Backgrounder

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Global Trade Freedom Needs a Boost

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Abstract: *The* 2012 Index of Economic Freedom *rankings of trade freedom around the world indicate that trade freedom has remained constant or regressed slightly since 2011. The lack of improvement is regrettable because countries with the most trade freedom have the highest per capita gross domestic product, the lowest incidence of hunger, and the cleanest environments. The U.S. needs to resume its global leadership on trade freedom by encouraging a successful, prompt conclusion to the Doha Round; implementing the free trade agreements with Colombia, Panama, and South Korea; and eliminating U.S. trade barriers.*

The 2012 rankings of trade freedom around the world (see Table 1), developed by The Heritage Foundation and *The Wall Street Journal* in connection with the forthcoming *2012 Index of Economic Freedom*,[1] show how countries that embrace free trade benefit compared to those that do not. The case for pending U.S. trade agreements with Colombia, Panama, and South Korea is bolstered by international statistics showing 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 fell slightly, from 74.8 to 74.5. This small drop is not necessarily cause for alarm because trade freedom remains at the second-highest level since The Heritage Foundation began tracking it in 1995.

Talking Points

- Global trade freedom is stuck in neutral or, even worse, may actually be rolling backward. The average trade freedom score fell slightly from 74.8 last year to 74.5.
- Global exports increased 14.5 percent in 2010, and the WTO projects a 6.5 percent increase for 2011.
- Countries with the most trade freedom have higher per capita GDP, lower incidence of hunger, and cleaner environments. Countries with lower tariffs have lower unemployment rates, lower poverty rates, and lower income inequality.
- U.S. tariffs cost Americans billions of dollars per year.
- Self-destructive U.S. trade barriers include tariffs on imported shoes and clothing, restrictions on sugar imports, antidumping laws, "Buy American" laws, and the Merchant Marine Act of 1920 (Jones Act) and the Passenger Vessel Services Act of 1886, which prohibits the direct movement of foreign-owned or foreign-crewed ships between U.S. ports.

This paper, in its entirety, can be found at:
http://report.heritage.org/bg2614

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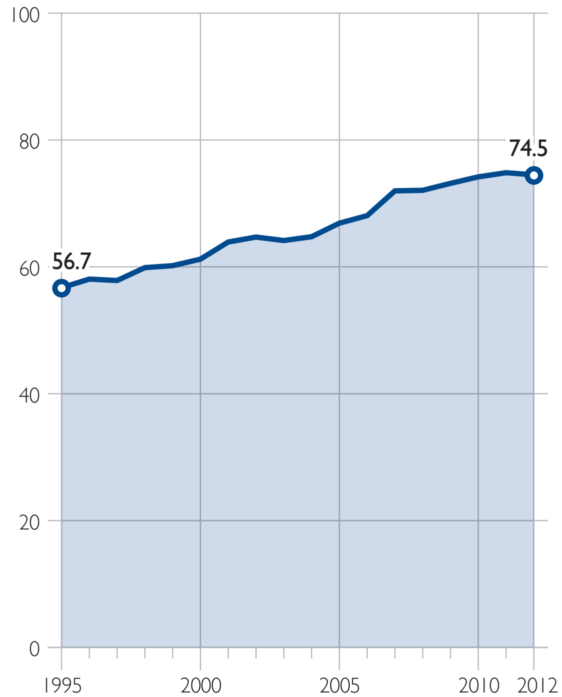
LEADERSHIP FOR AMERICA

Trade Freedom Gains Across the World

World Average of Trade Freedom Scores in the *Index of Economic Freedom*

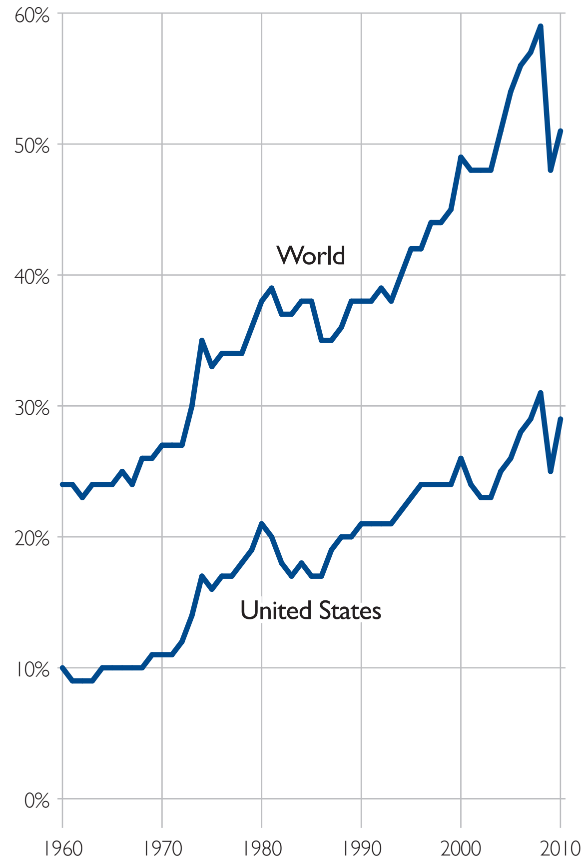


Source: Heritage Foundation calculations from the *2012 Index of Economic Freedom* (forthcoming January 2012).

Chart 1 • B 2614 heritage.org

Trade Constitutes a Growing Part of U.S. and World Economies

Trade Volume as a Percentage of GDP



Source: The World Bank, "Trade (% of GDP)," at *http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS* (September 12, 2011). The 2010 figures are Heritage Foundation estimates.

Chart 2 • B 2614 heritage.org

Trade freedom scores have improved substantially since 1995, when the inaugural *Index of Economic Freedom* was released, but there is plenty of room for additional improvement.

Trade On the Rise

According to the World Trade Organization (WTO), trade volume has recovered strongly from the global recession. Global exports increased 14.5 percent in 2010, and the WTO projects a 6.5 percent increase for 2011.[2]

International trade plays an increasingly significant role in the economies of the United States and other countries. Since 1960, trade as a percentage of gross domestic product (GDP) for the world has doubled. Trade as a percentage of U.S. GDP has nearly tripled, although U.S. trade volume remains lower than the world average due to the large U.S. internal market.

Why Trade Freedom Matters

A comparison of the countries with the best trade

1. The *2012 Index of Economic Freedom* will be published in January 2012. 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.
2. Press release, "Trade Growth to Ease in 2011 but Despite 2010 Record Surge, Crisis Hangover Persists," World Trade Organization, April 7, 2011, at *http://www.wto.org/english/news_e/pres11_e/pr628_e.htm* (September 12, 2011).

2012 Trade Freedom Scores

Rank	Country	Score	Rank	Country	Score	Rank	Country	Score
1-t	Hong Kong	90.0	62-t	France	82.1	124-t	Mauritania	69.9
1-t	Macao	90.0	62-t	Greece	82.1	126-t	Fiji	69.7
1-t	Singapore	90.0	65	Chile	82.0	126-t	Brazil	69.7
1-t	Switzerland	90.0	66	Japan	81.8	126-t	Swaziland	69.7
5	Norway	89.3	67	Kuwait	81.6	129	Comoros	69.4
6	Georgia	89.2	68	Yemen	81.5	130-t	Eritrea	69.1
7	Iceland	88.2	69	Mozambique	81.1	130-t	Lesotho	69.1
8-t	Mauritius	87.9	70	Micronesia	81.0	132	Russia	68.2
8-t	Canada	87.9	71-t	Belarus	80.4	133	Ecuador	68.1
10	Croatia	87.5	71-t	Lebanon	80.4	134	Ghana	67.8
11	Austria	87.2	73	Dominican Republic	80.1	135	Argentina	67.6
12-t	Belgium	87.1	74-t	Albania	79.8	136	Cape Verde	66.9
12-t	Bulgaria	87.1	74-t	Mongolia	79.8	137	Kenya	66.7
12-t	Czech Republic	87.1	76	Botswana	79.7	138	Sao Tome	66.6
12-t	Denmark	87.1	77-t	Jordan	79.6	139	Suriname	66.3
12-t	Estonia	87.1	77-t	Vietnam	79.6	140	Uzbekistan	66.1
12-t	Finland	87.1	77-t	Kazakhstan	79.6	141	Pakistan	66.0
12-t	Germany	87.1	80	Turkmenistan	79.2	142	Ethiopia	65.6
12-t	Hungary	87.1	81-t	El Salvador	79.0	143	Guinea-Bissau	65.3
12-t	Ireland	87.1	81-t	Moldova	79.0	144-t	Angola	65.2
12-t	Italy	87.1	83	Burundi	78.9	144-t	Cambodia	65.2
12-t	Latvia	87.1	84	Malaysia	78.8	146	India	64.1
12-t	Lithuania	87.1	85	Belize	78.1	147	Nigeria	63.9
12-t	Luxembourg	87.1	86	Rwanda	78.0	148	Kyrgyz Republic	63.2
12-t	Malta	87.1	87	Serbia	77.9	149	Dem. Rep. of Congo	63.0
12-t	The Netherlands	87.1	88	Azerbaijan	77.2	150	Sierra Leone	62.8
12-t	Poland	87.1	89-t	Sri Lanka	77.1	151	Cuba	62.7
12-t	Portugal	87.1	89-t	Honduras	77.1	152	Togo	61.7
12-t	Romania	87.1	91	South Africa	76.3	153	Nepal	61.5
12-t	Slovak Republic	87.1	92	Morocco	75.7	154	Guinea	61.2
12-t	Slovenia	87.1	93	The Philippines	75.5	155	Gabon	61.1
12-t	Spain	87.1	94	Tonga	75.3	156	Republic of Congo	60.7
12-t	Sweden	87.1	95	Thailand	75.2	157-t	The Gambia	60.5
12-t	United Kingdom	87.1	96-t	Haiti	74.8	157-t	Barbados	60.5
35	New Zealand	86.8	96-t	Panama	74.8	159	Djibouti	59.6
36	Namibia	86.5	98-t	Dominica	74.3	160	Benin	59.3
37	United States	86.4	98-t	Bolivia	74.3	161-t	Equatorial Guinea	58.8
38	Australia	86.2	100	Egypt	74.0	161-t	Venezuela	58.8
39	Bosnia and Herzegovina	86.0	101	Indonesia	73.9	163	Laos	58.7
40-t	Turkey	85.4	102-t	Burma (Myanmar)	73.6	164	Tunisia	58.1
40-t	Armenia	85.4	102-t	Uganda	73.6	165	Central African Republic	57.8
42	Costa Rica	85.1	104-t	Tanzania	73.5	166	Chad	55.6
43-t	Libya	85.0	104-t	Madagascar	73.5	167-t	Solomon Islands	55.4
43-t	Taiwan	85.0	106	St. Vincent and the Grenadines	73.3	167-t	Kiribati	55.4
43-t	Peru	85.0	107	Mali	73.2	169	Vanuatu	55.1
46	Nicaragua	84.9	108	Timor-Leste	73.0	170	Cameroon	54.9
47	Papua New Guinea	84.8	109	Mexico	72.9	171	Bangladesh	54.0
48	Guatemala	84.6	110-t	Algeria	72.8	172	Liberia	53.8
49	Ukraine	84.4	110-t	Syria	72.8	173	Zimbabwe	50.4
50	Oman	83.7	112	South Korea	72.6	174	Bhutan	49.5
51-t	Macedonia	83.6	113	Burkina Faso	72.5	175	Iran	45.7
51-t	Israel	83.6	114-t	Colombia	72.2	176	Maldives	43.7
51-t	Montenegro	83.6	114-t	Senegal	72.2	177	The Bahamas	42.2
54	Uruguay	82.9	116	Jamaica	72.1	178	Seychelles	33.4
55	Bahrain	82.8	117	Saint Lucia	71.9	179	North Korea	0.0
56	Paraguay	82.7	118	Niger	71.7	–	Afghanistan	NG
57	United Arab Emirates	82.6	119	China	71.6	–	Iraq	NG
58-t	Tajikistan	82.5	120	Guyana	71.5	–	Liechtenstein	NG
58-t	Qatar	82.5	121	Malawi	70.9	–	Somalia	NG
60-t	Zambia	82.3	122	Côte d'Ivoire	70.3	–	Sudan	NG
60-t	Saudi Arabia	82.3	123	Samoa	70.0			
62-t	Cyprus	82.1	124-t	Trinidad and Tobago	69.9			

t – Tie NG – Not Graded

Sources: Heritage Foundation calculations from the *2012 Index of Economic Freedom* (forthcoming January 2012).

Table 1 • B 2614 heritage.org

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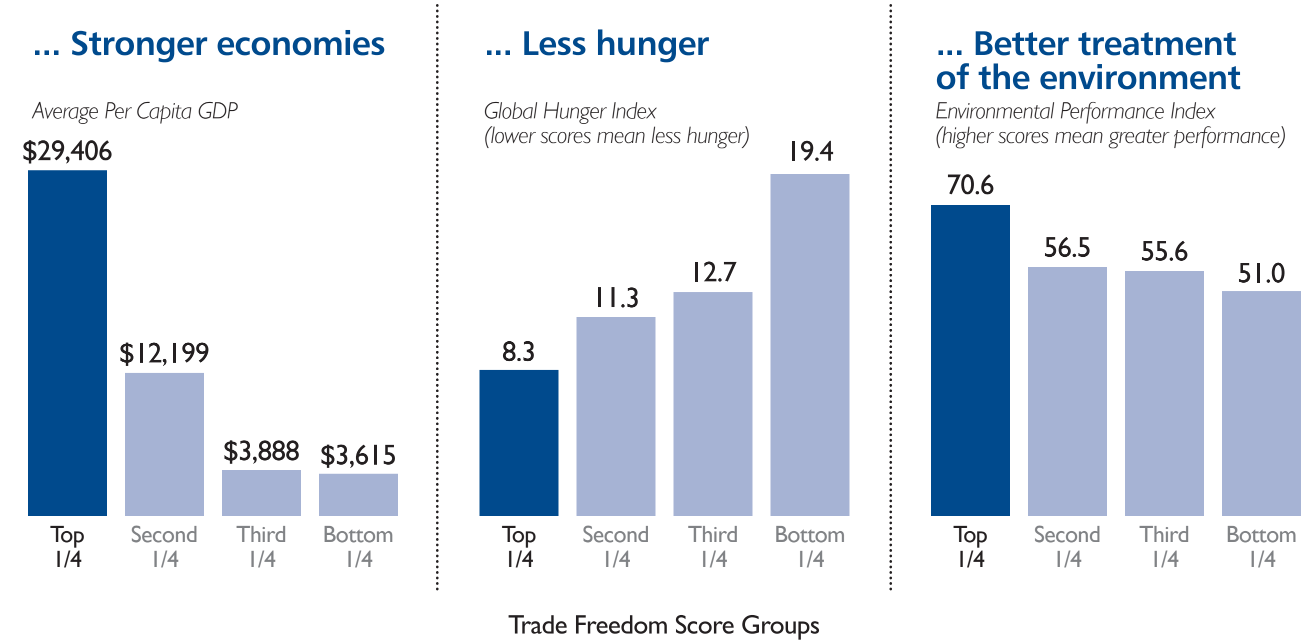
Some Benefits of Free Trade

We divided the nations of the world into four groups based on their trade freedom score in the *2012 Index of Economic Freedom*, then compiled each group's average in three other key variables. The chart below shows that **nations with more trade freedom also have ...**



Sources: Heritage Foundation calculations from the *2012 Index of Economic Freedom* (forthcoming January 2012) and:

- GDP per capita: The World Bank, "GDP per Capita (Current U.S.$)," at *http://data.worldbank.org/indicator/NY.GDP.PCAP.CD/countries* (September 12, 2011). Figures based on 180 countries.
- Global hunger: International Food Policy Research Institute, "2010 Global Hunger Index," October 11, 2010, at *http://www.ifpri.org/publication/2010-global- hunger-index* (September 12, 2011). Figures based on 122 countries.
- Environmental performance: Yale University, Center for Environmental Law & Policy, and Columbia University, Center for International Earth Science Information Network, Environmental Performance Index 2010, at *http://epi.yale.edu/* (September 12, 2011).

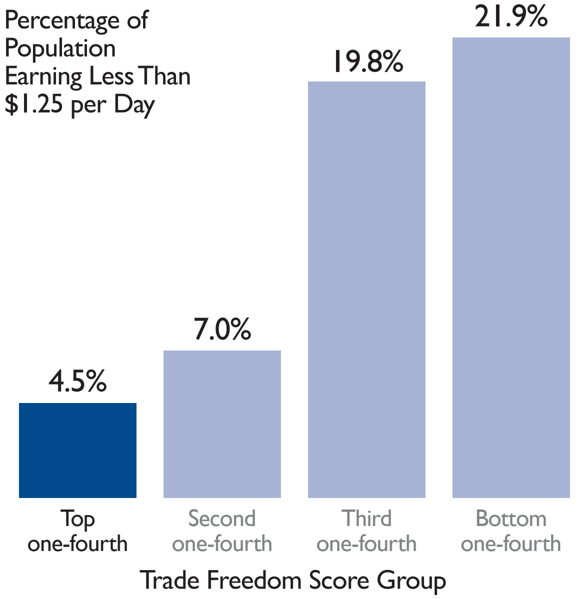
Chart 3 • B 2614 heritage.org

scores in the *2012 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 GDPs, lower incidence of hunger, and cleaner environments. (See Chart 3.)

Special interest groups often complain that "unfair" foreign competition destroys jobs, but countries with the highest trade barriers have nearly twice the unemployment rate of countries with the most trade freedom.[3] In the United States, 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.[4]

3. U.S. Central Intelligence Agency, *The World Factbook, s.v.*, "Country Comparison: Unemployment Rate," at *https://www.cia.gov/library/publications/the-world-factbook/rankorder/2129rank.html* (September 14, 2011). Figures based on unemployment rates of 120 countries with available data from 2007 to 2010.
4. U.S. Bureau of Labor Statistics, "Where Can I Find the Unemployment Rate for Previous Years?" February 3, 2011, at *http://www.bls.gov/cps/prev_yrs.htm* (September 14, 2011), and U.S. Bureau of Economic Analysis, U.S. International Transactions Accounts Data, Table 1, at *http://www.bea.gov/international/bp_web/simple.cfm?anon=71&table_id=1&area_id=3* (September 23, 2011).

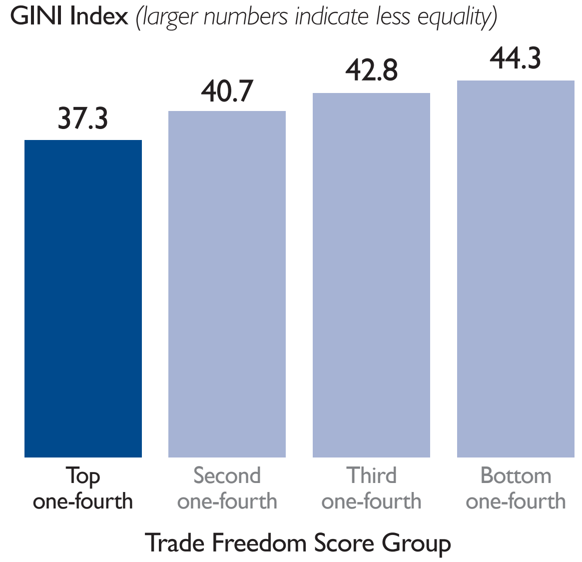
Nations With More Trade Freedom Have Less Poverty



Sources: Heritage Foundation calculations from the *2012 Index of Economic Freedom* (forthcoming January 2012) and The World Bank, "Poverty Headcount Ratio at $1.25 a Day (PPP) (% of Population)," at *http://data.worldbank.org/indicator/SI.POV.2DAY* (September 12, 2011). Figures based on available data since 2007 for 51 countries. PPP refers to purchasing power parity.

Chart 4 • B 2614 heritage.org

Nations with More Trade Freedom Have Lower Levels of Income Inequality



Sources: Heritage Foundation calculations from the *2012 Index of Economic Freedom* (forthcoming January 2012) and The World Bank, "GINI Index," at *http://data.worldbank.org/indicator/SI.POV.GINI* (September 12, 2011). Figures based on available data since 2007 for 56 countries.

Chart 5 • B 2614 heritage.org

Many critics of trade deals, such as the North American Free Trade Agreement (NAFTA) and the WTO agreement, argue that free trade benefits big multinational corporations and "the rich" at the expense of everyone else. In fact, as Chart 4 shows, poverty rates are lower in countries with low trade barriers.

One common measure of income inequality is the Gini coefficient. The larger the Gini coefficient, the greater the amount of inequality in a country. Chart 5 suggests that income inequality is greater in countries in which there is evidence of high levels of protectionism.

The U.S. trade deficit has led some Members of Congress to call for new trade barriers, but they would better serve their constituents by restraining excessive government spending and the resulting federal budget deficit. Trade deficits are driven more by macroeconomic factors than by trade policy. As Chart 6 shows, high trade barriers do not necessarily generate trade surpluses as a percentage of GDP.

World Trade Needs U.S. Leadership

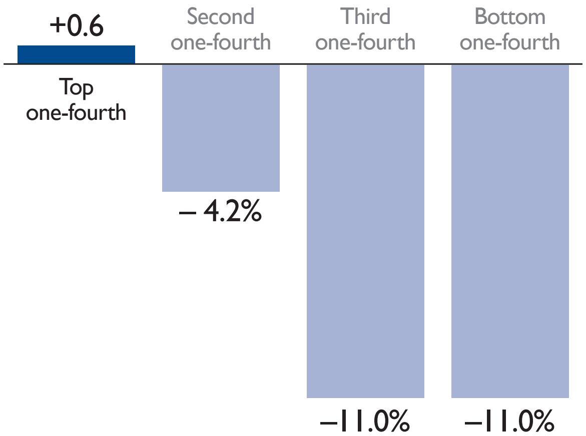
The United States can take several practical steps to encourage trade freedom. The Obama Administration can begin by setting a firm deadline for concluding the Doha Development Round of trade negotiations. The Doha Round's goal was to promote economic development through trade. Talks have been underway for 10 years, and the United States should lead them to a successful conclusion instead of allowing them to drag on indefinitely.

The United States should also encourage other countries' efforts to reduce trade barriers. For example, leaders in Africa are discussing a 26-country free trade area.[5] U.S. programs like the Generalized

5. Paige McClanahan, "African Free Trade Zone Planning Is Underway," *The Christian Science Monitor*, June 16, 2011, at *http://www.csmonitor.com/World/Africa/2011/0616/African-free-trade-zone-planning-is-under-way* (September 12, 2011).

Nations with Less Trade Freedom Have Large Trade Deficits

Trade Surplus or Deficit as Percentage of GDP, by Trade Freedom Score Group



Sources: Heritage Foundation calculations from the *2012 Index of Economic Freedom* (forthcoming January 2012) and The World Bank, "External balance on goods and services (% of GDP)," at *http://data.worldbank.org/indicator/NE.RSB.GNFS.ZS* (September 12, 2011). Figures based on data for 168 countries.

Chart 6 • B 2614 heritage.org

System of Preferences, African Growth and Opportunity Act, and Andean Trade Preference Act promote mutually beneficial trade and growth. These programs should be expanded to include more categories of imports and extended on a long-term basis.

The Obama Administration and Congress will hopefully enact free trade agreements with Colombia, Panama, and South Korea, which have been pending for years. In recent years, the United States has remained on the sidelines while other countries have aggressively moved forward with trade deals modeled on U.S. agreements, such as NAFTA. The Administration should follow up by exploring multilateral opportunities to reduce trade barriers in the Pacific, in the Western Hemisphere, across the Atlantic, and anywhere else it can find willing partners.

However, the United States need not wait for long, uncertain negotiations to reduce its own self-destructive trade barriers. Congress can take the first steps by eliminating:

- **Tariffs on imported shoes and clothing.** These tariffs, which have been called America's most regressive tax, cost Americans billions of dollars per year.[6]
- **Restrictions on sugar imports.** Sugar tariffs are the modern version of the Molasses and Sugar Acts, which contributed to the American Revolution. They should be as offensive to lawmakers today as they were to colonists in the 1700s.
- **Job-killing antidumping laws.** These laws reduce competition and increase the price of inputs for U.S. producers.[7] At the very least, Congress should require the government to conduct a cost-benefit analysis before considering any new antidumping duties.
- **"Buy American" laws.** Requirements for governments at the state, local, and federal levels to use domestically produced products when lower-priced imports are available increase government spending, leading to higher taxes or larger budget deficits. They also indirectly limit opportunities for competitive U.S. companies to sell their products to other governments.
- **The Merchant Marine Act of 1920 (Jones Act) and the Passenger Vessel Services Act of 1886.** These laws require ships moving from one U.S. port to another to be U.S.-made and U.S.-crewed, thereby artificially increasing cargo transportation costs.

Conclusion

The 2012 rankings of trade freedom show that people in the United States and around the world benefit when their governments allow them to

6. Edward Gresser, "The Rebirth of Pro-Shopper Populism: Affordable Shoes, Outdoor Apparel, and the Case for Tariff Reform," Progressive Economy, June 2011, at *http://www.outdoorindustry.org/pdf/Tariffs_Taxation.pdf* (September 14, 2011).
7. Daniel Ikenson, "A Tariff Reduction Plan for U.S. Jobs," *The Wall Street Journal*, September 10, 2011, at *http://online.wsj.com/article/SB10001424053111904716604576546910548548544.html* (September 14, 2011).

trade freely. Approval of pending trade agreements between the United States and Colombia, Panama, and South Korea would generate positive results including greater prosperity and less poverty in all four countries.

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Appendix
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:

$$Trade\ Freedom_i = \frac{Tariff_{max} - Tariff_i}{Tariff_{max} - Tariff_{min}} \times 100 - \mathrm{NTB}_i$$

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, 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 the forthcoming *2012 Index of Economic Freedom* France received a trade-freedom score of 82.1, based on the weighted average tariff of 1.4 percent common to all European Union countries. The tariff yields a base score of 97.1, 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.[8] In the very few cases in which data on duties and customs revenues are not available, the authors use international trade tax data instead. 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 2012 are based on data for the period covering the second half of 2010 through the first half of 2011. To the extent possible, the information considered was current as of June 30, 2011. 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 2011* and *Data on Trade and Import Barriers: Trends in Average Applied Tariff Rates in Developing and Industrial Countries, 1981–2009;*
- The World Trade Organization, *Trade Policy Review*, 1995–2011;
- Office of the U.S. Trade Representative, *2011 National Trade Estimate Report on Foreign Trade Barriers*;
- The World Bank, *Doing Business 2011* and *Doing Business 2012*;
- U.S. Department of Commerce, *Country Commercial Guide,* 2008–2011;
- Economist Intelligence Unit, *Country Report, Country Profile,* and *Country Commerce*, 2008–2011; and
- Official government publications of each country.

8. 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).