

## Index of Economic Freedom

The Index of Economic Freedom is an annual index published and created by the Heritage Foundation and the Wall Street Journal to measure the economic freedom of the nations around the world.

Economic Freedom Index 2021 has been published by the Heritage Foundation in March 2021.

Singapore topped the list while India ranked 26th in the Asia-Pacific region while ranking 121 overall.

This article will give details about the Index of Economic Freedom within the context of the IAS Exam

### Overview of Economic Freedom Index

The creation of the index is based around economist Adam Smith's theories in 'The Wealth of Nations'. One of them states that the "basic institutions that protect the liberty of individuals to pursue their own economic interests result in greater prosperity for the larger society".

As per the index, the score of economic freedom has increased by 2.6 points in 2008, a significant jump since its creation in 1995. In 2011, however, the score did reduce to 59.7 from its 2008 score of 60.2. Overall the Economic Freedom Score showed improvement for about 117 countries most of which were mainly developing and emerging market economies

### Methodology of the Economic Freedom Index

The methodology of Index of Economic Freedom is divided into four categories of which there are 12 aspects. They are as follows:

#### 1. Rule of Law

- A. Property Rights: The extent of a country's ability to legally protect the property rights of an individual.
- B. Judicial effectiveness: The extent of the efficiency and fairness of the judiciary when it comes to dealing with property laws
- C. Government Integrity: It examines how strong the government is and how prevalent practices such as bribery, extortion, nepotism, cronyism, patronage, embezzlement, and graft.

#### 2. Government size

- A. Tax Burden: Analyzes marginal tax rates on personal and corporate income and the overall taxation level - including direct tax and indirect tax - as a percentage of the GDP.

- B. Government spending: Analyzes the quantity of government expenditures and its resulting burden. It consists of consumption by the state and all transfer payments related to various entitlement programs.
- C. Fiscal health: It examines how well a nation manages its budgets by quantifying growing debt and deficit.

### 3. Regulatory Efficiency

- A. Business Freedom: Analyses the cost, time and freedom to open, operate and close a business, taking into consideration factors like electricity.
- B. Labour Freedom: Quantifies the intrusiveness of labor rights such as minimum wage, laws inhibiting layoffs, severance requirements, and measurable regulatory restraints on hiring and hours worked, plus the labor force participation rate.
- C. Monetary freedom: Examines how stable are prices and how much microeconomy intervenes.

### 4. Market openness

- A. Trade freedom: Quantifies the extent to which tariff and nontariff barriers affect imports and exports of goods and services into and out of the country.
- B. Investment freedom: Analyses how free or constrained is the flow of investment capital of individuals and firms.
- C. Financial Freedom: Indicates banking efficiency as well as how independent the government is from the financial sector.

## Rankings of the Economic Freedom Index 2021

The Rankings of the top 10 countries with their score is given in the table below:

Economic Freedom Index 2021			
Country	Rank	Score	Change in Rankings
Singapore	1	89.7	0.3
New Zealand	2	83.9	0.2

Australia	3	82.4	0.2
Switzerland	4	81.9	0.1
Ireland	5	81.4	0.5
Taiwan	6	78.6	1.5
United Kingdom	7	78.4	0.9
Estonia	8	78.2	0.5
Canada	9	77.9	0.3
Denmark	10	77.8	0.5

The Rankings of the SAARC nations for 2021 is given in the table below:

<b>Economic Freedom Index 2021 (SAARC)</b>			
Country	Rank	Score	Change in Rankings
Bhutan	109	58.3	3.8
Bangladesh	121	55.6	0.1
India	121	56.5	0.0
Sri Lanka	131	55.7	1.7
Afghanistan	146	53.0	1.7
Pakistan	152	51.7	3.1
Nepal	157	50.7	3.5

## Criticism of Economic Freedom Index

There has been consistent criticism regarding the methodology used in the Index of Economic Freedom. The main focus of the issue is the assumption that economic openness is the prerequisite for economic development. It has been pointed out that countries with good ratings like Switzerland and Uruguay had lukewarm economic growth while ones with poor ratings like China has had very strong economic growth

The UAE questioned the rating of their country's economic freedom in 2008, comparing its middling rating with the high rating they had received from other indicators such as Transparency International

and Moody's. They also argued that the report is "unreliable", because its methodology had changed twice in the last two years.