property rights, openness to global trade and financial flows, and sensible regulation. Together, these factors empower the individual and induce dynamic entrepreneurial activity.

Over the 15-year course of the *Index*, politicians have evidently been listening. Tax rates have been ratcheted down substantially. Inflation, despite recent setbacks, has been tamed in many parts of the world. Government spending is still growing, but not as fast as in the 1970s and 1980s, and in many countries, private-sector growth is outpacing the public sector. In other words, economic freedom is on the march, spreading more opportunities and higher standards

of living around the world.¹

1. Evidence of this comes from a Millennium Project assessment of how nations are working to alleviate poverty. Entitled *The State of the Future*, the report concludes that, beginning in 1985 and projected through 2015, 600 million people—twice as many as live in the United States—will have escaped dire poverty across the globe. Most of the progress comes from the two most populous nations, China and India, which are following free-market supply-side economic policies to the great economic benefit of their citizens. See Jerome C. Glenn and Theodore J. Gordon, *2007 State of the Future*, Millennium Project, 2007. The Millennium Project functions under the auspices of the World Federation of UN Associations, an “independent, non-governmental organization with Category One Consultative Status at the Economic and Social Council (ECOSOC) and consultative or liaison links with many other UN organizations and agencies,” and “is a global participatory futures research think tank of futurists, scholars, business planners, and policy makers who work for international organizations, governments, corporations, NGOs, and universities.” See Millennium Project Web site, at <http://www.millennium-project.org>.

In this chapter, I focus on the extraordinary tax-cutting revolution that started in the early 1980s, gathered momentum in the 1990s, and is now the most important economic policy trend on the planet. The movement was captured in a May 2007 story on Bloomberg News, which reported: “A tax-cut bidding war is spreading across Europe as leaders of the continent’s biggest economies give up criticizing smaller neighbors for cutting business tax rates and decide to join them instead.”²

The Wall Street Journal reports the same phenomenon. “Many countries have slashed their corporate rates,” a July 1, 2008, story proclaimed.³ Scott Hodge, president of the non-partisan Tax Foundation, adds that “[t]ax rates are being cut so quickly around the world that it’s hard to keep a good tally of all the latest developments.”⁴

This essay investigates how much tax rates have fallen, where they have fallen, and what the consequences have been.

THE LOW-TAX REVOLUTION

Let’s start the story in Sofia, Bulgaria. In early 2008, I met the instigator of the world’s lowest flat tax, Svetla Kostadinova, director of the Institute for Market Economics in Sofia. Ms. Kostadinova persuaded a socialist government in Bulgaria to adopt a flat tax. She and her free-market think tank colleagues managed to persuade the politicians that the flat tax would increase revenues to the government—money that could be used for social programs.

Ms. Kostadinova told me that “the situation was getting desperate in Bulgaria. We were losing our population and our best workers. They were leaving for Western Europe to find jobs, and the number one form of foreign capital came from remittances.” That changed when the corporate tax was cut to 10 percent in 2007

and the personal income tax to 10 percent in January of 2008. “We told the politicians that it would be symbolically important for Bulgaria to have the lowest flat tax,” she noted. Today, a nation that 10 years ago had a double-digit unemployment rate now has a 6 percent jobless rate. And instead of people leaving Bulgaria to find jobs overseas, she laughed, “now it is the reverse. Western Europeans come to Bulgaria for jobs. We’re gaining population now.”⁵

I asked her: Don’t the socialists say that the rich should pay more? “Of course, many do, and they want to raise the rates, but most understand that the flat tax gives us more jobs and more revenues.”⁶ In an interview in Washington later that year, Richard Rahn, the former chief economist for the U.S. Chamber of Commerce and now a senior fellow at the Cato Institute and chairman of the Institute for Global Economic Growth, agreed and added: “These countries understand that the flat tax is the key to enhancing their prosperity—even the former Communists know this.”

Mart Laar, the former Prime Minister of Estonia, was the first politician to bring the flat tax to Eastern Europe. Mr. Laar told me when I met him in 2007 that when he first pushed the flat tax, the major opponents were not the Estonian citizens, “who love the flat tax,” but the economists and other wise men of government “both inside and outside of this tiny country. Almost all of the smartest minds told me ‘We cannot have a flat tax. It is untested. It will not work. It will cause budget deficits,’” he recalls about their litany of objections.

But remembering the virtues of the flat tax in Milton Friedman’s classic book, *Free to Choose*, Mr. Laar insisted that the plan would work. So, in 1994, he heroically and wisely ignored the economic pundits and snapped in place one of the world’s first flat taxes at 23 percent. Since then, Estonia has had one of the most rapid growth spurts of any nation in the world, and the country’s adoption of the flat tax has been widely heralded as a cornerstone of its prosperity.

5. Interview, August 2008.

6. *Ibid.*

2. Simon Kennedy, “Tax-Cut War Widens in Europe as U.K., France, Germany Jump In,” Bloomberg.Com, May 29, 2008, at http://www.bloomberg.com/apps/news?pid=20601085&sid=aev_LMGsw3aw&refer=europe.

3. “Corporate Tax Cut Windfall,” *The Wall Street Journal*, July 1, 2008, p. A16.

4. Interview, July 2008.

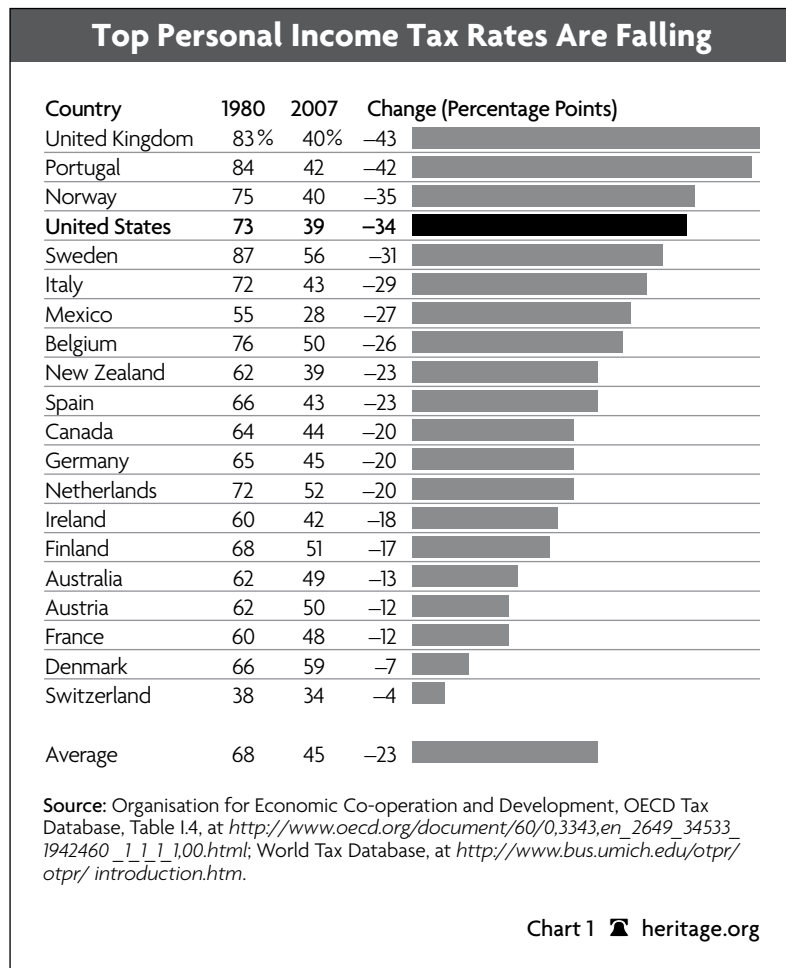
The U.S. has never had a flat tax, but the global tax-cutting spree, in fact, began in the U.S. when Ronald Reagan enacted two tax cuts—one in 1981 and another in 1986—that reduced the highest marginal personal income tax rate to 28 percent from 70 percent. Reagan also tamed the double-digit inflation that had crippled the U.S. economy in the late 1970s. Those policies proved to be a gravitational pull on foreign investment capital of more than \$5 trillion from 1982 to 2007. This tax advantage for the U.S. forced other nations to cut rates themselves or face a loss of competitiveness.

Over the past 20 years, and especially in the past five years, global personal and corporate tax rates have fallen at a faster pace than at any time in the past 100 years. (See Charts 1 and 2.) The average personal income tax rate among industrialized countries in 1980 was 68 percent. That rate fell to 50 percent in 1995 and today stands at 45 percent. This means that average personal income tax rates at the top of the income scale have fallen by over one-third. On the corporate income tax side, the tax-cutting momentum is even more pronounced. The average tax rate in industrialized nations has fallen by half, to 25 percent from 48 percent since the start of the Reagan era.

In the late 1980s, there was one nation in the world with a true flat tax: Hong Kong. Now there are 24 such jurisdictions, and most of these are in Eastern Europe. (See Table 1.) These nations, formerly behind the Iron Curtain of Communism, endured suffocating economic controls and declining living standards for half a century. Now they are capitalists par excel-

lence and avid flat-tax partisans. The average flat tax rate is 20 percent, which has made the tax rates of Old Europe (40 percent to 60 percent) look as high as the Swiss Alps.

For many decades after it adopted a flat tax rate of 15 percent in 1947, Hong Kong enjoyed the benefits of a competitively low tax rate with no tax on dividends or capital gains or money earned outside of the island. Hong Kong has also embraced free trade, which explains why it has evolved into a capitalist paradise brimming with entrepreneurial spirit. The tax code is about 180 pages, compared to tens of thousands of pages for the U.S. tax code. The result has been that Hong Kong, over several decades, evolved into one of the richest places on Earth despite its tiny land mass and no natural resources. The only mystery is why it took nearly half a century for the rest of the world to start copying the Hong Kong flat-tax model.



Tax reductions are also an underappreciated part of the story of China's economic surge. In 1978, the late Chinese leader Deng Xiaping unleashed a series of free market-based economic reforms, including the legalization of privately owned farms (which caused a near doubling of food output above what the communist state-owned farms produced), the establishment of coastal economic enterprise zones, new opportunities for foreign investment and the privatization of state-owned enterprises.

But as Alvin Rabushka of the Hoover Institution points out, "The application of supply-side tax policies was the main component."⁷ It helped to generate the double-digit rates of economic growth on the mainland that have

become the stuff of economic legend. China is staying on the supply-side course. Effective January 2008, the Chinese corporate tax rate became 25 percent, down from 33 percent.

EUROPE DISCOVERS THE SUPPLY SIDE

Even the fat welfare-state nations of Western Europe, whose tax rates climbed to hopelessly uncompetitive levels in the 1970s and 1980s, have been getting into the supply-side tax-cutting act.

The economic growth rate of European Union nations between 2002 and 2006 was about half the pace of U.S. economic growth.

7. Alvin Rabushka, "The Great Tax Cut of China," *Hoover Digest* 1998, No. 1, Hoover Institution, at <http://www.hoover.org/publications/digest/3523046.html>.

Corporate Tax Rates Are Falling

Country	1980	2007	Change (Percentage Points)
Ireland	45.0%	12.5%	-32.5
Austria	55.0	25.0	-30.0
Netherlands	48.0	25.5	-22.5
United Kingdom	52.0	30.0	-22.0
Portugal	47.2	26.5	-20.7
Germany	56.0	38.9	-17.1
Finland	43.0	26.0	-17.0
Australia	46.0	30.0	-16.0
France	50.0	34.4	-15.6
Denmark	40.0	25.0	-15.0
Belgium	48.0	34.0	-14.0
Mexico	42.0	28.0	-14.0
New Zealand	45.0	33.0	-12.0
Sweden	40.0	28.0	-12.0
Luxembourg	40.0	30.4	-9.6
Italy	40.0	33.0	-7.0
United States	46.0	39.3	-6.7
Canada	37.8	33.5	-4.3
Japan	42.0	39.5	-2.5
Norway	29.8	28.0	-1.8
Spain	33.0	32.5	-0.5
Average	43.5	30.3	-13.2

Source: Organisation for Economic Co-operation and Development, OECD Tax Database, Table II.I, at http://www.oecd.org/document/60/0,3343,en_2649_34533_1942460_1_1_1_1,00.html#table_III; World Tax Database, at <http://www.bus.umich.edu/otpr/otpr/introduction.htm>.

Chart 2  heritage.org

In the 1990s, European unemployment rates were consistently about 50 percent higher than the U.S. jobless rate. Euroland was no workers' paradise.


The Europeans are now slowly shedding many of the excesses of cradle-to-grave socialism and their confiscatory tax rates. In 2007, Germany under Chancellor Angela Merkel chopped the corporate income tax rate by about nine percentage points.⁸ Now, amazingly, Germany, which started this century with an effective corporate income tax rate of over 50 percent, has sliced and diced

8. Invest in Germany, "Company Taxation," at <http://www.invest-in-germany.com/homepage/business-guide-to-germany/the-tax-system/company-taxation>.

Flat-Tax Jurisdictions and Their Rates

Iceland.....	35.7%	Mauritius	15%
Lithuania	27%	Montenegro	15%
Jamaica	25%	Ukraine	15%
Latvia.....	25%	Russia	13%
Estonia.....	21%	Georgia	12%
Guernsey	20%	Albania.....	10%
Jersey.....	20%	Bulgaria	10%
Slovakia	19%	Kazakhstan	10%
Romania.....	16%	Kyrgyzstan	10%
Czech Republic	15%	Macedonia	10%
Hong Kong	15%	Mongolia	10%
Iraq	15%	Prednestrovie	10%

Source: Daniel J. Mitchell, "The Global Flat Tax Revolution: Lessons for Policy Makers," The Center for Freedom and Prosperity, *Prosperitas*, Vol. VIII, Issue 1 (February 2008), at <http://www.freedomandprosperity.org/Papers/flattax/flattax.shtml>.

Table 1  heritage.org

the corporate rate down to slightly less than 30 percent.⁹ Ms. Merkel sounds a lot like Jack Kemp or Ronald Reagan when she says that the purpose of the tax cuts is to boost "Germany's attractiveness as a location for international investment."¹⁰

Spain has also driven its taxation lower. Under José María Aznar, the former conservative Prime Minister, as well as under the leadership of José Luis Rodríguez Zapatero, the current socialist Prime Minister, measures to reform Spain's taxation have been implemented. Spain's top personal income tax rate has been reduced to 43 percent from 56 percent while its corporate tax rate has been cut to 30 percent from 35 percent.¹¹ Prime Minister Zapatero may have taken a staunchly anti-Ameri-

9. *Ibid.* Germany's standard federal corporate tax rate is 15 percent.

10. Kennedy, "Tax-Cut War Widens in Europe as U.K., France, Germany Jump In."

11. Economist Intelligence Unit, "Spain," *Country Briefing*, September 30, 2008, at <http://www.economist.com/countries/Spain/profile.cfm?folder=Profile-FactSheet>; Economist Intelligence Unit, *Country Commerce*, 1997 and 2000, available with subscription.

can stand on the war in Iraq, but he was able to recognize a bad tax when he saw one, and Spain's wealth tax was abolished in 2008.

The surest sign of all that there is a new economic paradigm taking hold in Europe is that just two years ago, Sweden, the socialist workers' paradise, completely eliminated its estate tax because the political leaders realized that the tax was economically counterproductive. In promising to "abolish the wealth tax," Swedish Prime Minister Fredrik Reinfeldt said, "We hope to give a boost to the desire to invest in Sweden and to create a condition for new, expansive companies to create more jobs."¹² So now Sweden and, more recently, Russia have no estate tax, while the land of the free, America, taxes death at 45 percent. In late 2008, Sweden also announced a plan to reduce its corporate tax rate by another percentage point to 24 percent, which is 11 points lower than the U.S. statutory rate.

Nor is Asia being left behind in this competition. South Korea cut its income tax to 40 percent by the late 1990s from 87 percent in 1978. Its tax revenues soared from \$2 billion in 1980 to \$24 billion by 1996 to nearly \$50 billion in 2007. Vietnam announced in 2008 that it intends to reduce the corporate rate to 25 percent from 28 percent while removing other government barriers to growth.

The motivation for this tax-slashing on every continent is the free flow of investment. In this age of information and technology, borders don't matter much any more. The world has become one massive shopping market for capital. Nations are in a contest to climb past each other in a race up the economic growth ladder. Singapore, for example, recently approved a corporate tax cut to keep pace with its low-tax rival Hong Kong. Northern Ireland is making a bid to lower its corporate tax rate to 12.5 percent in an effort to catch up to the economic gazelle of Europe: Ireland. When I recently met with the Prime Minister of Scotland, Alex Salmond, he related the same

12. "Björn Borg, Come Home," *The Wall Street Journal*, April 11, 2007.

story. "Supply-side economics works. We've seen that in Ireland." Then he added: "Their low tax rates are attracting all the capital of Europe, and if we want to compete, our rates need to fall to near theirs."

I call this global phenomenon Reaganomics 2.0. The supply-side economics model, which the Gipper installed with such great controversy 28 years ago, is now the economic operating system around the globe. Foreigners have witnessed with envy the American prosperity boom of the past quarter-century. Where American politicians have decried "tax cuts for the rich," the rest of the world has taken note of the impressive and sustained rates of growth. Now it is possible that capital will begin to flow back as many of these economies start to treat investors and capital more kindly at home.

REVISITING THE IRISH MIRACLE

Ireland does not qualify as a flat-tax country because it only has a low flat-rate corporate tax. Regrettably, it still has steeply graduated personal rates. Yet the Irish economic miracle may be the greatest supply-side economics success story of recent times (other than the Reagan revolution). Ireland turned to the idea only when the nation was on its knees and all other inferior alternatives had been tried.

Just over a century and a half ago, Ireland had a population of some 8 million, but by 1980, that number had dwindled to 4 million, with far more Irish living in America than in Ireland. From the 1960s to the 1980s, Ireland became a giant welfare state burdened with high taxation, generous benefits for not working, and an industrial base in demise. The movie *The Commitments* depicted a rock-and-roll band with several of the struggling band members collecting free welfare benefits from the government. "It beats working," was the famous response of one band member when asked why he stood in long lines for monthly benefits. Indeed, it did, and Ireland's GDP stagnated.

In the 1990s, things began to change. Welfare was reformed; government services and enterprises became more efficient through privatizations; and, most important, the cor-

porate income tax rate was cut to 12.5 percent—not just the lowest in Euroland, but one-third the average rate on the continent. In the succeeding 10 years, the population grew for the first time in decades, rising to 5.7 million; GDP rose at twice the rate of Europe's; and more than 1,000 international companies, such as Intel, Bristol-Myers Squibb, Microsoft, Dell, and Motorola, moved in. By 2000, Ireland's growth rate hit 8.7 percent a year and, perhaps most astonishing of all, with the lowest corporate tax rate in all of Europe, it achieved the biggest budget *surplus* as a share of GDP.

The winners in this economic transformation have been rank-and-file workers. The average hourly manufacturing wage soared by 126 percent from 1985 to 2004 at a time when many industrial nations were experiencing stagnant wage growth. The country's real GDP per person has climbed up to \$30,736 from \$9,957,¹³ and the Irish on a per capita basis are now more than three times as rich as they were in 1980.

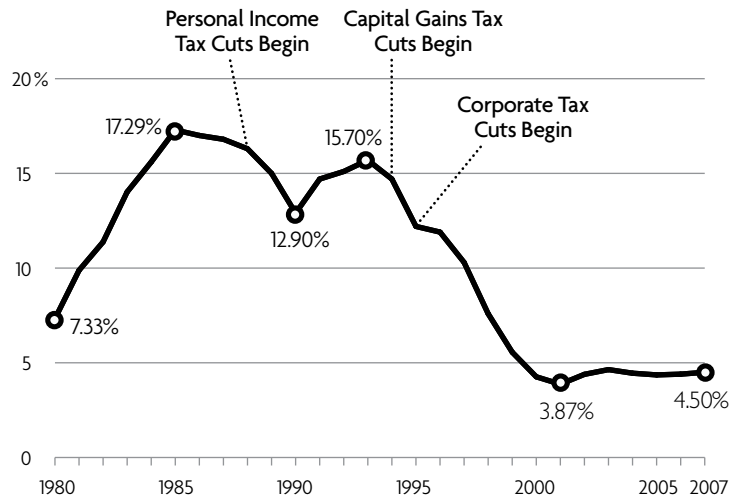
In 1991, Germany had a per capita income that was twice that of Ireland. By 2004, Ireland's per capita purchasing power exceeded Germany's.¹⁴ In less than a decade and a half, Ireland climbed from last to first in Europe. That's economic development at warp speed. The Irish brain drain, which started during the potato famine of 1845 and continued almost unabated for the next 150 years, has finally reversed course. Now brains are coming back to Ireland where more job opportunities have been created. The unemployment rate has fallen to 4.5 percent from over 17 percent in 1985. (See Chart 3.)

13. Figures are in real GDP per capita (in constant 2000 U.S. dollars). See World Bank, *World Development Indicators Online*, available with subscription at <http://www.worldbank.org/data>.

14. Eurostat, "GDP per Capita in 2004: GDP per Capita Varied by One to Five Across the EU25 Member States," news release 75/2005, June 3, 2005, at http://epp.eurostat.ec.europa.eu/pls/portal/docs/PAGE/PGP_PRD_CAT_PREREL/PGE_CAT_PREREL_YEAR_2005/PGE_CAT_PREREL_YEAR_2005_MONTH_06/2-03062005-EN-BP.PDF.

Ireland's Unemployment Rate Plummet

Joblessness in Ireland decreased from 17% to less than 4% in the span of 16 years, primarily due to tax cuts.



Source: International Monetary Fund 2008 World Economic Outlook, April 2008, at <http://www.imf.org/external/pubs/ft/weo/2008/01/weodata/index.aspx>; Central Statistics of Ireland, Labor Market, Principal Statistics, at <http://www.cso.ie/statistics/sasunemprates.htm>.

Chart 3 heritage.org

CUTTING CORPORATE TAXES

As the Irish success story illustrates, one of the taxes that has a large impact on a nation's ability to compete in global markets is the corporate tax, which is coming down rapidly just about everywhere—except the U.S. In 2006 and 2007, 12 nations cut their corporate rates, including Germany, Spain, and the Netherlands. In 2008, nine of the 30 most developed nations and 20 countries worldwide—from Israel to Germany to Turkey—cut corporate tax rates. For the first time ever, the U.S. statutory rate is now a full 50 percent higher than the average of our international competitors. (See Chart 4.)

The *Index of Economic Freedom* has shown that commitment to lower taxation is a key component of a country's effort to create a virtuous cycle of entrepreneurship, growth, and lasting prosperity for its citizens. A 2008 study by the Organisation for Economic Co-operation and Development, "Tax and Economic Growth,"

examines why some countries are becoming more prosperous than others and concludes that "corporate taxes are found to be most harmful for growth, followed by personal income taxes, and then consumption taxes."¹⁵ The study finds, not surprisingly, that investment rates fall when corporate tax rates rise and that the most profitable and most rapidly expanding companies tend to be the most sensitive to corporate tax rates.

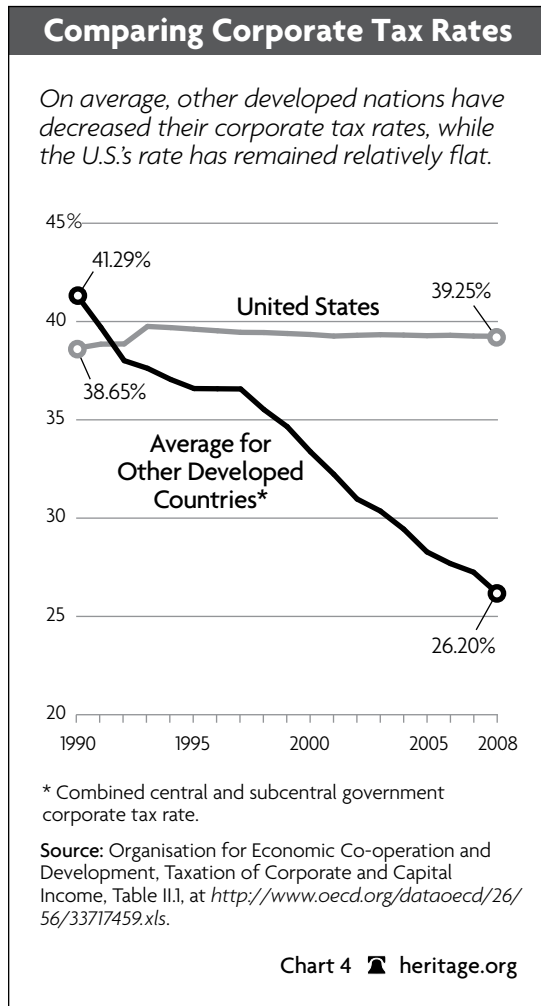
High corporate tax rates are also self-defeating because they don't produce much if any revenue. The average European nation's tax rates on corporate income are 10

percentage points *lower* than those in the U.S., but those countries on average raise almost twice the share of GDP in corporate taxes. Ireland, with its bargain-basement 12.5 percent rate, captures a higher share of its GDP in corporate taxes than the U.S. captures with a tax rate that is *three times higher* than Ireland's.

Policymakers in the two highest corporate tax nations, the U.S. and Japan, may want to take a look at a 2006 study by two scholars, Kevin Hassett and Aparna Mathur, at the American Enterprise Institute (AEI).¹⁶ They

15. Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys, and Laura Vartia, "Tax and Economic Growth," Organisation for Economic Co-operation and Development, Economics Department Working Paper No. 620, July 2008, at [http://www.oecd.org/olis/2008doc.nsf/LinkTo/NT00003502/\\$FILE/JT03248896.PDF](http://www.oecd.org/olis/2008doc.nsf/LinkTo/NT00003502/$FILE/JT03248896.PDF).

16. Aparna Mathur and Kevin A. Hassett, "Taxes and Wages," American Enterprise Institute *Papers and Studies*, March 6, 2006, at http://www.aei.org/publications/pubID.24063/pub_detail.asp.



find that the burden of the corporate income tax rate is borne in large part by workers in the form of lower wages. In a study of 72 nations, they found that manufacturing wages were negatively associated with high corporate tax rates.

The Laffer Curve effect suggests that nations will increase their economic output and competitive stature in the global race for capital by cutting business tax rates even further. Alan Reynolds, an economist at the Cato Institute (and formerly of the Hudson Institute), has confirmed this relationship: Countries that cut tax rates sharply outperform those that don't. He labels the tax rate reduction countries "supply-side economies" and the countries that raised tax rates in the 1990s "demand-side economies." The "supply-side economy nations—whose tax rates fell to an average of

34 percent from 61 percent—experienced economic growth rates three times higher than the demand-side countries." (See Table 2, work Mr. Reynolds did while an economist at the Hudson Institute.) "Hong Kong, Singapore, and most other economies that have adopted supply-side tax strategies, have seen their private consumption, and investment, good measures of living standards, increase three times the pace of the demand-side economies,"¹⁷ he wrote in a later paper.

WHY RATES MATTER

Very high tax rates can distort economic behavior and reduce the incentive to work and earn. Consider celebrities. Rock stars and highly paid actors regularly engage in tax-minimization strategies, much to the consternation of their home countries, as a January 2007 story in *The Economist* explained:


Sometimes it takes a rock star. By moving to Switzerland to flee punitive French taxes, Johnny Hallyday, France's 63-year-old rock idol, has set off a new debate. Many other high-earning French celebrities have become tax exiles, prompting periodic moral outrage. But this departure is politically embarrassing: Mr Hallyday's friend, Nicolas Sarkozy, is set to be the centre-right's presidential candidate. "If he reforms the wealth and inheritance law," Mr. Hallyday told *Paris-Match*, "well, then I will come back to France."¹⁸

Hallyday said that 70 percent of his earnings goes to the state and that he had "a particular gripe about the annual wealth tax, or ISF, which is applied to almost all assets, whether revenue-generating or not." According to *The Economist's* account, "Even Thierry Breton, the finance minister, once called the wealth tax 'economically dangerous.'"¹⁹

17. Alan Reynolds, "A Depressing Situation," *The Washington Times*, May 4, 2003, at http://www.cato.org/pub_display.php?pub_id=5674.

18. "Tax 'n' Wealth and Rock 'n' Roll," *The Economist*, January 4, 2007.

19. *Ibid.*

Comparing Supply-Side and Demand-Side Economies		
Top Marginal Tax Rate		
	Supply-Side Economies	Demand-Side Economies
1979	61%	63%
1989	43%	46%
1995	34%	49%
Average Growth in GDP		
	Supply-Side Economies	Demand-Side Economies
1985–1994	5.10%	1.40%
Source: Hudson Institute.		
Table 2  heritage.org		

Ségolène Royal, then the Socialist presidential candidate, “said top earners should ‘set an example’ and pay their taxes without a fuss.”²⁰ But they do put up a fuss, because rock stars are like everyone else: They don’t want to pay confiscatory taxes. The academic evidence confirms these anecdotes. One 2004 study by Nobel prize-winning economist Edward Prescott for the National Bureau of Economic Research (NBER) found that people work more when tax rates are lowered:

Americans now work 50 percent more than do Germans, French and Italians. This was not the case in the early 1970s.... [T]his marginal tax rate accounts for the predominance of the differences at points in time and the large change in relative labor supply over time.²¹

Another NBER study found that among rich nations, a lowering of tax rates in the 1990s led to an increase in hours worked and an increase in the number of people in the labor force. It also found that the “shadow economy”—i.e. underground activity—rises “by 3.8 percent of

20. *Ibid.*

21. Edward Prescott, “Why Do Americans Work So Much More Than Europeans?” National Bureau of Economic Research *Working Paper* No. 10316, February 2004.

GDP for every 12.8 percentage point increase in the tax rate.”²²

Finally, in a 2007 study financed by the National Science Foundation, Christina Romer and David Romer examined tax policy changes in the United States from 1947 through today. Their study found that “tax increases are highly contractionary. The effects are strongly significant, highly robust, and much larger than those obtained [in earlier studies]. The large effect stems in considerable part from a powerful negative effect on investment.”²³

CONCLUSION

Fifteen years ago, when the first edition of the *Index of Economic Freedom* was published, the supply-side idea of the Laffer Curve—that high tax rates reduce growth and can even reduce revenues—was still highly controversial and disregarded among the political class and even trained economists. Today, however, more nations around the globe are embracing the idea.

The sentiment among the tax-chopping nations is that lower tax rates are a critical component of the process of capitalizing on the globalization of financial markets. Hundreds of billions of dollars of investment capital are traded every day across international boundaries, and investors are attentive to each jurisdiction’s tax rates.

But there is still one place on the globe where the idea that lower tax rates generate more entrepreneurial activities and economic growth is being disparaged: the United States. James Surowiecki, a *New Yorker* financial page columnist, argued in 2007 that supply-side tax prescriptions for the economy are the equivalent of “saying that the best way to treat sick people is

22. Steven J. Davis and Magnus Henrekson, “Tax Effects on Work Activity, Industry Mix, and Shadow Economy Size: Evidence from Rich-Country Comparisons,” National Bureau of Economic Research *Working Paper* No. 10509, May 2004.

23. Christina Romer and David Romer, “The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks,” University of California, Berkeley, November 2006, at <http://www.economics.ucr.edu/seminars/fall06/ets/Romer11-27-06.pdf>.

to bleed them to let out the evil spirits.”²⁴

Today much of the talk in Washington is of higher income taxes, capital gains taxes, dividend taxes, payroll taxes, energy taxes, and hedge fund taxes. The threat of this tax assault on wealth and capital is taking a toll on investor confidence in the U.S. economy. Michael

24. James Surowiecki, “Tax Evasion: The Great Lie of Supply-Side Economics,” *The New Yorker*, October 29, 2007, at http://www.newyorker.com/online/2007/10/29/071029on_onlineonly_surowiecki.

Darda, a top Wall Street economic analyst for MKM Partners, hypothesizes that this is “one reason the U.S. dollar has fallen relative to the currencies of other nations.”

What this suggests is that if the U.S. refuses to cut its tax rates—or, even worse, if it follows the “tax-hike on the rich” course that has become so popular among many politicians in Washington—America’s economic freedom, competitiveness and prosperity will be in great peril.

Chapter 5

Economic Freedom by Region

Every region in the world has at least one country that can be considered a top performer in the 2009 *Index of Economic Freedom*, but average levels of economic freedom—and average levels of economic performance and prosperity—vary widely among the regions. It is popular to blame lagging economic performance in certain parts of the world on poor endowments of natural resources, geographical disadvantages, a history of colonialism, a lack of foreign aid, or an unfair international economic system. Those who are looking for excuses find that such subjects provide rich fodder for endless analysis and all-too-convenient evasion or shifting of responsibility for failure. Those who look instead for solutions will find in this *Index* the fruits of government policies and actions that can either promote or hinder growth.

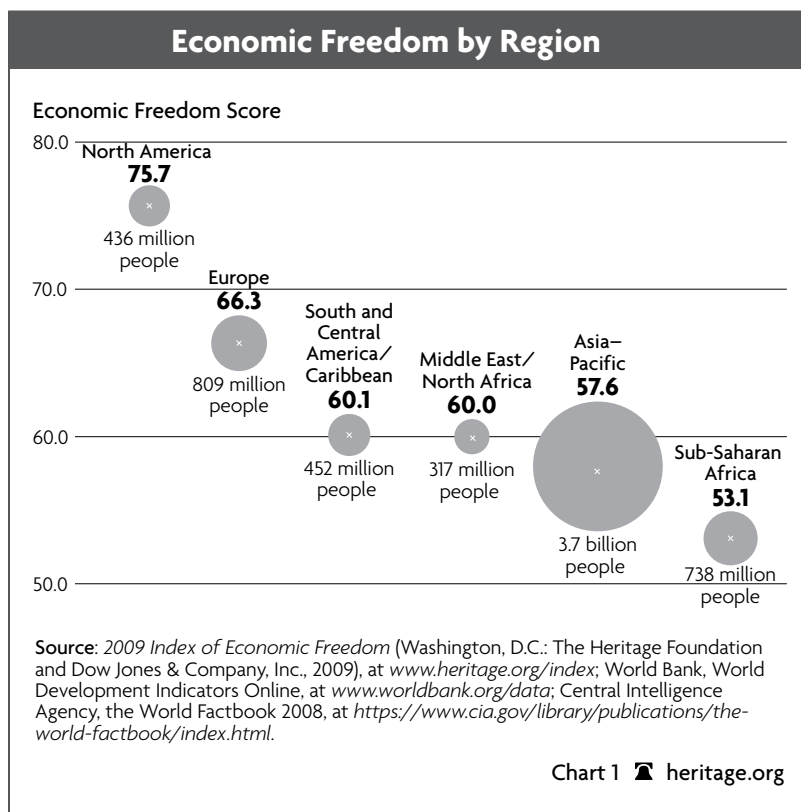
The *Index of Economic Freedom* is not a comprehensive blueprint for economic policy or a how-to manual for development and growth. The diversity of the world's peoples and cul-

tures implies that there will be many paths to prosperity. Indeed, the whole idea of economic freedom is to enlarge and sustain the space in which individuals can pursue their own goals in whatever ways they choose.

The *Index* looks at 10 areas of economic activity in which freedom may be enlarged or constrained. Although analyzing tendencies in various regions no doubt obscures important differences at the country level, it also may help to identify ways in which culture, history, or even geography are affecting the ability of countries to prosper in a globalized world.

In this chapter, we look at economic freedom in six regional groups. As shown in Chart 1, economic freedom varies significantly across regions, with inhabitants of North America and Europe enjoying far greater levels of economic freedom than those who live in other regions of the world.

Not surprisingly, levels of prosperity are far higher in those two regions than in other



areas. (See Table 1.) The world's two freest regions have more than three times the population-weighted average per capita income found in the other four regions. The freest regions also enjoy lower rates of unemployment and lower inflation.

Table 2 shows components of economic freedom in which regions perform better or worse than the world averages. Only the North America region has scores in every component of economic freedom that equal or exceed the world average. Each of the other regions has one or more

Economic Freedom and Performance by Region

	Average Economic Freedom 2009 Score			Population Weighted Average			
	Simple Average	Population Weighted Average	Population	GDP per Capita (PPP)	GDP 5-Year Growth Rate	Inflation	Unemployment Rate
North America	75.7	77.1	436,200,000	\$35,831	2.7	3.1	4.5
Europe	66.3	63.0	809,200,000	\$21,639	4.2	5.1	7.3
South and Central America/Caribbean	60.1	56.9	453,700,000	\$8,169	3.8	5.8	9.7
Middle East/North Africa	60.0	55.2	316,500,000	\$8,933	4.9	9.3	12.9
Asia-Pacific	57.6	54.6	3,674,700,000	\$5,206	7.8	5.9	5.8
Sub-Saharan Africa	53.1	54.2	736,700,000	\$1,784	6.2	8.2*	15.0
World	59.5	57.3	6,427,000,000	\$9,354	6.4	6.1*	7.6

*Excluding Zimbabwe, whose hyperinflation that is estimated at over 10,000 percent would distort the regional and the world average.

Source: 2009 Index of Economic Freedom (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2009), at www.heritage.org/index; International Monetary Fund, World Economic Outlook database, April 2007, at <http://www.imf.org/external/pubs/ft/weo/2008/01/weodata/index.aspx>; World Bank, World Development Indicators Online, at www.worldbank.org/data; Central Intelligence Agency, the World Factbook 2008, at <https://www.cia.gov/library/publications/the-world-factbook/index.html>

Table 1 heritage.org

Each Region's Ten Economic Freedoms in Comparison to the World Average

Region	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
North America	+	+	+	+	+	+	+	+	+	+
Europe	+	+	-	-	+	+	+	+	+	-
South and Central America/Caribbean	-	+	+	+	-	+	-	-	-	-
Middle East/ North Africa	+	+	+	+	-	-	-	-	-	+
Asia-Pacific	-	-	+	+	-	-	-	-	-	+
Sub-Saharan Africa	-	-	-	+	-	-	-	-	-	-

Source: 2009 *Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2009), at www.heritage.org/index.

Table 2 heritage.org

components in which the average level of economic freedom falls below the world average. European countries fall over four points below the world average in fiscal freedom and almost 18 points below the world average in government size—a reflection of their bloated government budgets that fund high levels of welfare spending.

South and Central America/Caribbean countries lag slightly behind the world average in six components of economic freedom, most significantly in corruption. The Middle East/North Africa region has lower than average scores in five economic freedoms, the Asia-Pacific region is behind in seven, and Sub-Saharan Africa lags in nine, beating the world average only in government size. Unfortunately, for many of the Sub-Saharan African countries, the high scores for government size reflect economic informality and lack of capacity rather than government efficiency and restraint.

The analyses that follow provide an overview of economic freedom in each region. While the data are informative for the casual reader and of potential interest to decision

makers and analysts in multilateral institutions and aid agencies, they may be of most use to government policymakers in individual countries who are interested in comparing their own performance to that of their closest peers and competitors.

NORTH AMERICA

The North America region has benefited from its openness to international trade and investment. Enjoying the highest degree of economic freedom among the six regions, North America's three countries have been linked by a regional trade agreement, the North American Free Trade Agreement (NAFTA), since 1994. NAFTA has been a positive force enhancing economic freedom in the North America region, connecting more than 400 million people in an economic area with about one-third of the world's total GDP.

Chart 2 shows North America's overall economic freedom and 10 economic freedoms in comparison to world averages. The region scores at or above the world average in every area of economic freedom. The region has high levels of business freedom, trade freedom,

Economic Freedom in North American Countries

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
6	1	United States	80.7	-0.3	91.9	86.8	67.5	59.6	84	80	80	90	72	95.1
7	2	Canada	80.5	0.3	96.5	88.2	76.6	53.7	80.8	70	80	90	87	81.9
49	3	Mexico	65.8	-0.3	80.3	80.2	83.4	81.8	77.5	50	60	50	35	59.8

■ 80–100 Free
 ■ 60–69.9 Moderately Free

Table 3  heritage.org

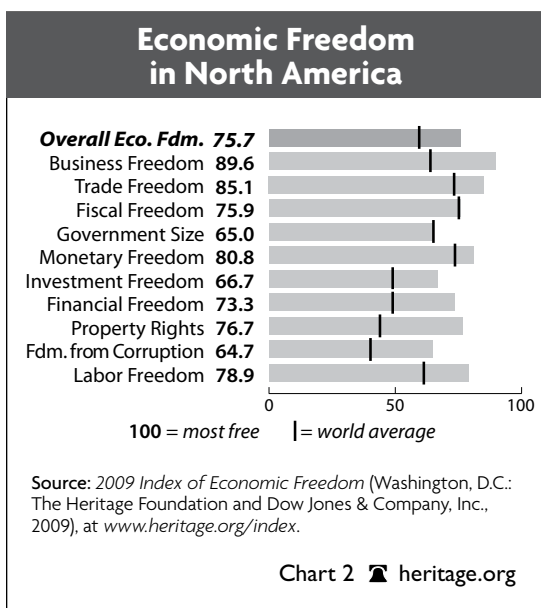
monetary freedom, and labor freedom. Weaknesses remain in investment freedom and freedom from corruption, as Mexico lags behind its two northern neighbors in these two areas.

With economic freedom scores over 80, the U.S. and Canada are among the 10 freest economies in the 2009 *Index*, while Mexico remains “moderately free” with a score of 65.8. Canada made a slight improvement of 0.3 point in its economic freedom score, but scores for the U.S. and Mexico are 0.3 point lower in each case than last year.

EUROPE

Europe served as the testing ground for the two great economic philosophies of the past century and witnessed the collapse of one of them: Communism, which proved unable to generate standards of living even remotely approximating those of capitalist Western Europe. Now that the old Cold War contrasts have been eclipsed by a new technology and innovation-driven globalization, many of the large economies in Europe that were built on a quasi-market welfare state model are looking for ways to improve their competitiveness with fast-growing small economies like Ireland and Estonia that are surpassing them in economic performance. Only Russia and a few other countries that emerged from the breakups of the Soviet Union and Yugoslavia have failed to embrace the principles of economic freedom.

Europe comprises 43 countries and, taken as a whole, is enjoying economic prosperity and stability. Extensive and long-established free-market institutions in most countries allow the region to score above the world average in eight of the 10 economic freedoms. It is about 15 points ahead in both investment freedom and financial freedom. The region’s freedom from corruption and property rights both lead the world by slightly more than 15 points. (See Chart 3.)





However, Europe's overall economic freedom is still hampered by weak scores in labor freedom, fiscal freedom, and government size, reflecting the price tag of welfare states that consume a large percentage of GDP. The bur-

densome labor regulations that are in place to protect traditional sectors are plainly hindering both productivity growth and job creation, and they leave the continent with high levels of unemployment that may at some point threaten social stability.

Half of the world's 20 freest countries are in Europe. (See Table 4.) With its economic freedom score over 80, Ireland is the highest ranking European country in the 2009 *Index*. Ireland is ranked 4th worldwide, followed by Denmark at 8th, Switzerland at 9th, and the United Kingdom at 10th. The Netherlands, Estonia, Iceland, Luxembourg, Finland, and Belgium round out the top 20.

Ireland leads in investment freedom, financial freedom, and property rights, reflecting Dublin's commitment to becoming a major European commercial and financial hub based on free-market principles. Denmark's overall score is 0.4 point higher than last year, reflecting improved scores in fiscal freedom, government size, monetary freedom, and property rights.

Economic Freedom in European Countries

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
4	1	Ireland	82.2	-0.3	93.0	85.8	69.2	64.9	84.3	90	90	90	75	79.7
8	2	Denmark	79.6	0.4	99.9	85.8	35.4	20.4	86.6	90	90	95	94	99.4
9	3	Switzerland	79.4	-0.1	82.9	85.4	67.5	65.3	83.9	70	80	90	90	79.2
10	4	United Kingdom	79.0	-0.5	89.8	85.8	61.0	40.3	80.4	90	90	90	84	78.5
12	5	Netherlands	77.0	-0.4	86.5	85.8	50.9	36.2	87.0	90	90	90	90	63.3
13	6	Estonia	76.4	-1.5	75.9	85.8	81.5	67.3	79.7	90	80	90	65	48.5
14	7	Iceland	75.9	0.1	93.6	88	76.2	44.0	75.3	70	70	90	92	59.9
15	8	Luxembourg	75.2	0.5	76.2	85.8	66.3	54.4	80.2	90	80	90	84	45.1
17	9	Finland	74.5	-0.1	95.1	85.8	64.3	28.6	87.4	70	80	95	94	44.8
20	10	Belgium	72.1	0.5	93.2	85.8	41.5	28.3	81.0	90	80	80	71	70.5
23	11	Austria	71.2	-0.2	78.6	85.8	49.9	27.1	80.9	70	70	90	81	78.7

(continued on next page)

■ 80–100 Free
 ■ 70–79.9 Mostly Free

Table 4 heritage.org

Economic Freedom in European Countries (continued)

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
24	12	Cyprus	70.8	-0.5	70.0	80.8	76.6	42.2	85.7	70	70	90	53	70.0
25	13	Germany	70.5	-0.1	90.3	85.8	58.5	38.2	80.8	80	60	90	78	43.4
26	14	Sweden	70.5	-0.4	95.9	85.8	35.0	7.3	82.1	80	80	90	93	55.5
28	15	Norway	70.2	1.6	88.1	89.2	50.3	50.5	78.1	60	60	90	87	48.6
29	16	Spain	70.1	1.0	76.8	85.8	58.6	55.3	78.9	80	80	70	67	48.3
30	17	Lithuania	70.0	-1.0	82.4	85.8	87.6	65.3	75.8	70	80	50	48	54.6
31	18	Armenia	69.9	0.0	83.7	86.4	90.0	89.7	77.8	70	70	35	30	66.3
32	19	Georgia	69.8	0.5	86.6	80.6	86.8	74.6	70.9	70	60	35	34	99.4
36	20	Slovak Republic	69.4	-0.6	73.4	85.8	84.1	57.4	78.7	70	70	50	49	75.3
37	21	Czech Republic	69.4	1.2	65.1	85.8	80.2	43.0	79.7	70	80	70	52	67.8
44	22	Hungary	66.8	-0.8	77.4	85.8	70.6	19.2	73.8	80	70	70	53	68.4
45	23	Latvia	66.6	-1.7	73.8	85.8	82.3	58.5	71.1	70	60	55	48	61.6
47	24	Malta	66.1	0.1	70.0	85.8	63.1	41.7	82.7	50	60	90	58	60.0
53	25	Portugal	64.9	1.0	81.1	85.8	61.6	35.4	79.9	70	60	70	65	40.3
56	26	Bulgaria	64.6	0.9	73.5	85.8	86.2	58.7	72.8	60	60	30	41	78.4
62	27	Albania	63.7	1.3	67.0	75.8	92.8	75.6	79.6	70	70	30	29	47.2
64	28	France	63.3	-1.4	87.4	80.8	50.9	14.5	71.7	60	70	70	73	54.5
65	29	Romania	63.2	1.5	74.9	85.8	87.0	70.0	75.0	60	50	35	37	57.1
68	30	Slovenia	62.9	2.7	84.5	85.8	62.9	38.4	78.6	60	50	60	66	42.8
75	31	Turkey	61.6	1.6	69.9	86.6	73.2	83.4	71.1	50	50	50	41	40.3
76	32	Italy	61.4	-1.2	78.7	80.8	55.8	24.7	80.8	70	60	50	52	61.3
78	33	Macedonia	61.2	0.2	58.2	81.6	89.4	65.1	85.4	50	60	30	33	59.8
81	34	Greece	60.8	0.2	78.7	80.8	66.5	46.3	78.8	50	50	50	46	61.2
82	35	Poland	60.3	0.0	53.7	85.8	69.0	42.2	80.8	60	60	50	42	59.8
94	36	Montenegro	58.2	n/a	68.7	80.2	89.1	45.3	78.9	40	50	40	33	57.2
109	37	Serbia	56.6	n/a	56.0	78	85.9	46.3	65.8	40	50	40	34	70.0
116	38	Croatia	55.1	1.0	59.9	87.6	68.7	31.7	79.0	50	60	30	41	43.4
120	39	Moldova	54.9	-3.0	70.1	81.6	85.3	51.3	67.6	30	50	40	28	45.1
134	40	Bosnia and Herzegovina	53.1	-0.8	59.9	77.2	71.8	37.6	79.0	50	60	10	33	52.1
146	41	Russia	50.8	1.0	54.0	60.8	78.9	70.6	65.5	30	40	25	23	60.0
152	42	Ukraine	48.8	-2.2	40.5	84	77.0	39.0	68.1	30	40	30	27	52.4
167	43	Belarus	45.0	-0.4	63.7	67.2	79.4	30.9	66.8	20	10	20	21	70.8
n/a	n/a	Liechtenstein	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

70–79.9 Mostly Free
 60–69.9 Moderately Free

50–59.9 Mostly Unfree
 0–49.9 Repressed

Table 4  heritage.org

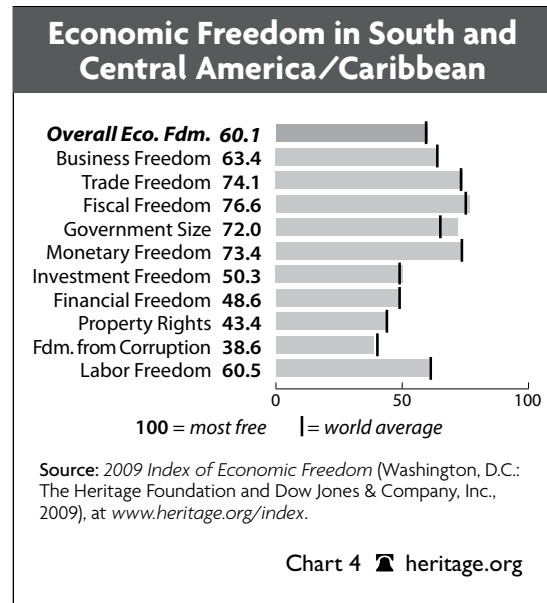
In addition to high transparency and low corruption, Denmark boasts an efficient regulatory regime and independent judiciary. Impressively for a post-Communist state, Georgia is a leader in labor freedom and fiscal freedom because of a combination of low taxes and a highly flexible labor market. Slovenia enjoyed the biggest gain in economic freedom in the Europe region, improving its score by 2.7 points.

Europe has benefited from economic competition over the past years, and around 80 percent of the 43 European countries score between 60 and 80, achieving the status of either “moderately free” or “mostly free.” Only Ukraine and Belarus remain “repressed” with scores below 50.

Overall, Europe has continued to maintain a high level of economic freedom in the 2009 *Index*. Thanks to such policy improvements as tax cuts and other business-friendly reforms by many of the region’s individual economies as they compete with one another to attract more investment, 19 countries have recorded overall score improvements.

SOUTH AND CENTRAL AMERICA/CARIBBEAN

The countries of the South and Central America/Caribbean region range from prosperous Chile and the developing economic colossus of Brazil to the small island economies of the Caribbean Sea. The region, which consists of 29 economies, is one of the world’s most economically diverse and presents a puzzle: Despite strong economic progress in many countries as the result of policy liberalization, governments and even electorates in some countries are turning away from free-market policies and embracing a new populism that looks very much like the old corrupt cronyism that characterized the region before the outbreak of democracy in the 1980s and 1990s. This newly packaged but really old-fashioned authoritarianism, backed by the oil revenue of an increasingly anti-democratic Venezuela, increases the risk, especially in the poorer countries of Central America or the smaller islands of the Caribbean, that econom-



ic freedom and long-term prosperity could be sacrificed for short-term payoffs and political expediency.

The countries in the South and Central America/Caribbean region perform better than the world average in four of the 10 components of economic freedom measured in the *Index*. (See Chart 4.) Corruption and a lack of protection for property rights are the major trouble areas, reflecting long-standing problems of poor governance and weak rule of law.

The typical country in the region stands out positively in terms of limited taxation and government expenditures. The freedom to trade and invest is slightly better protected than in other parts of the developing world.

The region has maintained an overall level of economic freedom that is slightly higher than the global average of 59.5. With its score 2.2 points higher than in the 2008 *Index*, Costa Rica is the most improved country in the region. (See Table 5.) Venezuela has recorded the worst performance, losing almost five points in overall economic freedom.

One of the 29 countries in the South and Central America/Caribbean region ranks among the top 20 in the world: Chile (11th). Indeed, the region’s countries are distributed throughout the rankings in a more balanced fashion than

Economic Freedom in South and Central America/ Caribbean Countries

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
11	1	Chile	78.3	-0.3	66.3	85.8	78.2	90.1	77.3	80	70	90	70	75.0
22	2	Barbados	71.5	0.2	90.0	64.6	70.9	66.3	74.5	50	60	90	69	80.0
27	3	Bahamas, The	70.3	-0.8	74.7	56	96.5	84.4	75.5	40	70	75	50	80.4
33	4	El Salvador	69.8	1.3	67.3	81.8	85.7	87.9	77.4	70	70	50	40	67.5
38	5	Uruguay	69.1	1.2	65.6	83.4	82.2	76.5	72.8	70	30	70	67	73.7
39	6	Saint Lucia	68.8	n/a	87.7	72	74.0	68.5	85.1	40	40	70	68	82.8
41	7	Trinidad and Tobago	68.0	-1.6	60.1	79.8	79.7	75.6	72.2	70	70	60	34	78.3
46	8	Costa Rica	66.4	2.2	60.3	81.8	82.8	88.4	69.7	70	50	50	50	61.2
52	9	Jamaica	65.2	-0.5	87.8	70.6	75.3	62.2	75.4	80	50	50	33	67.4
55	10	Panama	64.7	0.0	74.5	76.2	82.6	89.8	77.9	70	70	30	32	44.1
57	11	Peru	64.6	0.9	65.1	79.4	79.7	91.8	86.5	60	60	40	35	48.7
60	12	Saint Vincent and the Grenadines	64.3	n/a	78.2	73.6	64.7	60.9	75.6	40	40	70	61	78.5
66	13	Belize	63.0	0.0	75.5	69.6	68.8	77.6	78.4	50	50	50	30	80.6
70	14	Dominica	62.6	n/a	76.4	74.2	67.4	52.2	79.8	60	30	60	56	70.0
72	15	Colombia	62.3	0.2	77.4	72.4	72.9	65.9	70.6	60	60	40	38	66.0
79	16	Paraguay	61.0	1.0	61.7	83.6	96.6	90.4	76.7	60	60	30	24	27.0
84	17	Nicaragua	59.8	-1.0	57.6	79.2	78.8	71.0	69.5	70	50	25	26	70.6
87	18	Guatemala	59.4	-0.4	54.1	78.4	79.4	93.5	73.3	50	50	30	28	57.3
88	19	Dominican Republic	59.2	1.5	63.7	73	85.3	91.1	74.1	50	40	30	30	55.1
91	20	Honduras	58.7	-0.2	64.4	78	85.1	79.7	73.5	50	60	30	25	40.9
105	21	Brazil	56.7	0.5	54.4	71.6	65.8	50.3	77.2	50	50	50	35	62.7
125	22	Suriname	54.1	-0.2	41.5	64.2	67.7	75.5	72.2	30	30	40	35	84.8
130	23	Bolivia	53.6	0.5	58.5	81.8	84.8	71.9	67.9	20	60	20	29	41.9
137	24	Ecuador	52.5	-2.8	54.0	72.6	85.8	83.1	75.0	30	40	25	21	38.3
138	25	Argentina	52.3	-1.8	62.1	70	70.3	75.6	60.6	50	40	20	29	45.6
147	26	Haiti	50.5	1.5	37.7	79.4	77.9	93.8	69.0	30	30	10	16	61.2
155	27	Guyana	48.4	-0.4	60.9	72.6	66.5	3.2	69.6	40	40	40	26	65.2
174	28	Venezuela	39.9	-4.8	50.8	59.6	70.6	69.3	53.7	10	30	5	20	30.1
177	29	Cuba	27.9	0.4	10	64.4	45.9	0	67.0	10	10	10	42	20

■ 70–79.9 Mostly Free
■ 60–69.9 Moderately Free

■ 50–59.9 Mostly Unfree
■ 0–49.9 Repressed

Table 5  heritage.org

are the countries of any other region, almost like a bell curve. All but six countries receive an economic freedom score between 50 and 70, and roughly half fall in the middle category of “moderately free.”

MIDDLE EAST/NORTH AFRICA

Stretching from Morocco’s Atlantic shores to Iran and Yemen’s beaches on the Arabian Sea, the Middle East/North Africa region remains central to world affairs. Encompassing some of the world’s most ancient civilizations, the region consists of 17 countries. Unfortunately, many of the economies in this region remain either “moderately free” or “mostly unfree.” Cursed in some ways by enormous natural oil resources, most of the local populations still suffer from extreme concentrations of wealth and poverty.

Despite some progress in recent years, structural problems clearly abound in the region, as the regional unemployment rate, which averages more than 10 percent, is among the highest in the world and is most pronounced among younger members of the labor force. Despite the outflow of crude oil, the actual trade flows of the region’s countries remain relatively low, indicating a lack of economic dynamism. The oil industry requires very little

investment in labor or human capital and only a marginal amount of investment in the land. People need freedom to be productive, but oil does not generate the incentives needed for societies to embrace openness. To the contrary, an abundance of oil seems most often to inspire repression.

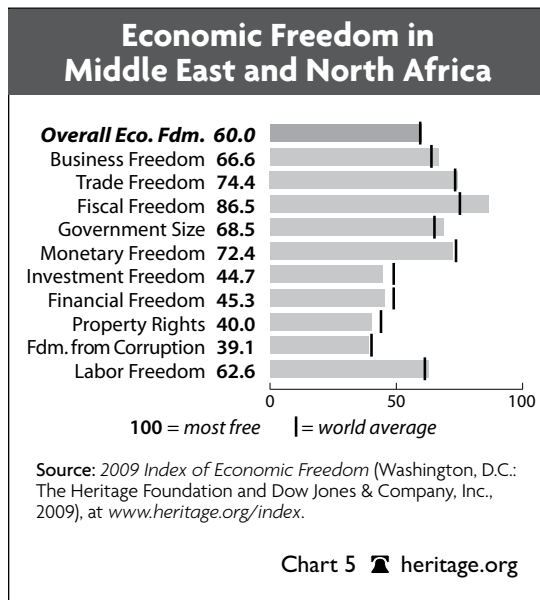
As shown in Chart 5, the region’s overall economic freedom score is slightly above the world average of 59.5, mainly due to a high degree of fiscal freedom that reflects low income and corporate tax rates. However, other institutional problems pose serious impediments to creating more dynamic private sectors and diverse economies. Investment freedom, financial freedom, property rights, and freedom from corruption all score below the world average, holding down the region’s overall economic freedom and its economic potential.

The ongoing transformation of innovative and reform-oriented states like Bahrain, Israel, Oman, Qatar, and the United Arab Emirates (UAE) may pave the way for more robust and dynamic regional economic growth.

As Table 6 shows, scores for over 80 percent of the 17 countries in the region are concentrated between 50 and 70. Syria and Libya made the biggest leaps forward with gains of over four points in economic freedom. In recent years, Syria’s private sector has contributed to steady economic growth, benefiting from reforms in banking, business regulation, and the investment regime.

Bahrain, ranked 16th globally with its economic freedom score of 74.8, is the only Middle Eastern country among the world’s 20 freest economies. It maintains a pro-business environment with low inflation, sound banking and finance systems, and low barriers to trade. Seven other countries ranging from Israel to Saudi Arabia—while politically very different—share a common commitment to economic freedom that is significantly greater than that of other countries in the region.

The lowest-ranking countries are Iran and Libya, bonded together by economic freedom scores that are among the worst in the world.



Economic Freedom in Middle East/North African Countries

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
16	1	Bahrain	74.8	2.6	79.6	80	99.9	79.4	74.0	60	80	60	50	85.1
42	2	Israel	67.6	1.3	67.8	86	57.1	35.1	83.7	80	70	70	61	64.9
43	3	Oman	67.0	-0.3	63.3	83.6	98.5	61.1	71.4	60	60	50	47	75.0
48	4	Qatar	65.8	3.6	75.7	81.6	99.9	69.1	67.3	40	50	50	60	64.7
50	5	Kuwait	65.6	-2.5	67.4	81	99.9	63.7	71.7	50	50	50	43	79.3
51	6	Jordan	65.4	1.3	68.9	78.8	83.0	56.9	80.3	50	60	55	47	74.1
54	7	United Arab Emirates	64.7	2.2	57.4	80.8	99.9	86.3	69.8	30	50	40	57	76.2
59	8	Saudi Arabia	64.3	1.8	79.6	81.8	99.6	73.4	68.4	40	50	40	34	76.4
95	9	Lebanon	58.1	-1.9	60.0	80.8	91.7	64.1	77.3	30	60	30	30	57.4
97	10	Egypt	58.0	-0.5	64.7	63.4	89.5	66.1	65.9	50	50	40	29	61.3
98	11	Tunisia	58.0	-2.1	81.6	53	76.5	78.3	78.4	30	30	50	42	60.1
101	12	Morocco	57.7	2.1	76.2	68	65.1	76.5	80.5	60	50	35	35	30.8
103	13	Yemen	56.9	3.1	74.9	76.2	83.2	57.1	66.5	50	30	30	25	75.8
107	14	Algeria	56.6	0.4	72.5	68.6	77.2	74.1	78.6	50	30	30	30	55.5
141	15	Syria	51.3	4.2	61.4	54	87.0	74.9	67.2	40	20	30	24	54.9
168	16	Iran	44.6	-0.4	60.6	57.4	81.0	79.7	60.1	10	10	10	25	52.4
171	17	Libya	43.5	4.8	20.0	90	81.7	68.1	70.3	30	20	10	25	20.0
n/a	n/a	Iraq	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

70–79.9 Mostly Free
 50–59.9 Mostly Unfree
 60–69.9 Moderately Free
 0–49.9 Repressed

Table 6  heritage.org

ASIA–PACIFIC

With 3.7 billion inhabitants, the Asia–Pacific region contains over half of the world’s population: one-third in China and nearly another third in India. Despite having one of the world’s poorest populations, the Asia–Pacific region has achieved an average annual economic growth rate of around 8 percent over the past five years, largely driven by China, India, and other export-oriented economies.

What sets the Asia–Pacific region apart from other regions is the extraordinary disparity in levels of economic freedom. Four of the world’s 10 freest economies—Hong Kong, Singapore,

Australia, and New Zealand—are in this region, yet most other countries in the region remain “mostly unfree.” Countries such as Turkmenistan, Bangladesh, and Burma have economies that are “repressed.” North Korea remains the least free economy, both in the region and in the world. The region’s overall economic freedom score is below the world average of 59.5.

The Asia–Pacific region, which consists of 41 economies, scores higher than the world average in only two of the 10 economic freedoms: government size and labor freedom. (See Chart 6.) Lower government expenditures result in a regional government size score that is more than five points better than the world average.

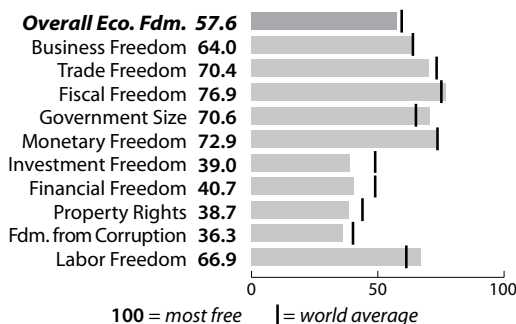
The region's labor freedom score is also better than the world average by five points, although many small Pacific island economies still lack fully developed formal labor markets.

The typical Asian country has notably lower scores in four components: investment freedom, financial freedom, property rights, and freedom from corruption. Asian countries could make the most progress by strengthening their banking and investment institutions and by enhancing transparency and corporate governance.

With the top scores in four of the 10 economic freedoms, Hong Kong once again is the freest economy in the 2009 *Index*. (See Table 7.) Singapore is the top country in labor freedom and second overall, both in the region and in the world. Singapore grants private firms the most flexibility in hiring and firing workers. New Zealand sets the standard for clean, corruption-free government and benefits significantly from its transparent and straightforward business environment.

Two-thirds of the 41 countries in the region

Economic Freedom in Asia–Pacific



Source: 2009 *Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2009), at www.heritage.org/index.

Chart 6 heritage.org

score between 40 and 60 on the economic freedom scale, remaining either “mostly unfree” or “repressed.” In the 2009 *Index*, the scores of 18 countries in the region have improved, while those of 12 are worse. Azerbaijan and Bangla-

Economic Freedom in Asia–Pacific Countries

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
1	1	Hong Kong	90.0	0.3	92.7	95	93.4	93.1	86.2	90	90	90	83	86.3
2	2	Singapore	87.1	-0.2	98.3	90	91.1	93.8	86.8	80	50	90	93	98.1
3	3	Australia	82.6	0.4	90.5	84.8	61.4	64.3	84.7	80	90	90	86	94.7
5	4	New Zealand	82.0	1.2	99.9	84.6	62.5	49.6	84.6	80	80	95	94	89.6
19	5	Japan	72.8	-0.2	85.8	82	67.5	61.1	93.6	60	50	70	75	82.5
21	6	Macau	72.0	n/a	60.0	90	79.3	93.3	80.3	70	70	60	57	60.0
35	7	Taiwan	69.5	-0.7	69.5	85.2	76.2	89.4	82.1	70	50	70	57	45.7
40	8	South Korea	68.1	-0.5	90.4	70.2	70.4	72.5	80.0	70	60	70	51	46.4
58	9	Malaysia	64.6	0.7	70.8	78.2	83.0	81.4	79.9	40	40	50	51	71.5
67	10	Thailand	63.0	0.7	71.1	75.6	74.4	90.6	69	30	60	50	33	76.5

(continued on next page)

- 80–100 Free
- 70–79.9 Mostly Unfree
- 60–69.9 Moderately Free

Table 7 heritage.org

Economic Freedom in Asia–Pacific Countries (continued)

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
69	11	Mongolia	62.8	-0.8	71.0	81.2	81.3	69.9	76.7	60	60	30	30	67.7
74	12	Kyrgyz Republic	61.8	0.7	75.3	87.6	93.4	74.9	71.5	50	50	25	21	69.5
80	13	Fiji	61.0	-0.8	66.0	69.6	76.0	76.0	77.3	30	60	30	40	84.8
83	14	Kazakhstan	60.1	-1.0	57.9	86.2	82.8	87.5	70.0	30	60	25	21	80.5
86	15	Samoa	59.5	n/a	61.5	70	86.2	56.2	75.7	30	30	60	45	80.2
92	16	Vanuatu	58.4	n/a	69.0	63	95.3	84.0	78.7	30	40	40	31	52.6
99	17	Azerbaijan	58.0	2.6	74.6	78.4	79.7	77.5	66.3	30	40	25	21	87.0
100	18	Bhutan	57.7	n/a	61.7	42	83.6	58.3	75.9	30	30	60	50	85.8
102	19	Pakistan	57.0	1.4	72.5	65.6	80.4	90.7	72.2	40	40	30	24	54.5
104	20	Philippines	56.8	0.8	49.3	78.6	75.4	90.8	77.2	40	50	30	25	51.4
106	21	Cambodia	56.6	0.8	42.7	63.4	91.4	94.5	80.0	50	50	30	20	44.5
111	22	Sri Lanka	56.0	-2.4	73.7	71	73.2	80.5	59.4	20	40	40	32	70.8
121	23	Papua New Guinea	54.8	n/a	60.1	87.2	67.4	71.0	81.4	30	30	20	20	81.1
122	24	Tajikistan	54.6	0.2	45.1	82.6	89.3	85.9	63.2	30	40	30	21	58.7
123	25	India	54.4	0.3	54.4	51	73.8	77.8	69.3	30	40	50	35	62.3
126	26	Tonga	54.1	n/a	79.0	56	82.5	58.0	68.9	40	20	20	17	99.4
131	27	Indonesia	53.4	0.2	46.7	76.4	77.5	88.0	71.6	30	40	30	23	50.9
132	28	China	53.2	0.1	51.6	71.4	70.6	88.9	72.9	30	30	20	35	61.8
133	29	Nepal	53.2	-0.9	60.5	63.2	86.3	91.0	78.7	20	30	30	25	46.9
139	30	Micronesia	51.7	n/a	59.8	81	97.4	0.0	76.7	30	30	30	30	82.3
143	31	Maldives	51.3	n/a	83.2	44	95.8	0.0	76.5	30	30	30	33	90.1
145	32	Vietnam	51.0	0.6	61.7	63.4	74.3	77.3	67	30	30	10	26	70.0
148	33	Uzbekistan	50.5	-1.4	68.4	65.4	88.3	68.1	62.6	30	20	20	17	64.9
149	34	Timor-Leste	50.5	n/a	47.0	73	64.7	84.0	74.1	30	20	20	26	66.0
150	35	Laos	50.4	0.1	59.5	66.4	70.6	89.7	75.4	30	20	10	19	63.5
160	36	Bangladesh	47.5	3.3	62.9	40.2	72.8	94.2	67.3	20	20	25	20	52.3
163	37	Solomon Islands	46.0	n/a	67.2	66.4	68.9	0.0	73.5	20	30	30	28	76.3
164	38	Kiribati	45.7	n/a	62.5	55	42.2	0.0	88.7	30	30	30	33	85.6
169	39	Turkmenistan	44.2	0.8	30.0	79.2	90.9	93.6	68	10	10	10	20	30.0
176	40	Burma	37.7	-1.8	20.0	72.2	81.8	98.5	45.3	10	10	5	14	20.0
179	41	North Korea	2.0	-1.0	0.0	0.0	0.0	0.0	0.0	10	0	5	5	0.0
n/a	n/a	Afghanistan	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

- 60–69.9 Moderately Free
- 50–59.9 Mostly Unfree
- 0–49.9 Repressed

Table 7  heritage.org

desh are the region's most improved countries. Burma and Sri Lanka, by contrast, lost the most economic freedom.

India and China are ranked 25th and 28th, respectively, in the region, and both remain "mostly unfree." Despite these seemingly low scores, however, there can be no denying that the winds of change are still blowing in Asia, particularly in these two economic leviathans. Notwithstanding very slow progress, it should be noted that economic freedom has been improving gradually in India and China over the years.

SUB-SAHARAN AFRICA

With annual average economic growth rates of around 6 percent, Sub-Saharan Africa has progressed significantly over the past five years, yet the region continues to be characterized primarily by poverty and instability. Civil wars flare sporadically from the Horn of Africa to the Atlantic Coast. HIV/AIDS is a continuing burden. Mass unemployment is common. Unsurprisingly, with just a fraction of the population of Asia, Sub-Saharan Africa receives more absolute foreign aid, both multilateral and bilateral, than any other region.

Africa's overall level of economic freedom is weaker than that of any other region. Sub-Saharan Africa is ranked last in eight of the 10 components of economic freedom and performs

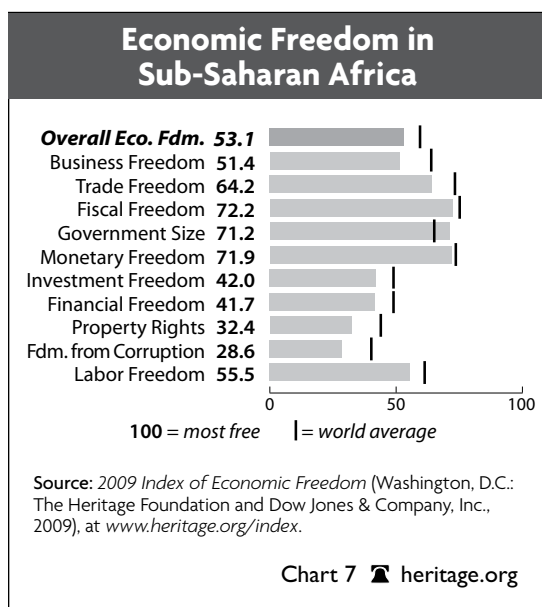
especially poorly in terms of property rights and freedom from corruption. (See Chart 7.)

Some of the gaps between Sub-Saharan Africa's scores and the world averages are especially striking; it lags by over seven points in business freedom and about 11 points in both property rights and freedom from corruption. The single component in which the region scores higher than the world average is government size. However, it is worse than average in terms of fiscal freedom, and the combination of the two scores is likely an indicator of poor government capacity and inefficiency. Labor freedom is restricted, reflecting in part the region's lack of progress in developing modern and efficient labor markets.

Thankfully, there are some success stories. Mauritius remains among the world's 20 freest economies. (See Table 8.) With an economic freedom score of 74.3, it is both the 18th freest economy in the world and the leader in economic freedom in the region. It scores 10 points or more above the global average in eight economic freedoms: trade freedom, investment freedom, property rights, business freedom, freedom from corruption, fiscal freedom, labor freedom, and government size. Mauritius has also demonstrated its strong commitment to enhancing economic freedom by accelerating major tax reforms. Botswana remains the region's second freest economy, followed by South Africa and Uganda.

Unlike other regions that have a more diverse range of "free" economies, in Sub-Saharan Africa there are only distinctions among less free economies. A majority of nations in the region are ranked either "mostly unfree" with scores between 50 and 60 or "repressed" with scores below 50.

With its economic freedom continuing to deteriorate, Zimbabwe recorded the biggest overall score loss in the 2009 *Index*. Zimbabwe's economy has crumbled under the tyrannical and oppressive rule of Robert Mugabe. All components of economic freedom score below or far below the world averages. Causing one of the worst periods of hyperinflation in world history, the government's continuing control of the economy has put the population at great risk.



Economic Freedom in Sub-Saharan African Countries

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
18	1	Mauritius	74.3	1.7	83.3	86.8	92.2	80.8	71.1	80	70	60	47	71.5
34	2	Botswana	69.7	1.5	71.2	69	75.1	70.6	71.8	70	70	75	54	70.0
61	3	South Africa	63.8	0.4	74.6	74.8	68.9	77.6	74.3	50	60	50	51	56.8
63	4	Uganda	63.5	-0.3	58.7	75.2	80.4	86.9	78.4	50	60	30	28	87.9
71	5	Namibia	62.4	1.0	74.4	88.4	67.2	69.7	74.6	40	50	30	45	85.0
73	6	Madagascar	62.2	-0.2	60.5	72.6	80.9	86.3	73.9	70	50	50	32	46.0
77	7	Cape Verde	61.3	3.4	57.1	65.4	65.5	62.2	76.9	60	60	70	49	46.9
85	8	Burkina Faso	59.5	3.8	58.7	70.4	80.7	83.7	83.7	40	50	30	29	69.0
89	9	Swaziland	59.1	0.6	68.6	71.6	64.3	70.6	73.1	50	40	50	33	69.6
90	10	Kenya	58.7	-0.6	66.9	71.8	78.6	81.5	74.0	50	50	30	21	63.1
93	11	Tanzania	58.3	1.8	48.1	75.6	80.6	83.4	73.4	60	50	30	32	49.9
96	12	Ghana	58.1	1.0	56.7	63	83.2	65.7	69.6	50	60	50	37	45.3
108	13	Zambia	56.6	0.4	68.8	71.2	72.9	82.1	64.1	50	50	30	26	51.0
110	14	Senegal	56.3	-2.0	65.0	71.2	65.1	77.0	76.5	40	40	50	36	42.5
112	15	Gambia, The	55.8	-1.1	59.9	59.6	71.9	74.4	71.9	50	50	30	23	67.0
113	16	Mozambique	55.7	0.2	54.2	73.4	77.7	76.5	75.9	50	50	30	28	41.1
114	17	Mali	55.6	0.1	42.2	73	69.4	81.4	79.6	50	40	30	27	63.8
115	18	Benin	55.4	0.1	43.8	67.4	67.2	88.5	79.6	40	60	30	27	50.3
117	19	Nigeria	55.1	0.0	55.1	61.8	84.4	64.3	77.9	30	40	30	22	85.8
118	20	Gabon	55.0	0.9	59.9	57	61.7	84.8	73.8	40	40	40	33	60.0
119	21	Côte d'Ivoire	55.0	1.0	45.8	70.4	58.1	87.6	79.1	40	60	30	21	57.8
124	22	Rwanda	54.2	0.0	58.9	61.2	76.8	76.8	70.8	40	40	30	28	59.5
127	23	Mauritania	53.9	-1.2	53.6	75.6	75.4	65.9	77.7	50	40	25	26	50.2
128	24	Niger	53.8	1.0	36.9	70.4	66.3	88.8	89.5	50	40	30	26	40.6
129	25	Malawi	53.7	1.1	45.2	68.8	70.7	48.6	69.8	50	50	50	27	57.2
135	26	Ethiopia	53.0	0.5	62.6	68.6	77.4	82.7	65.5	40	20	30	24	59.4
136	27	Cameroon	53.0	-1.3	39.3	56	69.6	93.6	76.0	40	50	30	24	51.5
140	28	Djibouti	51.3	0.1	38.1	31.8	80.8	59.4	76.6	50	60	30	29	57.9
142	29	Equatorial Guinea	51.3	-0.3	45.7	59.4	75.5	86.3	81.4	30	40	30	19	46.1
144	30	Guinea	51.0	-1.8	45.2	59.6	71.1	91.9	57.4	40	40	20	19	66.3
151	31	Lesotho	49.7	-2.5	61.7	57	63.1	36.2	73.1	30	40	40	33	62.7
153	32	Burundi	48.8	2.6	34.4	63	72.5	55.8	72.7	40	30	30	25	64.3
154	33	Togo	48.7	-0.2	36.6	70.6	53.7	86.6	81.5	30	30	30	23	44.7

(continued on next page)

■ 70–79.9 Mostly Free
■ 60–69.9 Moderately Free

■ 50–59.9 Mostly Unfree
■ 0–49.9 Repressed

Table 8  heritage.org

Economic Freedom in Sub-Saharan African Countries (continued)

World Rank	Region Rank	Country	Overall Score	Change from 2008	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom from Corruption	Labor Freedom
156	34	Central African Republic	48.3	-0.3	39.5	50.4	65.4	94.0	75.0	40	30	20	20	48.7
157	35	Liberia	48.1	n/a	40.2	53.8	73.8	97.2	70.1	30	20	25	21	49.8
158	36	Sierra Leone	47.8	-0.5	57.0	66	80.9	86.3	73.8	30	20	10	21	33.4
159	37	Seychelles	47.8	n/a	65.5	28.4	73.8	0.0	78.1	50	30	50	45	57.1
161	38	Chad	47.5	-0.4	35.7	58.4	50.5	90.8	78.6	40	40	20	18	42.6
162	39	Angola	47.0	0.1	43.6	72	85.2	62.2	61.8	20	40	20	22	43.5
165	40	Guinea-Bissau	45.4	1.1	24.2	66.8	88.4	49.1	73.5	30	30	20	22	50.5
166	41	Rep. of Congo	45.4	0.0	50.1	55.4	60.2	77.6	73.9	30	30	10	21	45.6
170	42	São Tomé and Príncipe	43.8	n/a	45.1	60	75.0	22.0	61.4	40	30	30	27	48.0
172	43	Comoros	43.3	n/a	46.5	27.2	64.6	88.1	78.9	20	20	30	26	31.8
173	44	Dem. Rep. of Congo	42.8	n/a	34.3	62.2	73.3	85.3	59.5	30	20	10	19	34.5
175	45	Eritrea	38.5	n/a	18.3	69.2	86.4	9.9	59.0	10	20	10	28	73.9
178	46	Zimbabwe	22.7	-6.7	30.8	50.4	44.1	4.6	0	10	10	5	21	51.2
n/a	n/a	Sudan	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

□ 0-499 Repressed

Table 8  heritage.org

Chapter 6

The Countries

This chapter reports data on economic freedom in each of the 183 countries covered in the *Index of Economic Freedom*, including 21 countries added this year to further expand the reach of the publication's economic analysis.¹ Only 179 countries are fully scored and ranked because of data constraints for Afghanistan, Iraq, Sudan, and Liechtenstein. Each graded country is given a score ranging from 0 to 100 for all 10 components of overall economic freedom, and these scores are then averaged (using equal weights) to get the country's final *Index of Economic Freedom* score.

In addition to these scores, the country pages include a brief introduction describing economic strengths and weaknesses and the

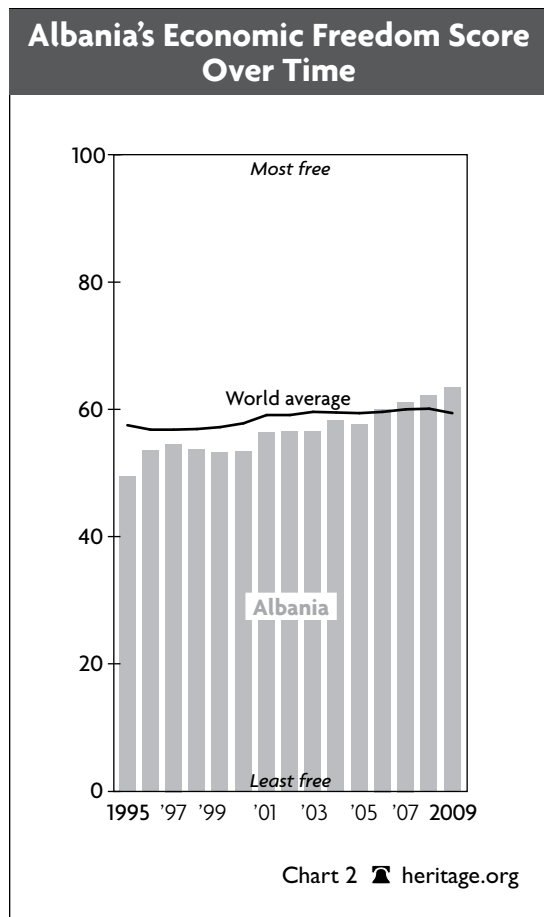
1. The 21 newly added countries are Afghanistan, Bhutan, Comoros, Dominica, Eritrea, Kiribati, Liberia, Liechtenstein, Macao, Maldives, Micronesia, Papua New Guinea, Saint Lucia, Saint Vincent and the Grenadines, Samoa, São Tomé and Príncipe, Seychelles, Solomon Islands, Timor-Leste, Tonga, and Vanuatu.

political and economic background influencing a country's performance, as well as a statistical profile giving the country's main economic indicators. These statistics and their sources are outlined in detail below.

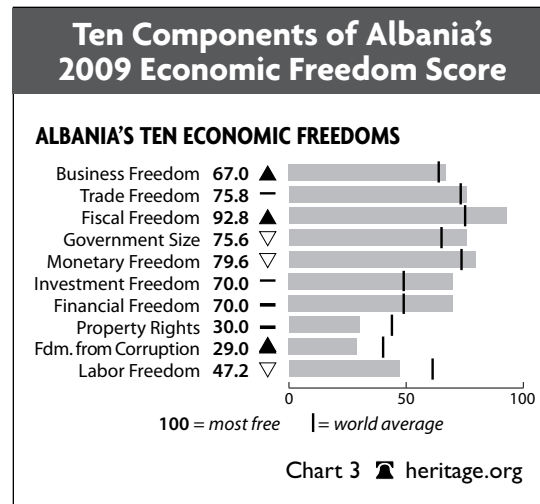
Three charts are included for each country. The first indicates the total economic freedom score earned in the 2009 *Index*. The range of scores, from 0 to 100, is displayed on a 180 degree arc, and a pointer indicates the country's exact score.



The second shows a time series of the country's overall economic freedom score for each year from 1995 (or the earliest year for which data are available) through 2009, compared to the world average. In some cases, a country is not graded continuously for all 15 years, often because grading did not begin in the 1995 edition and frequently because violence, political instability, or natural disaster has resulted in a lack of reliable information.



The third chart graphs the country's 10 freedom component scores for 2009 using horizontal bars. A hash mark is included to show the world average so that one can quickly identify the comparative strengths and weaknesses of economic freedom in each country. Additionally, up or down arrows are placed to illustrate the direction of score changes from the 2008 *Index* to the 2009 *Index*.



The charts for Albania presented here are examples of what the reader will see on each country page.

To assure consistency and reliability for each of the 10 components on which the countries are graded, every effort has been made to use the same source consistently for all countries; when data are unavailable from the primary source, secondary sources are used. (See appendix, "Methodology for the 10 Economic Freedoms.")

DEFINING THE "QUICK FACTS"

Each country page includes "Quick Facts" with eight different categories of information. Unless otherwise indicated, the data in each country's profile are for 2006 (the year for which the most recent data are widely available) and in current 2006 U.S. dollars (also the most recent available). The few cases in which no reliable statistical data were available are indicated by "n/a." Definitions and sources for each category of information are as follows.

Population: 2006 data from World Bank, *World Development Indicators Online*. For some countries, another source is the country's statistical agency and/or central bank.

GDP: Gross domestic product—total production of goods and services—adjusted to reflect purchasing power parity (PPP). The primary source for GDP data is World Bank, *World Development Indicators Online 2008*. The

major secondary source is International Monetary Fund, *World Economic Outlook Database April 2008*. Other sources include a country's statistical agency and/or central bank.

GDP growth rate: Annual percentage growth rate of real GDP derived from constant national currency units, based on country-specific years. Annual percent changes are year-on-year. The primary source is International Monetary Fund, *World Economic Outlook Database April 2008*. Secondary sources include World Bank, *World Development Indicators Online 2008*; Economist Intelligence Unit, *Country Reports, 2007–2008*; Asian Development Bank, *Asian Development Outlook 2008*; and a country's statistical agency and/or central bank.

GDP five-year compound annual growth: The geometric average growth rate measured over a specified period of time. The compound annual growth rate is measured using data from 2001 to 2006, based on real GDP expressed in constant national currency units, based on country-specific years. It is calculated by taking the n th root of the total percentage growth rate, where n is the number of years in the period being considered. The primary source is International Monetary Fund, *World Economic Outlook Database, April 2008*. Secondary sources are World Bank, *World Development Indicators Online 2008*, and Asian Development Bank, *Asian Development Outlook 2008*. In two instances, for Afghanistan and Montenegro, a four-year compound annual growth rate has been used.

GDP per capita: Gross domestic product (adjusted for PPP) divided by total population. The sources for these data are World Bank, *World Development Indicators Online 2008*; International Monetary Fund, *World Economic Outlook Database April 2008*; U.S. Central Intelligence Agency, *The World Factbook 2008*; and a country's statistical agency and/or central bank.

Unemployment rate: A measure of the portion of the workforce that is not employed but is actively seeking work. The primary sources are U.S. Central Intelligence Agency, *The World Factbook 2008*; Economist Intelligence Unit, *Country Reports, 2007–2008*, and *Country Pro-*

files, 2006–2008; International Monetary Fund, *Article IV Staff Reports, 2007–2008*; and a country's statistical agency.

Inflation: The annual percent change in consumer prices as measured for 2007 (or the most recent available year). The primary source for 2007 data is International Monetary Fund, *World Economic Outlook Database, April 2008*. Secondary sources are Economist Intelligence Unit, *Country Reports, 2007–2008*, and *Country Profiles, 2006–2008*; Asian Development Bank, *Asian Development Outlook 2008*; and a country's statistical agency and/or central bank.

Foreign direct investment (FDI) inward flow: This series indicates the total annual inward flow of FDI. Data are in current 2006 U.S. dollars, reported in millions. FDI flows are defined as investments that acquire a lasting management interest (10 percent or more of voting stock) in a local enterprise by an investor operating in another country. Such investment is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments and both short-term and long-term international loans. Data are from United Nations Conference on Trade and Development, *World Investment Report 2007*, and Economist Intelligence Unit, *Country Reports, 2007–2008*, and *Country Profiles, 2007–2008*.

COMMONLY USED ACRONYMS

CIS: Commonwealth of Independent States, consisting of Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

EU: European Union, consisting of Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

IMF: International Monetary Fund, established in 1945 to help stabilize countries during crises, that now includes 185 member countries.

MERCOSUR: Customs union that includes Argentina, Brazil, Paraguay, Uruguay, and Venezuela.

OECD: Organisation for Economic Co-operation and Development, an international organization of developed countries, founded in 1948, that now includes 30 member countries.

SACU: Southern African Customs Union, consisting of Botswana, Lesotho, Namibia, South Africa, and Swaziland.

WTO: World Trade Organization, founded in 1995 as the central organization dealing with the rules of trade between nations and based on signed agreements among 153 member countries.