



Index of Economic Freedom: Lessons for Chile

There are three lessons from the 2011 Index that we should consider in the light of the reforms expected for this year: the countries with most free economies have higher per capita incomes, the countries that control their government spending have higher average growth rates than those with excessive public spending and, finally, there is a clear relationship between economic freedom and prosperity of individuals.

This week, the Index of Economic Freedom, version 2011, prepared by The Heritage Foundation, The Wall Street Journal and a think tank network, including Libertad y Desarrollo, was published. The report has good news for the world: despite the strong financial and economic crisis suffered recently, the countries did not close but rather advanced to strengthen their economic freedom. Thus, 117 from 183 studied countries improved their scores in relation to 2010, and the global average slightly rose in spite of the fact that data were collected when the global scenario was still suffering turbulences.

With regard to Chile, our country occupies the 11th place in the general ranking, leading in South and Central America, and the Caribbean. Chile's score is 77.4, slightly improved from the 77.2 registered in 2010. Our country decreased in 3 of 10 parameters measured by the Index. In particular, it descended in the public spending level in relation to the GDP, corruption presence and minimum wage increases exceeding overall productive growth.

Nevertheless, Chile improved in the item measuring the overall regulatory framework for entrepreneurial activity, and the reduction of the inflation pressure was positively rated. In issues concerning trade freedom, financial freedom and investment freedom, and also property rights protection, our country kept its 2010 score.

Chile's overall score places it as a "mostly free economy", ranging from 70 to 79.9 points, since a score over 80 is that of a free economy. Hong Kong, which has managed to keep, for seventeen consecutive years, its status of the freest country in the world, obtained this time an overall score of 89.7. Only five other countries have a score over 80: Singapore, Australia, New Zealand, Switzerland and Canada.

Despite its leadership in South and Central America, and the Caribbean, Chile is still behind other economies such as New Zealand, having comparable levels of trade freedom, investment freedom and property rights protection. However, we still have a long way to go in business freedom, labor freedom and freedom from corruption, which can be explained by the existence of regulations in several industries, a labor market which is still rigid, and furthermore, regulations and increases concerning the minimum wages have exceeded the average productivity increase in the economy.

A Glance at the Latin American Context

In relation to other countries of Latin America and the Caribbean, Uruguay is 33 in the ranking, El Salvador, 39; Peru, 41; Colombia, 45; Mexico, 48 and Costa Rica, 49. On the other hand, and under place 100 but over place 150, are: Brazil, 113; Argentina, 138 and Bolivia, 147. Finally, and among the group of the less free in the world are Ecuador, with a score of 158, Venezuela with 175, and Cuba with 177, the latter only surpassed by Zimbabwe and North Korea.

Among the countries showing this year a substantial increase in their overall score are Colombia, Peru and Mexico. On the other hand, among those who slightly descended are Brazil and Argentina, while Bolivia, Ecuador and Venezuela strongly descended in the ranking.

Although Chile is the leader in Latin America and the Caribbean in terms of the overall score, this is not so when analyzing specific features; for example, in business freedom issues, Chile is surpassed by Peru, Colombia and Mexico. In fiscal freedom and public spending issues, the same happens with El Salvador, Peru and Costa Rica. In monetary freedom matters, Chile is behind El Salvador and Peru, while in labor freedom, it is surpassed by Uruguay and Colombia.

Table 1

INDEX OF ECONOMIC FREEDOM FOR THE
OTHER LATIN AMERICAN COUNTRIES

	2010	2011
Uruguay	69.8	70.0
El Salvador	69.9	68.8
Peru	67.6	68.6
Colombia	65.5	68.0
Mexico	68.3	67.8
Costa Rica	65.9	67.3
Panama	64.8	64.9
Paraguay	61.3	62.3
Guatemala	61.0	61.9
Dominican Republic	60.3	60.0
Nicaragua	58.3	58.8
Honduras	58.3	58.6
Brazil	55.6	56.3
Haiti	50.8	52.1
Argentina	51.2	51.7
Bolivia	49.4	50.0
Ecuador	49.3	47.1
Venezuela	37.1	37.6
Cuba	26.7	27.7

Source: Index of Economic Freedom, 2011

Chile's place in the ranking must be considered with prudence, because in the scores' recent evolution, we observe certain alert signals which could threaten our leading country condition in economic freedom issues.

It is necessary to give a methodological explanation on the construction of this Index before detailing these alert signals. The inputs required by the Index are mostly "tough" data obtained beforehand. For example, in the 2011 ranking, tough data correspond to 2009; in the item "Freedom from Corruption", the report of Transparency International is used, which was published in November 2009, although the 2010 ranking is already available. The qualitative features, which are less relevant, are "closed" by September 2010.

Once we have cleared this point, it is interesting to analyze the behavior of the Index of Economic Freedom for Chile since 2008 until the present days – constructed with 2006 tough figures and qualitative features by September 2007 – concerning the average performance of Latin America, emerging Asia and the world in the same period. 2008 has been chosen for this purpose since, according to the Heritage Foundation, it was the year when the world and Chile achieved their highest overall score.

Chile descended in the ranking of the Index of Economic Freedom between 2008 and 2011 together with other six countries of Latin America and the Caribbean, from a total of 20. But what calls our attention is that the global average during the same period descended less than in Chile (-0.5 versus -1.2 points respectively) and, on the other hand, in Latin America and the Caribbean a 0.2 point increase of the Index of Economic Freedom was registered between 2008 and 2011. In the last four years ending by September 2010, it is evident that Chile lost relative positions in the Latin American context. Not to mention the emerging Asian countries; this increased their average index by 0.9 points in the same period.

In Latin America and the Caribbean, in the period 2008-2011, the countries which progressed more in economic freedom matters were Colombia and Peru, in that order, while the countries with worst performance were Ecuador and Venezuela. Moreover, Colombia was the country showing the fifth greatest global progress in that period, and Peru followed closely; a fact which is consistent with the financial and commercial interest shown by Chilean investors.

The outcomes of the 2011 Index are a warning both for those who thought they had faced extraordinarily well the aftereffects of the recent international financial crisis and those who have now the huge responsibility of definitely “paving” the road towards the development of our country.

Lessons for the Future

In general terms, the ranking teaches us certain lessons with regard to the coming and future reforms taking place in Chile.

In the first place, *the countries with most free economies have higher per capita incomes*. This ranking makes it evident that within each of the 5 studied regions, this premise is fulfilled. For example, in Pacific Asia, the freest countries have a per capita income 15 times higher

than the least free countries: the 5 most free economies average US\$44 thousand per capita, while the 5 least free, only US\$3 thousand per capita. In the case of America, the 5 most free have an average GDP per capita over US\$24 thousand, while the 5 least free ones do not reach US\$9 thousand. Although it may seem politically hard, the fact of regulating at the slightest polemic and distributing instead of giving opportunities makes the countries poorer.

Second, *the countries that control their government spending have higher average growth rates than those with excessive public spending.* The difference between those who registered the best scores in the item called “government spending control” and those who had the worst scores, accounts for 4.5 annual percentage points of GDP growth. In this perspective, the fiscal austerity efforts shown by the Chilean government will derive benefits, and it is imperative to continue in this direction, in spite of the pressures that will come due to the high copper prices.

Third, *there is a clear relationship between economic freedom and overall individual prosperity.* The Heritage Foundation crossed the ranking of Economic Freedom with an index of the Legatum Institute which measures prosperity in the world’s different countries. The result was clear: the countries with more economic freedom are better places to live in.

To bear this in mind is a key factor when facing the ambitious changes in public policies announced by the government for 2011.