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Congress Should Get Smart and Cut Tariffs to Boost Trade Freedom

Bryan Riley and Ambassador Terry Miller

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Abstract

The Heritage Foundation has been tracking and ranking trade freedom around the world since 1995. The rankings have consistently shown a correlation between trade freedom and improved lives. The latest rankings, in the forthcoming 2014 Index of Economic Freedom, *once again confirm that connection. This* Special Report *describes why free trade is important to people in the United States and in countries around the world, and how Congress can promote freedom and prosperity by eliminating tariffs on imported materials used by U.S. companies.*

The latest rankings of trade freedom around the world,[1] developed by The Heritage Foundation and *The Wall Street Journal* in the forthcoming *2014 Index of Economic Freedom*,[2] once again demonstrate how citizens of countries that embrace free trade are better off than those in countries that do not. Data continue to show a strong correlation between trade freedom and a variety of positive indicators, including economic prosperity and low poverty rates.

The United States can do more to promote the positive outcomes generated by trade freedom. Worldwide, the average trade freedom score has barely improved, from 74.5 to 74.8 of a maximum score of 100. The U.S. score of 86.8 is the same as in 2009, when President Barack Obama took office.

Trade Activity on the Rise

The volume of world trade in goods and services plunged by 20 percent from 2008 to 2009 during the global recession, but since then has rebounded to record-high levels. In 2011, total world trade volume approached $44 trillion, equivalent to 61 percent of combined gross domestic product (GDP) for all countries.[3]

In the United States, trade volume reached a new high of $4.9 trillion in 2011, up 39 percent from 2008. Since 2002, U.S. trade in goods and services has grown at a fast pace, increasing from 23 percent of GDP to 32 percent of GDP.

Why Trade Freedom Matters

A comparison of the countries with the best trade scores in the *2014 Index of Economic Freedom* with those that have the worst scores demonstrates the importance of trade freedom. Countries with the most trade freedom have higher per capita incomes, lower incidences of hunger in their populations, and cleaner environments.

More Trade, More Jobs

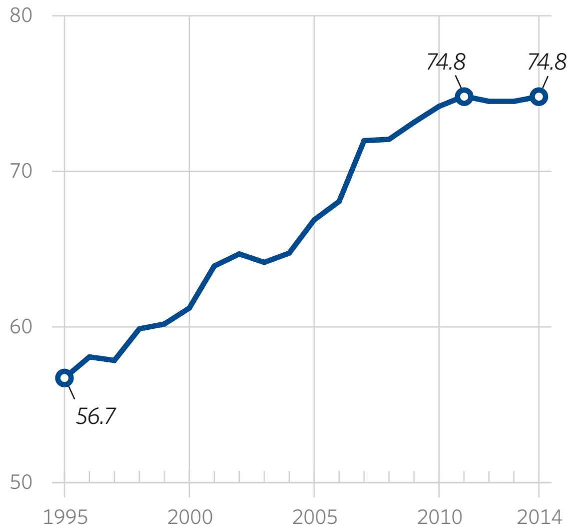
Protectionists routinely claim that imports destroy jobs. Headlines with assertions like "U.S. Economy Lost Nearly 700,000 Jobs Because of NAFTA," and "Growing U.S. Trade Deficit with

CHART 1

Global Trade Freedom Levels Off

The average trade freedom score in the Index of Economic Freedom *rose steadily for 15 years, but has remained essentially flat since 2011.*

AVERAGE TRADE FREEDOM SCORE IN THE *INDEX OF ECONOMIC FREEDOM*



Source: Heritage Foundation calculations from the *2014 Index of Economic Freedom* (forthcoming January 2014).

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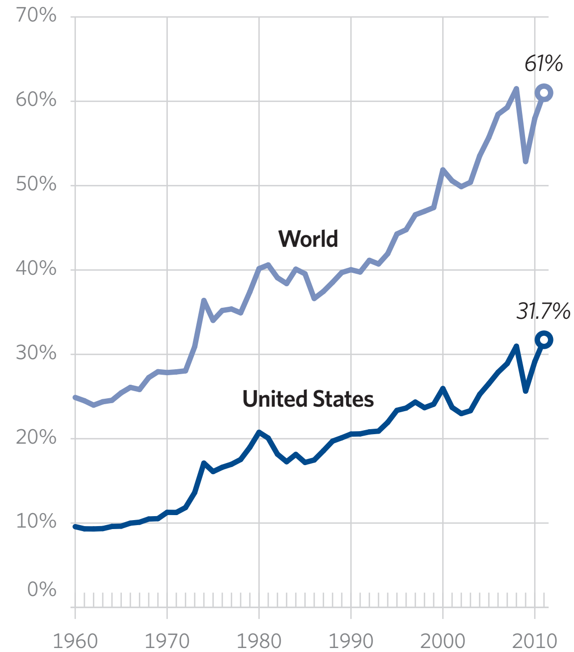
CHART 2

Importance of Trade Increasing for U.S., World

PERCENTAGE OF GDP FROM TRADE



Source: The World Bank, "Trade (% of GDP)," http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS (accessed October 8, 2013).

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China Cost 2.8 Million Jobs Between 2001 and 2010," are not uncommon.[4] But in reality, the U.S. economy has generated over 19 million net new jobs since the North American Free Trade Agreement (NAFTA) took effect in 1994, and 5.5 million net new jobs since China joined the World Trade Organization in 2001.

Misguided Trade Deficit Concerns

American special interest groups often complain that "unfair" foreign competition results in a trade deficit that destroys jobs in the United States, but the trade deficit and the unemployment rate usually have an inverse relationship: When the trade deficit increases, the unemployment rate decreases, and vice versa. For example, in 2009, the U.S. trade deficit shrank by 46 percent, and the unemployment rate increased by 60 percent.[5]

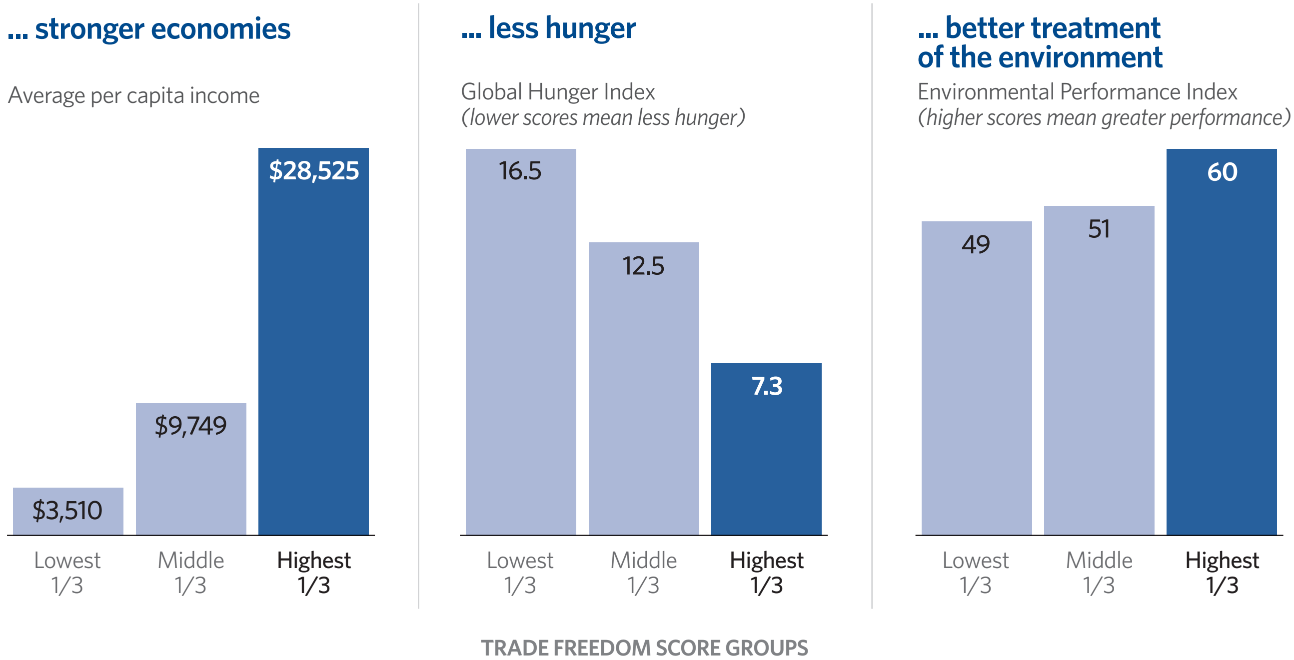
Recent news reports explain how a growing U.S. economy may result in an increased trade deficit.

1. See Table 1 in Appendix A.
2. The *2014 Index of Economic Freedom* will be published in January 2014. 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, which uses them as part of its criteria for determining countries' eligibility for grants.
3. The World Bank, "Trade (% of GDP)," 2011, http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS (accessed October 11, 2013).
4. Maxwell Strachan, "U.S. Economy Lost Nearly 700,000 Jobs Because of NAFTA, EPI Says," *The Huffington Post*, July 12, 2011, http://www.huffingtonpost.com/2011/05/12/nafta-job-loss-trade-deficit-epi_n_859983.html (accessed October 9, 2013), and Robert E. Scott, "Growing U.S. Trade Deficit with China Cost 2.8 Million Jobs Between 2001 and 2010," Economic Policy Institute, September 20, 2011, http://www.epi.org/publication/growing-trade-deficit-china-cost-2-8-million/ (accessed October 4, 2013).

CHART 3

Major Benefits of Free Trade

The nations of the world are divided into three groups based on their trade freedom score in the 2013 Index of Economic Freedom. *The chart below shows that* ***nations with more trade freedom also have …***



Source: Heritage Foundation calculations from the *2014 Index of Economic Freedom* (forthcoming January 2014) and:

- Gross national income per capita: The World Bank, "GNI Per Capita, Atlas Method (Current U.S.$)," http://data.worldbank.org/indicator/NY.GNP.ATLS.CD (accessed October 8, 2013). Figures based on 168 countries.
- Global hunger: International Food Policy Research Institute, "2012 Global Hunger Index," http://www.ifpri.org/publication/2012-global-hunger-index (accessed October 8, 2013). Figures based on 118 countries.
- Environmental performance: Yale University, Center for Environmental Law and Policy, and Columbia University, Center for International Earth Science Information Network, Environmental Performance Index 2012, http://epi.yale.edu/ (accessed October 8, 2013). Figures based on 131 countries.

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According to the Associated Press, "[E]conomists noted that the wider deficit does show growth in the United States remains stronger than most other nations. That growth has helped fuel more spending by consumers on domestic and imported goods."[6] According to Reuters: "In another sign of improving domestic economic conditions, the U.S. trade deficit widened sharply in May, as stronger U.S. demand pulled in more imports, a report from the Commerce Department showed."[7]

Critics who focus on the trade deficit overlook the fact that once all international transactions are accounted for, there is no deficit of dollars leaving the United States for other countries.

5. Bureau of Labor Statistics, "Labor Force Statistics from the Current Population Survey: Where Can I Find the Unemployment Rate for Previous Years?" February 3, 2011, http://www.bls.gov/cps/prev_yrs.htm (accessed October 4, 2013), and Bureau of Economic Analysis, "International Data: International Transactions," Table 1. "U.S. International Transactions," http://www.bea.gov/iTable/iTable.cfm?ReqID=6&step=1 (accessed October 11, 2012).
6. Martin Crutsinger, "U.S. Trade Deficit Widens to $45 Billion in May," *U.S. News & World Report*, July 3, 2013, http://www.usnews.com/news/business/articles/2013/07/03/us-trade-deficit-widens-to-45-billion-in-may (accessed October 4, 2013).
7. "U.S. Jobs Data Upbeat, Trade Deficit Widens," CNBC, July 3, 2013, http://www.cnbc.com/id/100862705 (accessed October 4, 2013).

CHART 4

U.S. Employment Grew Steadily Until 2008 Recession

TOTAL EMPLOYMENT, AGES 16 AND ABOVE, IN MILLIONS

Source: U.S. Department of Labor, Bureau of Labor Statistics, http://data.bls.gov/timeseries/LNS12000000 (accessed October 7, 2013).

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In 2012, $3.4 trillion came into the United States through trade and investment, and $3.4 trillion left, according to the Bureau of Economic Analysis (BEA). Every dollar Americans sent to people in other countries was balanced by a dollar sent back to the United States: 64 cents for U.S. exports, 22 cents for payments to U.S. investors, 11 cents for investment in U.S. assets, and 3 cents on other transactions (for a total of 100 cents).[8]

So why do critics complain about the trade deficit? The main reason is that they focus only on dollars spent on exports of U.S. goods and services and not dollars invested in the U.S. economy. For some reason they ignore the benefits of foreign investment, including the 5.6 million jobs for Americans who work in U.S. subsidiaries of foreign-owned companies.[9]

The U.S. government also relies heavily on foreign investment to finance its deficit spending. In 2012, the government sold $382 billion in Treasury securities to foreign buyers.[10] Those Treasury sales do not count as exports, but they benefit the U.S. economy nevertheless. Because of foreign purchases of Treasury securities—in other words, U.S. government borrowing from abroad—the government does not have to borrow as much from domestic investors.

Based on transactions in goods such as tee shirts, the U.S. has a deficit. Based on financial flows, the U.S. has a surplus. When the individual deficits and surpluses are added up, they balance out.[11] Instead of worrying about the makeup of foreign dollars that are spent in the United States—whether they are used to buy wheat, cars, factories, or bonds—U.S. policymakers should make it their goal to reduce barriers to economic freedom.

Trade Agreements and Investment Freedom

An important complement to trade freedom is investment freedom. Most trade agreements not only call for reductions in trade barriers, but also for improved protection for investment rights. For example, draft provisions of the proposed Trans-Pacific Partnership (TPP) between the United States and 11 other countries call for:

- No discrimination between domestic and foreign investors;
- Equal treatment for investors from all TPP countries;
- No "performance requirements" on foreign investors, such as requiring them to purchase domestically produced inputs;

8. Heritage Foundation calculations using BEA data.
9. Organization for International Investment, "Jobs by State," 2013, http://www.ofii.org/resources/insourcing-facts (accessed October 4, 2013).
10. U.S. Department of the Treasury, "Net Purchases of U.S. Treasury Bonds and Notes by Major Foreign Sector," http://www.treasury.gov/resource-center/data-chart-center/tic/Documents/tressect.txt (accessed October 4, 2013).
11. Mark J. Perry, "U.S. Trade with the Rest of the World Is Always Balanced," American Enterprise Institute, September 15, 2011, http://www.aei-ideas.org/2011/09/u-s-trade-with-rest-of-world-is-always-balanced/ (accessed October 11, 2013).

- Allowing investors to freely transfer profits; and
- No expropriation of investments without prompt and fair compensation.[12]

These investment protection provisions attempt to extend a right enumerated in the U.S. Bill of Rights to people who invest in other countries: "No person shall be…deprived of…property, without due process of law; nor shall private property be taken for public use without just compensation."

One vital element of the TPP text is a provision allowing investors who believe that a government has violated its commitments to request international arbitration. Otherwise, investors could see their property expropriated, and then be forced to rely on the court system of the very government that expropriated their property to receive fair compensation.

The draft provisions related to investment protection in the TPP are quite similar to the factors used to assess countries' investment freedom in the *Index of Economic Freedom*. According to the data in the 2013 *Index*, countries that have adopted policies promoting greater investment freedom are much more prosperous than those that restrict investment. While the average GDP per capita of the eight countries with an investment freedom score of zero is $5,350; the per capita GDP of nine countries with a score of 90 or higher is close to $40,000.

The Best Farm Policy: Free Trade

Congress has spent much of the last year fighting over the future of U.S. farm programs. In 2011, taxpayers subsidized farmers to the tune of $10.4 billion in direct government payments.[13]

Imagine if the government had a way to increase farm income while reducing taxpayer subsidies to zero.

Such a policy exists. It is called free trade. From 2004 to 2011, U.S. agricultural exports grew by an average of $10.7 billion per year.[14] In other words, during each of the past seven years, U.S. export growth boosted agricultural income by as much as total current annual direct government payments to farmers.

While there is no guarantee that exports will continue to grow at that rate, foreign markets are an important and growing source of income for agricultural producers. Today, 31 percent of U.S. gross farm income comes from exports, despite U.S. opposition to free trade in agricultural products including milk, sugar, and tomatoes.[15] Restrictions on these imports make Americans pay more for food while encouraging other countries to impose similar limits on U.S. agricultural exports.

"We cannot feed 9 billion people without open trade," observed David MacLennan, president and chief operating officer of international food and financial giant Cargill. "We encourage governments to advance policies that will help the world realize the benefits of trade flows, which include better access to safe, affordable and nutritious food for all."[16]

Rotten Trade Policy from the Obama Administration

To this date in his tenure, the best symbol for President Obama's trade policy may well be a rotten tomato. As a result of an agreement between the Obama Administration and Mexico earlier this year, Americans will be paying inflated prices for tomatoes. The increase is entirely due to minimum prices

12. Citizens Trade Campaign, "Newly Leaked TPP Investment Chapter Contains Special Rights for Corporations," June 13, 2012, http://www.citizenstrade.org/ctc/wp-content/uploads/2012/06/tppinvestment.pdf (accessed October 4, 2013.)
13. U.S. Department of Agriculture, Economic Research Service, "Direct government payments, 2009-2013F," http://web.archive.org/web/20130426171602/http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx (accessed October 16, 2013).
14. U.S. Department of Agriculture, Economic Research Service, "U.S. Agricultural Exports, Commodity detail by State [New series]: CY2000-2011," http://web.archive.org/web/20130429120735/http://www.ers.usda.gov/data-products/state-export-data.aspx#25532 (accessed October 16, 2013).
15. American Farm Bureau Federation, "Fast Facts about Agriculture," 2013, http://www.fb.org/index.php?action=newsroom.fastfacts (accessed October 4, 2013).
16. Food Product Design, "Free Trade Key to Global Food Security," March 11, 2013, http://www.foodproductdesign.com/news/2013/03/free-trade-key-to-global-food-security.aspx (accessed October 4, 2013).

imposed by the Obama Administration because U.S. tomato growers do not want to compete with Mexican tomato producers.

According to Francisco J. Sanchez, the U.S. Under Secretary of Commerce for International Trade: "The draft agreement raises reference prices substantially, in some cases more than double the current reference price for certain products."[17]

The tomato agreement undermines the spirit of NAFTA, which was designed to allow consumers in Canada, Mexico, and the United States to do business with each other without interference from special interests seeking government protection from competition. NAFTA does allow each country to maintain protectionist anti-dumping laws—a loophole that was seized upon by U.S. tomato producers. According to an executive for the Florida Tomato Exchange, "Mexican tomatoes were being sold in the U.S. market in rapidly increasing volumes at prices that did not reflect the cost of production."[18]

On the surface, the charge sounds far-fetched—Florida's tomato growers seriously expected the Obama Administration to believe that Mexican farmers were toiling in their tomato fields year after year, producing tomatoes in order to sell them to Americans at a loss. If that is the business model used by Mexican farmers, perhaps the Obama Administration should send them a thank-you letter.

Instead, the Administration decided to force Americans to pay more for tomatoes. The Mexican government and representatives from Mexican tomato growers grudgingly accepted the new mandatory minimum prices because under protectionist anti-dumping laws, it was possible that the U.S. government could impose even larger penalties on imported tomatoes if Mexico refused to accept the tomato pact.

Congress Should Act By Cutting Tariffs on Inputs

Fortunately, Congress does not have to wait on President Obama to pursue a more productive trade policy. A good start would be to permanently phase out all tariffs on inputs used by U.S. producers.

Imports such as steel for carmakers, wood for homebuilders, and sugar for candy manufacturers help these U.S. industries produce affordable, high-quality cars, homes, and food.

Because tariffs increase the cost of many inputs, they make it harder for U.S. companies to compete with foreign companies. In some cases, U.S. businesses have even been forced to relocate to countries where tariffs on inputs are lower than they are in the United States.[19] The government's trade policy should make it easier for companies to operate, not drive them out of the country.

In 2012, the federal government collected $29.8 billion in tariff revenue. Around one-third to one-half of this amount comes from tariffs on inputs used by U.S. manufacturers, farmers, and other industries. These tariffs drive up the cost of doing business in the United States, and they affect just about every industry in the country:

- The government penalized U.S. clothing and furniture manufacturers by collecting $585 million from taxes on imported textile supplies.
- The government penalized construction workers by collecting $108 million from taxes on lumber.
- The government penalized autoworkers by collecting $1.6 billion from tariffs on automobile parts.
- The government penalized farmers by collecting $111.6 million from tariffs on fertilizers, pesticides, and insecticides.

Tariff cuts would boost the U.S. manufacturing sector. A recent study by the Federal Reserve Bank of St. Louis concluded that "perhaps contrary to conventional wisdom, imports of manufactured goods are extremely important for the manufacturing

17. Stephanie Strom, "United States and Mexico Reach Tomato Deal, Averting a Trade War," *The New York Times*, February 3, 2013, http://www.nytimes.com/2013/02/04/business/united-states-and-mexico-reach-deal-on-tomato-imports.html?_r=0 (accessed October 4, 2013).

18. Doug Palmer, "U.S., Mexico Reach Tomato Deal to Avert Trade War," Reuters, February 2, 2013, http://www.reuters.com/article/2013/02/03/us-usa-mexico-tomatoes-idUSBRE9110F120130203 (accessed October 4, 2013).

19. U.S. International Trade Administration, "Employment Changes in U.S. Food Manufacturing: The Impact of Sugar Prices," February 2006, http://ita.doc.gov/td/ocg/sugar06.pdf (accessed September 30, 2013).

sector. Specifically, imports of intermediate goods contribute significantly to the industry's strong rate of productivity growth."[20]

Cutting tariffs on inputs would also contribute to export growth, a stated goal of the Obama Administration. According to a recent report by the Organisation for Economic Co-operation and Development (OECD): "Protective measures against imports of intermediate products increase the costs of production and reduce a country's ability to compete in export markets: tariffs and other barriers to imports are effectively a tax on exports."[21] The Center for Strategic and International Studies concluded:

> Since imports are essential for exports, import tariffs amount to a tax on exports. In 1974 it may have been reasonable for trade policy objectives to be formulated considering only exports. Today, we should be proposing ways for the United States to be a better importer, both for the benefits imports bring to consumers as well as to boost export competitiveness.[22]

Get Smart: Cut U.S. Tariffs to Boost the Economy

Our neighbors to the north and south are slashing tariffs on inputs in order to help their companies compete. Canada's Economic Action Plan is phasing out many tariffs on manufacturing inputs. Mexico's PROSEC program reduces tariffs on raw materials, parts, and other inputs used by industries including electronics, apparel, and automobiles.[23] The United States should take a lesson in trade policy from its neighbors and permanently eliminate tariffs on products used by U.S. producers. This positive supply shock would boost U.S. output and put us back on the path to prosperity.

Eliminating tariffs on inputs used by U.S. producers would be economically and politically advantageous. Some people may argue that the United States should maintain its own self-destructive trade barriers until other countries eliminate their own tariffs, quotas, and subsidies. President Ronald Reagan had an answer to this argument: "We're in the same boat with our trading partners. If one partner shoots a hole in the boat, does it make sense for the other one to shoot another hole in the boat? Some say, yes, and call that getting tough. Well, I call it stupid."[24]

Policymakers should get smart and cut tariffs on inputs needed by U.S. producers to compete in the global economy.

20. Kevin L. Kliesen and John A. Tatum, "U.S. Manufacturing and the Importance of International Trade: It's Not What You Think," *Federal Reserve Bank of St. Louis Review* (January/February 2013), p. 47, http://research.stlouisfed.org/publications/review/13/01/Kliesen.pdf (accessed April 22, 2013).
21. Organisation for Economic Co-operation and Development, "Interconnected Economies: Benefiting from Global Value Chains," 2013, p. 25, http://www.oecd.org/sti/ind/interconnected-economies-GVCs-synthesis.pdf (accessed October 4, 2013).
22. Scott Miller, "Trade Promotion Authority and Global Value Chains," Center for Strategic and International Studies *International Business Quarterly*, July 2013, http://csis.informz.net/CSIS/data/images/scholl/schollchair_newsletter_july2013.pdf (accessed October 4, 2013).
23. Bryan Riley, "Tariff Reform Needed to Boost the U.S. Economy," Heritage Foundation *Backgrounder* No. 2792, April 29, 2013, p. 6, http://www.heritage.org/research/reports/2013/04/tariff-reform-needed-to-boost-the-us-economy (accessed October 4, 2013).
24. President Ronald Reagan, "Radio Address to the Nation on International Free Trade," November 20, 1982, http://www.presidency.ucsb.edu/ws/index.php?pid=42022#axzz2gh2bIZJj (accessed October 4, 2013).

APPENDIX A

2014 Trade Freedom Scores

NG — Not graded

Rank	Country	Score	Rank	Country	Score	Rank	Country	Score
1-t	Hong Kong	90.0	62-t	Yemen	82.4	125	Cambodia	71.0
1-t	Liechtenstein	90.0	64	Chile	82.0	126	Haiti	70.4
1-t	Macao	90.0	65	Brunei	81.8	127-t	Sierra Leone	70.2
1-t	Singapore	90.0	66	Swaziland	81.5	127-t	Fiji	70.2
1-t	Switzerland	90.0	67	Belarus	81.4	129	Angola	70.1
6	Norway	89.1	68	Paraguay	81.1	130	Cape Verde	69.6
7-t	Mauritius	88.6	69	Micronesia	81.0	131	Brazil	69.3
7-t	Georgia	88.6	70	Moldova	80.1	132	Eritrea	69.1
9	Canada	88.3	71	Qatar	79.8	133	Mauritania	69.0
10	Iceland	87.9	72	Jordan	79.6	134	Argentina	68.9
11-t	Austria	87.8	73	Tonga	79.5	135	Lesotho	68.6
11-t	Belgium	87.8	74	Turkmenistan	79.2	136-t	Belize	67.8
11-t	Bulgaria	87.8	75	El Salvador	79.0	136-t	Burkina Faso	67.8
11-t	Czech Republic	87.8	76	Colombia	78.8	138	St. Vincent & Grenadines	67.6
11-t	Denmark	87.8	77-t	Vietnam	78.7	139	Suriname	66.2
11-t	Estonia	87.8	77-t	Oman	78.7	140	Uzbekistan	66.1
11-t	Finland	87.8	79-t	Bahrain	78.6	141-t	Niger	65.6
11-t	Germany	87.8	79-t	Trinidad and Tobago	78.6	141-t	India	65.6
11-t	Hungary	87.8	81	Kazakhstan	78.2	143	The Gambia	65.0
11-t	Ireland	87.8	82-t	Dominican Republic	77.8	144-t	Ghana	64.8
11-t	Italy	87.8	82-t	Madagascar	77.8	144-t	Pakistan	64.8
11-t	Latvia	87.8	84	Rwanda	77.7	146	Timor-Leste	64.4
11-t	Lithuania	87.8	85	Bolivia	77.6	147	Ethiopia	64.2
11-t	Luxembourg	87.8	86	Azerbaijan	77.2	148	Liberia	64.1
11-t	Malta	87.8	87	Serbia	77.0	149	Nigeria	63.8
11-t	Netherlands	87.8	88	Tanzania	76.8	150	Dem. Rep. Congo	63.0
11-t	Poland	87.8	89	Kuwait	76.7	151	Togo	62.8
11-t	Portugal	87.8	90	Malaysia	76.4	152	Venezuela	62.7
11-t	Romania	87.8	91	South Africa	76.1	153	Tunisia	61.8
11-t	Slovak Republic	87.8	92-t	Lebanon	75.8	154	Guinea-Bissau	61.4
11-t	Slovenia	87.8	92-t	Samoa	75.8	155-t	Cameroon	61.2
11-t	Spain	87.8	94-t	Mozambique	75.5	155-t	Guinea	61.2
11-t	Sweden	87.8	94-t	Philippines	75.5	157-t	Gabon	61.0
11-t	United Kingdom	87.8	96-t	Honduras	75.4	157-t	Nepal	61.0
35	Albania	87.5	96-t	Uganda	75.4	159	Algeria	60.8
36	Croatia	87.4	98	São Tomé and Príncipe	75.3	160	Barbados	60.6
37	Peru	87.0	99	Kyrgyz Republic	75.2	161-t	Cuba	60.0
38	Bosnia and Herzegovina	86.9	100	Jamaica	75.1	161-t	Benin	60.0
39-t	**United States**	**86.8**	101	Thailand	75.0	163	Bangladesh	59.0
39-t	New Zealand	86.8	102	Indonesia	74.8	164	Morocco	58.8
41	Australia	86.4	103	Mongolia	74.7	165	Laos	58.6
42	Ukraine	86.2	104	Russian Federation	74.6	166-t	Rep. Congo	55.6
43	Macedonia	85.9	105	Panama	74.2	166-t	Sudan	55.6
44	Taiwan	85.8	106	Saudi Arabia	74.0	168	Kiribati	55.4
45	Mexico	85.6	107-t	Burma	73.6	169	Chad	55.2
46	Armenia	85.5	107-t	Sri Lanka	73.6	170	Djibouti	54.8
47-t	Guatemala	85.4	109-t	Mali	73.2	171	Zimbabwe	54.2
47-t	Nicaragua	85.4	109-t	Tajikistan	73.2	172	Equatorial Guinea	53.8
49	Papua New Guinea	85.1	109-t	Senegal	73.2	173	The Bahamas	52.2
50	Zambia	84.6	112	Solomon Islands	73.0	174	Central African Republic	51.8
51	Turkey	84.5	113	Kenya	72.8	175	Bhutan	49.4
52	Costa Rica	83.8	114-t	Dominica	72.7	176	Vanuatu	48.0
53	Montenegro	83.1	114-t	Malawi	72.7	177	Maldives	43.8
54-t	Israel	82.9	114-t	Comoros	72.7	178	Iran	41.4
54-t	Namibia	82.9	117	South Korea	72.6	179	Seychelles	33.4
56-t	Cyprus	82.8	118	Guyana	72.0	180	North Korea	0.0
56-t	France	82.8	119	Saint Lucia	71.9	—	Afghanistan	NG
56-t	Greece	82.8	120-t	Burundi	71.8	—	Iraq	NG
59	Botswana	82.7	120-t	China	71.8	—	Kosovo	NG
60-t	United Arab Emirates	82.5	120-t	Ecuador	71.8	—	Libya	NG
60-t	Uruguay	82.5	123-t	Côte d'Ivoire	71.4	—	Somalia	NG
62-t	Japan	82.4	123-t	Egypt	71.4	—	Syria	NG

Source: Heritage Foundation calculations from the *2014 Index of Economic Freedom* (forthcoming January 2014).

Appendix B

Methodology

The trade freedom scores reported in this paper 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. 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.

- 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, and countertrade measures, among others;

- **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; state trading, government monopolies, and exclusive franchises; government procurement policies.

An example: In 2014, France received a trade freedom score of 82.8, based on the weighted average tariff of 1.1 percent common to all European Union countries. The tariff yields a base score of 97.8, 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 of this *Special Report* use the World Bank’s most recently reported weighted average tariff rate for a country. 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.[25] 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 2014 are based on data for the period covering the second half of 2012 through the first half of 2013. To the extent possible, the information considered is current as of June 30, 2013. Any changes in law effective after that date have no positive or negative impact on the trade freedom scores.

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 2013" and "Data on Trade and Import Barriers: Trends in Average Applied Tariff Rates in Developing and Industrial Countries, 1981–2011";
- The World Trade Organization, "Trade Policy Review, 1995–2013";
- Office of the U.S. Trade Representative, "2013 National Trade Estimate Report on Foreign Trade Barriers";
- The World Bank, "Doing Business 2012" and "Doing Business 2013";
- U.S. Department of Commerce, "Country Commercial Guide, 2010–2013";
- Economist Intelligence Unit, "Country Report, Country Profile, and Country Commerce, 2009–2012"; and
- Official government publications of each country.

25. The most-favored-nation (MFN) 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).

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