

BACKGROUND

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2017 Index of Economic Freedom: Trade and Prosperity at Risk

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Abstract

The latest rankings of trade freedom around the world, in the forthcoming 2017 Index of Economic Freedom, once again demonstrate that citizens of countries that embrace freedom to trade are better off than those in countries that do not. The data continue to show a strong correlation between trade freedom and a variety of positive indicators, including economic prosperity and unpolluted environments. Reducing trade barriers remains a proven recipe for prosperity that a majority of Americans support.

The latest rankings of trade freedom around the world, developed by The Heritage Foundation in the forthcoming *2017 Index of Economic Freedom*,¹ once again demonstrate that citizens of countries that embrace trade freedom are better off than those in countries that do not. The data continue to show a strong correlation between trade freedom and a variety of positive indicators, including economic prosperity, low poverty rates, and clean environments.

Worldwide, the average trade freedom score improved just barely over the past year, from 75.6 to 75.9 out of a maximum score of 100. The improvement was due to a small decline in average tariff rates among the countries measured.

Why Trade Freedom Matters

A comparison of economic performance and trade scores in the *2017 Index of Economic Freedom* demonstrates the importance of trade freedom to prosperity and well-being. Countries with the most trade freedom have higher per capita incomes, lower incidences of hunger in their populations, and cleaner environments.

KEY POINTS

- A comparison of economic performance and trade scores in the forthcoming *2017 Index of Economic Freedom* demonstrates the importance of trade freedom for prosperity and well-being.
- Countries with the most trade freedom have higher per capita incomes, lower rates of hunger in their populations, and cleaner environments.
- Openness to trade encourages freedom in general—including protection of private property rights and the freedom of average people to buy what they think is best for their families.
- Current trade policies are being questioned in the United States and around the world, and the volume of world trade is stagnating.
- Despite the relatively weak economy, most Americans are open to the idea of more trade freedom.

This paper, in its entirety, can be found at <http://report.heritage.org/bg3168>

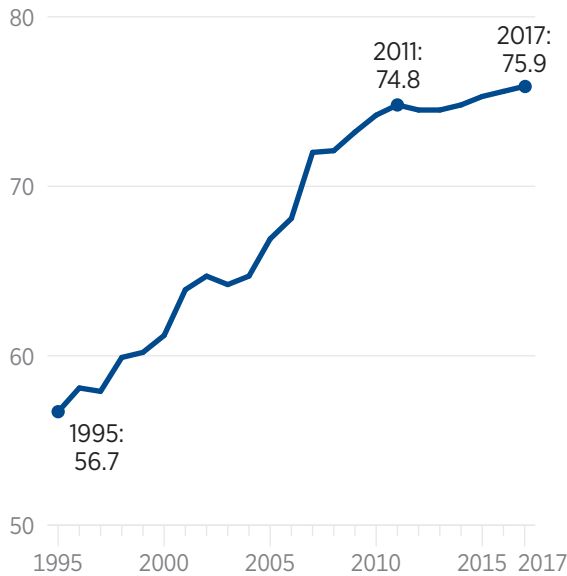
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CHART 1

Average Trade Freedom Scores Show Modest Gains

AVERAGE TRADE FREEDOM SCORE IN THE INDEX OF ECONOMIC FREEDOM



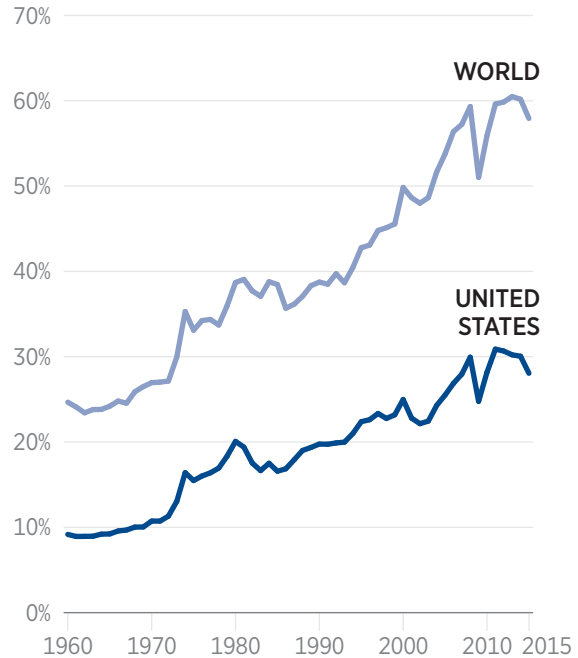
SOURCE: Heritage Foundation calculations from the 2017 Index of Economic Freedom (forthcoming 2017).

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CHART 2

U.S., World Trade Declining

TRADE AS A PERCENTAGE OF GDP



SOURCE: World Bank, "Trade (% of GDP)," <http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS> (accessed October 12, 2016).

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Boosting Trade and Economic Freedom. Since World War II, government barriers to global commerce have been reduced significantly. Today, the average worldwide tariff rate is less than 3 percent. The average world tariff rate has fallen by one-third since the turn of the century alone.² Sixteen countries have an average tariff rate of 1 percent or less.

These countries with low tariffs and few non-tariff barriers benefit from stronger economic growth. But more open trade policies do not just promote economic growth, they encourage freedom—including protection of property rights and the freedom

of average people to buy what they think is best for their families, regardless of attempts by special interest groups to restrict that freedom.

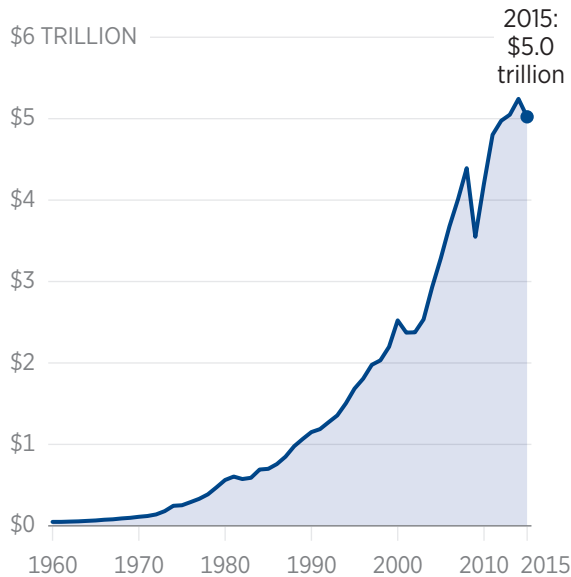
But not all countries have embraced openness to trade. Double-digit tariff rates are applied in 34 countries, and even countries with low average tariff rates often have high tariff peaks for some items. In the United States, for example, the average tariff rate is just 1.4 percent, but pickup trucks face a prohibitive 25 percent tariff, and many types of clothing are subject to double-digit tariffs.³

Threats to Trade. The volume of U.S. and world trade in goods and services plummeted during the

1. See Appendix A.
 2. The World Bank, "Tariff Rate, Applied, Weighted Mean, All Products (%)," <http://data.worldbank.org/indicator/TM.TAX.MRCH.WM.AR.ZS> (accessed October 17, 2016).
 3. U.S. International Trade Commission, "Harmonized Tariff Schedule (2016 HTSA Supplement Edition)," <http://hts.usitc.gov/current> (accessed October 18, 2016).

CHART 3

U.S. International Trade Growth



SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis, International Data, Table 1.1, http://www.bea.gov/iTable/index_ita.cfm (accessed October 12, 2016).

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The recent stagnation in global trade volume and anti-trade rhetoric is cause for concern in many quarters. Consider the following observations:

- International Monetary Fund (IMF): “The slowdown in trade growth since 2012 is largely because of weak growth, but also fewer trade deals and a recent uptick in protectionism.”⁵
- Peterson Institute for International Economics: “[T]he absence of liberalization and the eruption of micro-protection have been major contributors to weak trade and investment performance.”⁶
- WTO Director-General Roberto Azevêdo: “Out of the more than 2,800 trade-restrictive measures recorded...since October 2008, only 25 per cent have been removed. In the current environment, a rise in trade restrictions is the last thing the global economy needs.”⁷
- Center for Economic and Policy Research: “Between 1 January and 31 October 2015, a total of 539 measures were taken by governments worldwide that harmed foreign traders, investors, workers, or owners of intellectual property. In no previous year have we found so many trade distortions so quickly.”⁸

global recession, declining by roughly 20 percent between 2008 and 2009. From 2009 to 2014, U.S. and world trade volume increased by around 50 percent, followed by a 10 percent drop in world trade volume in 2015, along with a 4 percent decline in U.S. trade volume. The World Trade Organization (WTO) predicts an increase in global trade of just 1.7 percent in 2016.⁴

Trade Is for Everyone

There is no doubt that free trade is popular among economists and CEOs. A panel of economic experts was recently asked to respond to the following proposition: “Adding new or higher import duties on products such as air conditioners, cars, and cookies—to encourage producers to make them

4. News release, “Trade in 2016 to Grow at Slowest Pace since the Financial Crisis,” World Trade Organization, September 27, 2016, https://www.wto.org/english/news_e/pres16_e/pr779_e.htm (accessed October 18, 2016).

5. News release, “Keeping the Wheels of Trade in Motion,” International Monetary Fund, September 26, 2016, <http://www.imf.org/en/News/Articles/2016/09/26/NA092716%20Keeping-the-Wheels-of-Trade-in-Motion> (accessed October 18, 2016).

6. Gary Clyde Hufbauer and Euijin Jung, “Why Has Trade Stopped Growing? Not Much Liberalization and Lots of Micro-Protection,” Peterson Institute for International Economics, March 23, 2016, <https://piie.com/blogs/trade-investment-policy-watch/why-has-trade-stopped-growing-not-much-liberalization-and-lots> (accessed October 18, 2016).

7. News release, “Report Urges WTO Members to Resist Protectionism and ‘Get Trade Moving Again,’” World Trade Organization, July 25, 2016, https://www.wto.org/english/news_e/news16_e/trdev_22jul16_e.htm (accessed October 18, 2016).

8. Simon J. Evenett and Johannes Fritz, *The Tide Turns? Trade, Protectionism, and Slowing Global Growth: The 18th Global Trade Alert Report* (London: CEPR Press, 2015), http://voxeu.org/sites/default/files/file/GTA18_final.pdf (accessed October 18, 2016).

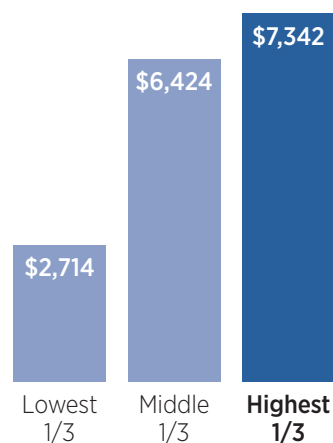
CHART 4

Major Benefits of the Freedom to Trade

The nations of the world are divided into three groups based on their trade freedom score in the *2017 Index of Economic Freedom*. The chart below shows that nations with more trade freedom also have ...

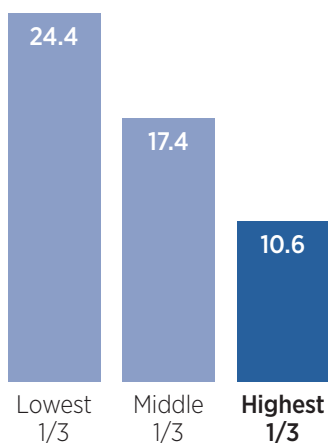
... stronger economies

Average per-capita income



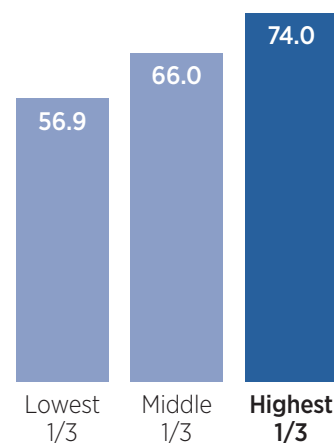
... less hunger

Global Hunger Index (lower scores mean less hunger)



... better environmental performance

Environmental Performance Index (higher scores mean better performance)



TRADE FREEDOM SCORE GROUPS

NOTE: Figures are based on 102 countries.

SOURCES: Heritage Foundation calculations from the *2017 Index of Economic Freedom* (forthcoming 2017) and:

• World Bank, “GNI per Capita, Atlas Method (Current US\$),” <http://data.worldbank.org/indicator/NY.GNP.PCAP.CD> (accessed October 12, 2016).

• International Food Policy Research Institute, “2016 Global Hunger Index,” <http://ghi.ifpri.org/trends/> (accessed October 12, 2016).

• Yale University, “2016 Environmental Performance Index,” <http://www.epi.yale.edu> (accessed October 12, 2016).

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in the US—would be a good idea.” All of the respondents either “disagreed” or “strongly disagreed.”⁹

According to the Business Roundtable, an association of chief executive officers of leading U.S. companies, “Expanding international trade is essential to higher economic growth and creating new jobs.”¹⁰

But support for trade is not limited to economists and CEOs. Despite the relatively weak economy and

an increase in anti-trade rhetoric, most Americans remain open to the idea of expanding trade:

- According to a February 2016 Gallup Poll, 58 percent of Americans view trade as more of an opportunity for the U.S. economy than a threat, versus just 34 percent who viewed trade as more of a threat than an opportunity.¹¹

9. IGM Economic Experts Panel, “Import Duties,” October 4, 2016, <http://www.igmchicago.org/igm-economic-experts-panel> (accessed October 18, 2016).

10. Business Roundtable, “Momentum for America,” 2016, <http://businessroundtable.org/growth> (accessed October 18, 2016).

11. Frank Newport, “Americans Split on Idea of Withdrawing from Trade Treaties,” Gallup, April 28, 2016, <http://www.gallup.com/poll/191135/americans-split-idea-withdrawing-trade-treaties.aspx> (accessed October 18, 2016).

- According to a June 2016 survey from the Chicago Council on Global Affairs, 59 percent of Americans believe international trade is good for the U.S. economy.¹²
- A July 2016 NBC News/*Wall Street Journal* poll found 55 percent of Americans believe trade with foreign countries is good and just 38 percent believe it is bad.¹³
- The Heritage Foundation's American Perceptions Initiative asked, "Which is more important: allowing free trade so companies can buy the inputs they need at a lower cost, low-income families can buy clothing at more affordable prices, and the economy can create new jobs, or allowing Congress to protect some politically connected industries from low-priced imports?" Just 9 percent of Americans chose protectionism.¹⁴

Freedom to Trade Is a Populist Policy

The idea behind freedom to trade is simple: People are better off when they decide for themselves how to spend their money than when politicians or bureaucrats decide for them. This is hardly an elitist point of view.

The *2017 Index of Economic Freedom* shows that people who live in countries with low trade barriers are better off than those who live in countries with high trade barriers. Reducing those barriers remains a proven recipe for prosperity. Governments interested in higher economic growth, less hunger, and better environmental quality should promote freedom, not pander to special interests who want to restrict it.

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12. Dina Smeltz, Craig Kafura, and Lily Wojtowicz, "Actually, Americans Like Free Trade," Chicago Council on Global Affairs, September 7, 2016, <https://www.thechicagocouncil.org/publication/actually-americans-free-trade> (accessed October 18, 2016).

13. Vaughn Ververs, "NBC News/Wall Street Journal July National Poll," Hart Research Associates/Public Opinion Strategies, July 2016, <https://www.scribd.com/document/318518107/NBC-News-Wall-Street-Journal-July-National-Poll> (accessed October 18, 2016).

14. Bryan Riley, "Americans Are Pro-Trade When They Understand the Tradeoffs," The Daily Signal, July 10, 2015, <http://dailysignal.com/2015/07/10/americans-are-pro-trade-when-they-understand-the-tradeoffs/> (accessed October 18, 2016).

APPENDIX TABLE 1

2017 Trade Freedom Scores

NG — Not Graded

Rank	Country	Score	Rank	Country	Score	Rank	Country	Score
1-t	Hong Kong	90.0	63-t	Qatar	83.1	125	Togo	71.3
1-t	Liechtenstein	90.0	63-t	Vietnam	83.1	126	Kosovo	70.8
1-t	Macao	90.0	65-t	Thailand	82.8	127-t	Guyana	70.7
1-t	Singapore	90.0	65-t	Bahrain	82.8	127-t	Samoa	70.7
1-t	Switzerland	90.0	67	Japan	82.6	129	Haiti	70.6
6	Brunei Darussalam	89.1	68-t	Jordan	82.0	130	Malawi	70.5
7	Swaziland	88.9	68-t	France	82.0	131	Rwanda	70.3
8	Mauritius	88.7	68-t	Greece	82.0	132-t	Egypt	70.2
9	Georgia	88.6	71	Colombia	81.6	132-t	Comoros	70.2
10	Canada	88.4	72	Malaysia	81.2	134-t	Mali	70.1
11-t	Israel	88.0	73	Nicaragua	81.0	134-t	Belize	70.1
11-t	Iceland	88.0	74-t	Uruguay	80.6	136	Ecuador	69.7
13-t	Albania	87.7	74-t	Belarus	80.6	137-t	Brazil	69.4
13-t	Norway	87.7	76	Indonesia	80.5	137-t	Sierra Leone	69.4
15-t	Croatia	87.4	77	Cambodia	80.3	139-t	Eritrea	69.2
15-t	New Zealand	87.4	78-t	Armenia	80.2	139-t	Burkina Faso	69.2
17-t	Peru	87.1	78-t	Lesotho	80.2	141	Fiji	68.8
17-t	United States	87.1	80-t	Libya	80.0	142	Benin	68.7
19-t	Guatemala	87.0	80-t	Mexico	80.0	143	Suriname	68.4
19-t	Austria	87.0	80-t	Moldova	80.0	144	Cabo Verde	68.2
19-t	Belgium	87.0	80-t	Timor-Leste	80.0	145-t	Pakistan	67.2
19-t	Bulgaria	87.0	80-t	Turkmenistan	80.0	145-t	Kenya	67.2
19-t	Cyprus	87.0	85	Tonga	79.7	147	Uzbekistan	66.8
19-t	Czech Republic	87.0	86	South Korea	79.5	148	Argentina	66.7
19-t	Denmark	87.0	87	Turkey	79.4	149	Niger	66.4
19-t	Estonia	87.0	88	Kuwait	78.7	150-t	Guinea-Bissau	65.2
19-t	Finland	87.0	89	Trinidad and Tobago	78.6	150-t	St. Vincent & Grenadines	65.2
19-t	Germany	87.0	90	Kazakhstan	78.5	152-t	Ethiopia	65.1
19-t	Hungary	87.0	91	Honduras	78.4	152-t	Ghana	65.1
19-t	Ireland	87.0	92-t	Uganda	78.3	154	Gambia	65.0
19-t	Italy	87.0	92-t	Zambia	78.3	155	Dem. Rep. Congo	64.6
19-t	Latvia	87.0	94	Saudi Arabia	78.2	156	Cuba	64.5
19-t	Lithuania	87.0	95	Madagascar	78.0	157	Tunisia	63.8
19-t	Luxembourg	87.0	96-t	Panama	77.8	158	Bangladesh	63.6
19-t	Malta	87.0	96-t	Serbia	77.8	159	Algeria	63.3
19-t	Netherlands	87.0	98	South Africa	77.3	160	Nepal	63.1
19-t	Poland	87.0	99	Dominican Republic	77.0	161-t	Nigeria	62.3
19-t	Portugal	87.0	100	Mozambique	76.7	161-t	Mauritania	62.3
19-t	Romania	87.0	101	Paraguay	76.6	163	Barbados	62.2
19-t	Slovak Republic	87.0	102	Philippines	76.4	164	Gabon	61.8
19-t	Slovenia	87.0	103-t	Bolivia	76.0	165	Guinea	61.2
19-t	Spain	87.0	103-t	Tanzania	76.0	166	Venezuela	60.7
19-t	Sweden	87.0	105-t	Kyrgyz Republic	75.3	167	Bhutan	60.0
19-t	United Kingdom	87.0	105-t	Jamaica	75.3	168	Kiribati	58.2
45	Bosnia and Herzegovina	86.6	107	Russian Federation	75.2	169	Angola	56.7
46	El Salvador	86.5	108	Mongolia	74.9	170	Syria	56.6
47	Chile	86.4	109	Laos	74.6	171	Central African Republic	55.2
48-t	Australia	86.2	110	Sri Lanka	74.5	172	Djibouti	54.9
48-t	Taiwan	86.2	111	Azerbaijan	74.4	173	Chad	54.7
50	Macedonia	86.1	112-t	Burma	74.2	174	Iran	54.5
51	Ukraine	85.9	112-t	Burundi	74.2	175	Equatorial Guinea	53.8
52	Micronesia	85.6	114-t	Vanuatu	73.9	176	Cameroon	53.4
53	Papua New Guinea	85.4	114-t	Tajikistan	73.9	177	Zimbabwe	52.8
54	Oman	85.2	116	China	73.6	178	Rep. Congo	52.2
55-t	Montenegro	84.7	117	Senegal	73.1	179	Bahamas	50.6
55-t	Costa Rica	84.7	118	Solomon Islands	73.0	180	Sudan	50.5
57	Lebanon	84.4	119	Liberia	72.8	181	Maldives	47.8
58	Morocco	84.0	120-t	Dominica	72.6	—	Afghanistan	NG
59	Botswana	83.8	120-t	India	72.6	—	Iraq	NG
60-t	United Arab Emirates	83.5	122	Côte d'Ivoire	72.3	—	North Korea	NG
60-t	Namibia	83.5	123	São Tomé and Príncipe	71.8	—	Somalia	NG
62	Seychelles	83.4	124	Saint Lucia	71.6	—	Yemen	NG

SOURCE: Heritage Foundation calculations from the 2017 *Index of Economic Freedom* (forthcoming 2017).

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Appendix B: Methodology

The trade freedom scores reported in this *Background* are based on two variables: trade-weighted average tariff rates 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 equation:

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

where Trade Freedom_i represents the trade freedom in country i , Tariff_{\max} and Tariff_{\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, and the upper bound was set as a score of 50. NTB_i , 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:

- **Penalty of 20.** NTBs are used extensively across many goods and services or impede a significant amount of international trade.
- **Penalty of 15.** NTBs are widespread across many goods and services or impede a majority of potential international trade.
- **Penalty of 10.** NTBs are used to protect certain goods and services or impede some international trade.
- **Penalty of 5.** NTBs are uncommon, protecting few goods and services, with very limited impact on international trade.
- **No penalty.** NTBs are not used to limit international trade.

Both qualitative and quantitative data are used to determine the extent of NTBs in a country's trade policy regime. Restrictive rules that hinder trade vary widely, and their overlapping and shifting nature makes gauging their complexity difficult. The categories of NTBs considered in the trade freedom penalty include:

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

As an example: Brazil received a trade freedom score of 69.4. By itself, Brazil's weighted average tariff of 7.8 percent would have yielded a score of 84.4, but the existence of NTBs in Brazil reduced its score by 15 points.

Gathering data on tariffs to make a consistent cross-country comparison can be a challenging task. Unlike data on inflation, for instance, some countries do not report their weighted average tariff rate or simple average tariff rate every year. To preserve consistency in grading trade policy, the authors use the World Bank's most recently reported weighted average tariff rate for a country. If another reliable source reported more updated information on a country's tariff rate, the authors note this fact and may review the grading if strong evidence indicates

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. 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. In the very few cases in which data on duties and customs revenues are not available, the authors use international trade tax data 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 factor. When none of this information is available, the authors simply analyze the overall tariff structure and estimate an effective tariff rate.

The trade freedom scores for 2017 are based on data for the period covering the second half of 2015 through the first half of 2016. To the extent possible, the information is current as of June 30, 2016. Any changes in law effective after that date have no positive or negative impact on the 2017 trade freedom scores.

Finally, unless otherwise noted, the authors use the following sources to determine scores for trade policy, in order of priority:

1. The World Bank, *World Development Indicators 2016*.
2. The World Trade Organization, *Trade Policy Review, 1995–2016*.
3. Office of the U.S. Trade Representative, *2016 National Trade Estimate Report on Foreign Trade Barriers*.
4. The World Bank, *Doing Business 2015* and *Doing Business 2016*.
5. U.S. Department of Commerce and U.S. Department of State, *Country Commercial Guide, 2011–2016*.
6. Economist Intelligence Unit, *Country Commerce, 2016*.
7. World Economic Forum, *The Global Enabling Trade Report 2014*.
8. Official government publications of each country.