

Background

No. 2472
September 29, 2010



Published by The Heritage Foundation

Trade Freedom Continues to Advance—Barely

Bryan Riley and Ambassador Terry Miller

Abstract: *The Heritage Foundation began ranking trade freedom around the world in 1995. The newest rankings (to appear in the 2011 Index of Economic Freedom) show global trade freedom as high as it has ever been. That is encouraging: Countries with higher levels of trade freedom have higher levels of economic prosperity. Still, the latest average score showed only a slight improvement, and far too many people continue to live in poverty because their political leaders have blocked attempts at opening paths to freer trade. Countries should reduce trade barriers that protect politically powerful elites at the expense of the general population. More free trade leads to higher incomes, more jobs, and greater equality. Heritage Foundation trade policy experts Bryan Riley and Ambassador Terry Miller lay out the facts.*

The 2011 rankings of trade freedom around the world, developed by The Heritage Foundation as part of its annual *Index of Economic Freedom*, show average trade freedom at its highest level to date.¹ Since 1995, the average score out of a possible 100 has grown from 56.7 to 74.8—an impressive 31.9 percent improvement over the 17-year period. The average score improved 0.6 point from the 2010 rankings, a significant achievement given the worldwide recession from which most countries were emerging. (See Chart 1.)

The continuing commitment to trade liberalization is good news. Countries with the highest levels of

Talking Points

- Trade freedom scores are at their highest since The Heritage Foundation began its ranking in 1995. The average score (out of a possible 100) has grown from 56.7 to 74.8—an impressive 31.9 percent improvement.
- Despite the recent recession, many countries have continued to liberalize trade, with the average trade-freedom score improving from 74.2 in 2010 to 74.8 in 2011.
- Over the past 10 years, 142 countries have improved their trade scores; only 11 have regressed.
- Institutions like the World Trade Organization have succeeded in maintaining reductions in trade barriers: During times of economic distress, countries have largely maintained their free-trade commitments instead of retreating to Depression-era trade policies.
- Countries with the highest per capita GDP, lowest poverty rates, and least income inequality all have above-average trade-freedom scores.

This paper, in its entirety, can be found at:
<http://report.heritage.org/bg2472>

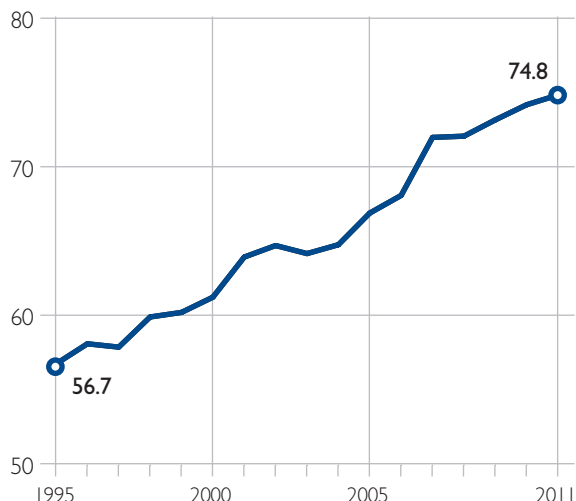
Produced by the Center for International
Trade and Economics (CITE)

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002-4999
(202) 546-4400 • heritage.org

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Trade Freedom Scores Continue to Rise

Average Trade Freedom Score in the *Index of Economic Freedom*



Source: Heritage Foundation calculations.

Chart 1 • B 2472 heritage.org

Trade Freedom Scores—Top Ten Winners and Losers

Countries Showing the Ten Highest Gains and Losses in Trade Freedom Scores from 2010 to 2011

Gaining Freedom		Losing Freedom	
Country	Score Change	Country	Score Change
Djibouti	+27.7	Kyrgyz Republic	-12.7
Syria	+11.4	Honduras	-6.7
Rwanda	+10.4	Albania	-6.0
Burundi	+10.2	Iran	-5.4
Sri Lanka	+10.0	Kazakhstan	-5.0
Côte d'Ivoire	+7.9	Haiti	-4.3
Mozambique	+6.5	Indonesia	-4.1
Yemen	+5.5	Niger	-3.9
Guinea-Bissau	+5.4	India	-3.7
Bosnia and Herzegovina	+5.2	Chad	-2.8

Source: Heritage Foundation calculations.

Table 1 • B 2472 heritage.org

trade freedom have the most wealth, the lowest poverty rates, and the lowest levels of income inequality.

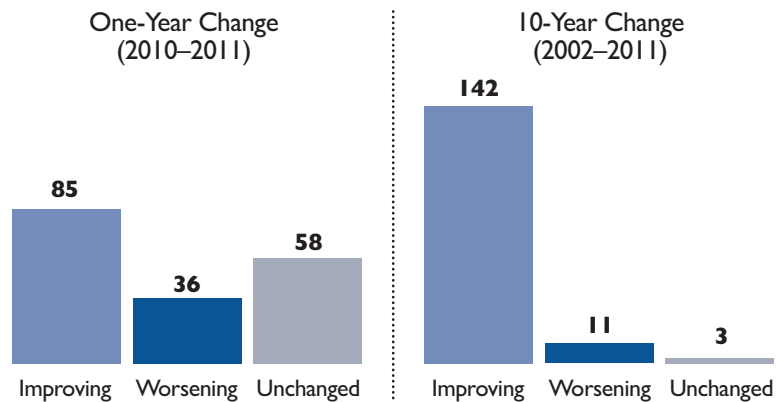
Trade Freedom Trends

More Countries Improving than Not. In the 2011 *Index*, 85 countries improved their scores and 58 countries declined, resulting in a “gainers to losers” ratio of 2.36 to 1. Countries whose scores changed by at least one full point demonstrated a similar trend, with 39 countries improving and 18 regressing.

For the past 10 years, gainers outpaced losers by a ratio of 12.9 to 1. Only 11 countries had declining trade scores, and just three countries have lower trade scores now than

More Nations Show Gains in Trade Freedom

Nations With Improving or Worsening Trade Freedom Scores



Source: Heritage Foundation calculations.

Chart 2 • B 2472 heritage.org

1. The 2011 *Index of Economic Freedom* will be published in January 2011. The trade freedom rankings, which account for 10 percent of a country’s overall economic freedom score, were released early at the request of the Millennium Challenge Corporation (MCC), which uses them as part of its criteria for determining countries’ eligibility for MCC grants.

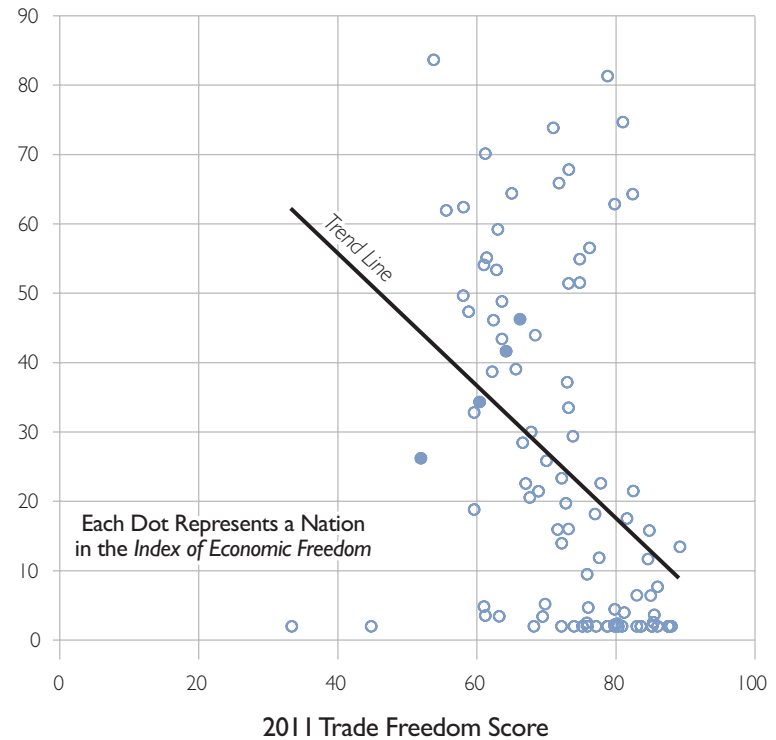
they did in 1995: Haiti, Venezuela, and Zimbabwe.

More Trade Freedom = Less Poverty. The World Bank provides poverty rates for 120 countries based on the percentage of the population who earn less than \$1.25 per day.² The 10 countries with the highest percentage of people living in poverty have an average freedom score of only 70.3 in the 2011 *Index*. By contrast, the 31 countries with the lowest poverty levels have an average trade freedom score nearly 10 points higher, at 79.9. The lesson here is that reducing trade barriers reduces poverty. (See Chart 3.)

More Trade Freedom = More Equality. Many critics of international trade contend that globalization leads to a greater level of income inequality. They appear to have things backwards. The World Bank ranks 149 countries based on the percentage of national income earned by the richest 10 percent of the population. The 10 countries with the highest concentration of income in the hands of the richest 10 percent of the population have an average trade freedom score of 70.2.³ The 10 countries with the least concentration of income in the hands of the richest 10 percent of the population have an average trade freedom score of 84.1. This comparison suggests that opponents of income inequality should advocate more trade freedom. (See Chart 4.)

Nations With Greater Trade Freedom Have Significantly Less Poverty

Percent of Population Earning Less than \$1.25 per Day



Sources: Heritage Foundation calculations, and The World Bank, "Poverty Gap at \$1.25 a Day (PPP) (%)," at <http://data.worldbank.org/indicator/SI.POV.GAPS> (September 15, 2010).

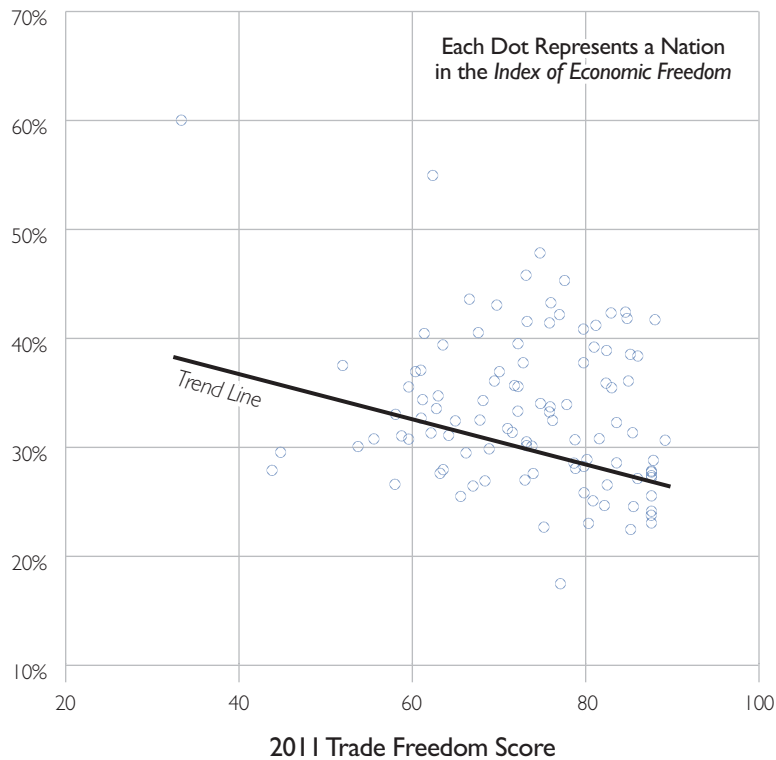
Chart 3 • B 2472  heritage.org

More Trade Freedom = More Money in People's Pockets. The world's 10 poorest countries as measured by per capita gross domestic product (GDP) have an average trade score of 64.5.⁴ The 10 countries with the highest per capita GDP have an average trade score of 87.0, more than 20 points

2. The World Bank, "Poverty Gap at \$1.25 a Day (PPP) (%)," 2010, at <http://data.worldbank.org/indicator/SI.POV.GAPS> (September 15, 2010).
3. The World Bank, "Income Share Held by Highest 10%," 2010, at <http://data.worldbank.org/indicator/SI.DST.10TH.10> (September 15, 2010).
4. The World Bank, "GDP Per Capita (Current US\$)," 2010, at <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD> (September 15, 2010).

Trade Freedom Fosters Income Equality

Income Share Held by Highest 10 Percent



Sources: Heritage Foundation calculations, and The World Bank, "Income Share Held by Highest 10%," at <http://data.worldbank.org/indicator/SI.DST.10TH.10> (September 15, 2010).

Chart 4 • B 2472  heritage.org

higher. These numbers support the widely accepted view among economists that free trade boosts economic growth. (See Chart 5.)

Ratcheting Down Trade Barriers

In 1947, 23 countries formed the General Agreement on Tariffs and Trade (GATT) as a forum to reduce trade barriers and to mediate disputes

between trading partners.⁵ Over the years, GATT members have reduced tariff and non-tariff trade barriers, and more countries have joined. In 1995, GATT became the World Trade Organization (WTO), with 128 member countries. Today there are 153 WTO members, with 31 "observer" nations interested in joining.⁶

WTO members are held to the high standards of global trade agreements, and are allowed to negotiate additional bilateral or regional free trade agreements (FTAs) and customs unions with even lower internal trade barriers than required for WTO membership. More than 200 of these regional trade agreements exist today.⁷

These institutions and agreements have helped prevent a replay of the global trade collapse that contributed to the Great Depression. In 1930, Congress passed the Smoot-Hawley Tariff Act in response to the U.S. economic crisis. Imposing new tariffs on 20,000 products ignited an international trade war as other countries retaliated by imposing tariffs on U.S.-made products, and worldwide trade declined by two-

thirds.⁸ These protectionist policies contributed to a decade of destroyed jobs and ruined lives.

Today, in contrast to the unconstrained protectionist free-for-all of the 1930s, the formal trade liberalization commitments and agreements embodied in organizations like the WTO help counter protectionist pressure on countries to impose new trade barriers in response to economic downturns. The

5. The World Trade Organization, "The GATT Years: From Havana to Marrakesh," at http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm (September 15, 2010).
6. The World Trade Organization, "Members and Observers," July 23, 2008, at http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm (September 15, 2010).
7. The World Trade Organization, "List of all RTAs," at <http://rtais.wto.org/UI/PublicAllRTAList.aspx> (September 15, 2010).
8. James Jay Carafano, "'Buy America' is Bad for National Security," *Heritage Foundation Commentary*, August 18, 2009, at <http://www.heritage.org/Research/Commentary/2009/08/Buy-America-is-bad-for-national-security>.

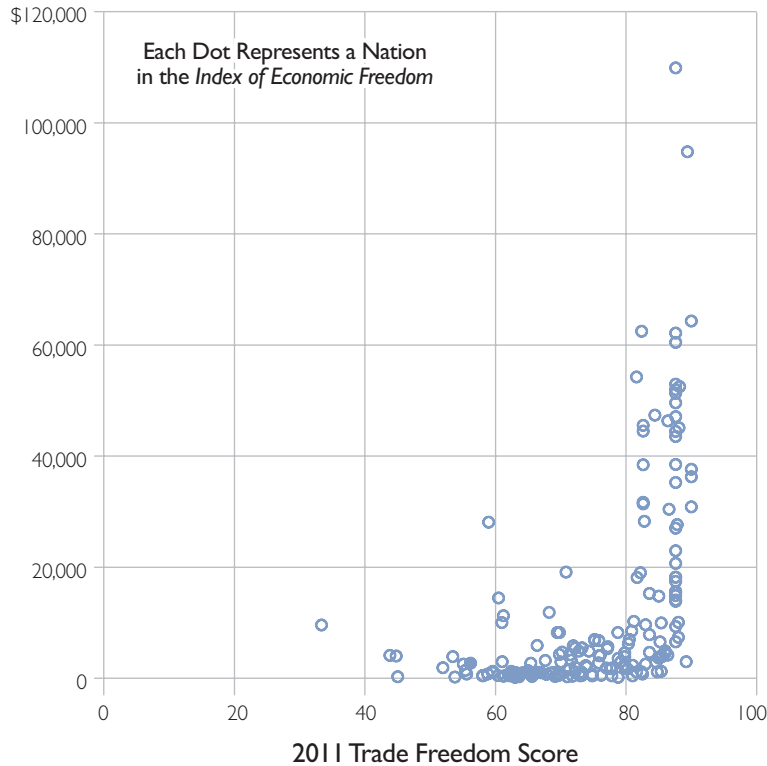
continued improvement of trade-freedom scores suggests that these trade agreements help lock in lower trade barriers. Each time a new trade agreement is signed or a new country joins the WTO, the

world takes another step toward free trade. Politicians in the United States and elsewhere may respond to economic pressures with pandering statements about unfair competition and assertions

that these trade deals “didn’t benefit our workers,”⁹ but they have been too smart, so far at least, to return to Depression-era trade policies.

Trade Freedom Boosts Incomes

Per-Capita Gross Domestic Product



Sources: Heritage Foundation calculations, and The World Bank, “GDP Per Capita (Current US\$),” at <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD> (September 15, 2010).

Chart 5 • B 2472 heritage.org

Looking Ahead

Although the world’s average trade-freedom score improved since last year, the amount of improvement was modest. Far too many people continue to live in poverty because their political leaders have blocked efforts to promote economic freedom.

Whenever possible, countries should unilaterally reduce trade barriers that protect politically powerful elites at the expense of the general population. They should also continue to improve on multilateral trade agreements. Free trade will create more freedom, prosperity, and equality for everyone around the world.

—Bryan Riley is Jay Van Andel Senior Analyst in Trade Policy at the Center for International Trade and Economics (CITE) at The Heritage Foundation and Ambassador Terry Miller is Director of CITE.

9. Press Release, “Remarks by the President on the Economy in Parma, Ohio,” The White House, September 8, 2010, at <http://www.whitehouse.gov/the-press-office/2010/09/08/remarks-president-economy-parma-ohio> (September 17, 2010).

2011 Trade Freedom Scores

Rank	Country	Score	Rank	Country	Score	Rank	Country	Score
1(t)	Hong Kong	90.0	59(t)	Greece	82.6	121	Malawi	71.0
1(t)	Macau	90.0	59(t)	Japan	82.6	122	South Korea	70.8
1(t)	Singapore	90.0	59(t)	United Arab Emirates	82.6	123	Angola	70.2
1(t)	Switzerland	90.0	64	Tajikistan	82.5	124	Cambodia	70.0
5	Norway	89.4	65(t)	Qatar	82.4	125	Samoa	70.0
6	Georgia	89.2	65(t)	Zambia	82.4	126	Mauritania	69.9
7	Iceland	88.2	67	Saudi Arabia	82.2	127(t)	Brazil	69.8
8	Canada	88.1	68	Trinidad and Tobago	81.7	127(t)	Fiji	69.8
9(t)	Chile	88.0	69(t)	Kuwait	81.6	129	Tanzania	69.6
9(t)	Mauritius	88.0	69(t)	Yemen	81.6	130	Argentina	69.5
11	Israel	87.8	71	Mexico	81.2	131	Eritrea	69.1
12(t)	Austria	87.6	72(t)	Micronesia	81.0	132	Vietnam	68.9
12(t)	Belgium	87.6	72(t)	Mozambique	81.0	133	Laos	68.4
12(t)	Bulgaria	87.6	74	Kazakhstan	80.9	134	Russia	68.2
12(t)	Croatia	87.6	75	Lebanon	80.5	135	Ghana	67.8
12(t)	Czech Republic	87.6	76	Belarus	80.3	136	Cape Verde	67.6
12(t)	Denmark	87.6	77	Moldova	80.2	137	Pakistan	67.0
12(t)	Estonia	87.6	78(t)	Albania	79.8	138	São Tomé and Príncipe	66.6
12(t)	Finland	87.6	78(t)	Dominican Republic	79.8	139	Suriname	66.4
12(t)	Germany	87.6	78(t)	Mongolia	79.8	140	Uzbekistan	66.2
12(t)	Hungary	87.6	78(t)	Swaziland	79.8	141	Ethiopia	65.6
12(t)	Ireland	87.6	82	Turkmenistan	79.2	142	Syria	65.4
12(t)	Italy	87.6	83	Burundi	78.8	143	Nigeria	65.0
12(t)	Latvia	87.6	84	Jordan	78.8	144	India	64.2
12(t)	Lithuania	87.6	85	Malaysia	78.7	145	Guinea-Bissau	63.6
12(t)	Luxembourg	87.6	86(t)	Philippines	77.8	145	Lesotho	63.6
12(t)	Malta	87.6	86(t)	Rwanda	77.8	147	Kyrgyz Republic	63.2
12(t)	Netherlands	87.6	88	Bolivia	77.6	148	Democratic Republic of Congo	63.0
12(t)	Poland	87.6	89	South Africa	77.2	149	Sierra Leone	62.8
12(t)	Portugal	87.6	90	Azerbaijan	77.1	150(t)	Comoros	62.4
12(t)	Romania	87.6	91	Honduras	77.0	150(t)	Solomon Islands	62.4
12(t)	Slovakia	87.6	92	Burkina Faso	76.2	152(t)	Cuba	62.2
12(t)	Slovenia	87.6	93	Ecuador	76.0	152(t)	Togo	62.2
12(t)	Spain	87.6	94	Thailand	75.9	154	Nepal	61.4
12(t)	Sweden	87.6	95	Panama	75.8	155(t)	Guinea	61.2
12(t)	United Kingdom	87.6	96	Morocco	75.8	155(t)	Venezuela	61.2
37	New Zealand	86.6	97(t)	Botswana	75.2	157	Republic of Congo	61.0
38(t)	Namibia	86.4	97(t)	Serbia	75.2	158	Gabon	61.0
38(t)	United States	86.4	99(t)	Haiti	74.8	159	Barbados	60.5
40	Taiwan	86.2	99(t)	Uganda	74.8	160	Gambia	60.4
41(t)	Bosnia and Herzegovina	86.0	101	Dominica	74.3	161(t)	Cameroon	59.6
41(t)	Peru	86.0	102	Egypt	74.0	161(t)	Djibouti	59.6
43	Armenia	85.5	103	Indonesia	73.8	163	Equatorial Guinea	58.9
44(t)	Papua New Guinea	85.4	104	St. Vincent and the Grenadines	73.3	164	Benin	58.8
44(t)	Turkey	85.4	105	Madagascar	73.2	165	Central African Republic	58.1
46(t)	Costa Rica	85.2	106(t)	Colombia	73.2	166	Bangladesh	58.0
46(t)	Ukraine	85.2	106(t)	Mali	73.2	167	Tonga	56.2
48(t)	El Salvador	85.0	106(t)	Senegal	73.2	168	Chad	55.6
48(t)	Libya	85.0	109	Timor-Leste	73.0	169	Kiribati	55.4
50	Nicaragua	84.8	110(t)	Algeria	72.8	170	Vanuatu	55.1
51	Guatemala	84.6	110(t)	Kenya	72.8	171	Liberia	53.8
52	Australia	84.4	112	Burma	72.3	172	Tunisia	53.5
53(t)	Macedonia	83.6	113(t)	Côte d'Ivoire	72.2	173	Bhutan	52.0
53(t)	Montenegro	83.6	113(t)	Sri Lanka	72.2	174	Zimbabwe	45.0
53(t)	Oman	83.6	115	Jamaica	72.2	175	Iran	44.8
56(t)	Paraguay	83.0	116	Saint Lucia	71.9	176	Maldives	43.8
56(t)	Uruguay	83.0	117	Niger	71.8	177	Bahamas	42.2
58	Bahrain	82.8	118	China	71.6	178	Seychelles	33.4
59(t)	Cyprus	82.6	119	Belize	71.5	179	North Korea	0.0
59(t)	France	82.6	120	Guyana	71.3			

Source: Heritage Foundation calculations.

Table 2 • B 2472  heritage.org

METHODOLOGY

The trade-freedom scores reported in this paper are based on two inputs:

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

Both qualitative and quantitative information is 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 it difficult to gauge their complexity. The categories of NTBs considered in the trade freedom 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; safety and industrial standards regulations; packaging, labeling, and trademark regulations; advertising and media regulations;
- **Customs restrictions:** advance deposit requirements, customs valuation procedures, customs classification procedures, customs clearance procedures; and
- **Direct government intervention:** 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; government procurement policies; state trading, government monopolies, and exclusive franchises.

As an example, in 2011 France received a trade-freedom score of 82.6, based on the weighted average tariff of 1.2 percent common to all European Union countries. The tariff yields a base score of 97.6, but the existence of significant French NTBs reduces the nation's trade-freedom 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, 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 most recently reported weighted average tariff rate for a country from the World Bank. If another reliable source reports more updated information on a country's tariff rate, the authors note this fact and may review the grading 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.¹⁰ In the very few cases where 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. Sometimes, 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 2011 are based on data for the period covering the second half of 2009 through the first half of 2010. To the extent possible, the information considered was current as of June 30, 2010. Any changes in law effective after that date have no positive or negative impact.

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

- The World Bank, *World Development Indicators 2010* and *Data on Trade and Import Barriers: Trends in Average Applied Tariff Rates in Developing and Industrial Countries, 1981–2007*;
- The World Trade Organization, *Trade Policy Review, 1995–2010*;
- Office of the U.S. Trade Representative, *2010 National Trade Estimate Report on Foreign Trade Barriers*;
- The World Bank, *Doing Business 2010* and *Doing Business 2009*;
- U.S. Department of Commerce, *Country Commercial Guide, 2004–2010*;
- Economist Intelligence Unit, *Country Report, Country Profile, and Country Commerce, 2004–2010*; and
- Official government publications of each country.

10. The most-favored-nation tariff rate is the “normal,” non-discriminatory tariff charged on imports. In commercial diplomacy, exporters seek MFN treatment; that is, the promise that they will be treated as well as the most favored exporter. The MFN rule requires that the concession be extended to all other members of the World Trade Organization. MFN is now referred to as permanent normal trade relations (PNTR).