

# THE BENCHMARKING PRACTICES OF THE ECONOMICALLY FREEST COUNTRIES IN EUROPE AND THE WORLD

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**Abstract.** *In our increasingly globalised economy, global competitiveness of countries and the means to measure it gain increasing significance. One of the ways to measure global competitiveness is by comparing an extent of the economic freedom that a country has, which also can, as surveys show, largely explain differences in living standards across the world. Seeing as how European economy is similar to most of the Western world capitalist economies in the sense that it has, for a number of reasons, very different economic policy traditions than many countries in other parts of the world, we may approach this topic from a European perspective; consequently, we can see that the main hypothesis of the work can be confirmed, and it is possible, for reasons based in economic or national image nature, to discern which is the freest of world economies by adopting the benchmarking practices of the continent. Nevertheless, the other hypothesis of the work does not fulfill itself, meaning that by adopting taxing policies of some of the wealthiest European Union economies it is not possible anymore to reach the result of the freest economy, both in the world and particularly Europe. Looking at the components and scores of the Index of Economic Freedom, it becomes apparent that the inclusion of government share components in its methodology is very controversial, similarly as the labour freedom component and even monetary freedom, albeit in lesser extent.*

**Key words:** *Economic freedom and its components; competitiveness; The Index of Economic Freedom*

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## Introduction

In our increasingly globalised economy, global competitiveness of countries becomes only more and more important. It is not surprising, then, that this matter receives more attention from countries, researchers and the institutions they represent, organisations as well as from others concerned about the topic.

In order to maintain their competitiveness in the global economy, countries devote significant resources for analysing it and taking the proper steps for necessary improvements, which usually require mid-term and long-term policy planning. Researchers, with the institutions and organisations on whose behalf they act as representatives, have put

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great effort in establishing methodologies used to evaluate competitiveness of countries, despite the complicated nature of the subject.

Despite the huge criticism that these indexes often receive, largely due to different misunderstandings about their role and goals, the overall trends show that the same countries earn the same rank positions from index to index, which are also in accordance with their relative wealth and quality of life, when used in comparison with other countries. To a large extent based on the concept of free market capitalism philosophy, formulated by the 18<sup>th</sup> century Scottish philosopher and economist Adam Smith, we deduce that one of the means that serves to evaluate economic competitiveness of countries is the assessment the extent of its economic freedom.

The aim of this paper is to investigate what benchmarking practices countries would have to adopt for economic or national image reasons to become the freest economies in the world and Europe in each of the components from the Index of Economic Freedom.

We base the hypothesis of this work on the belief that it is possible for a European economy, given its different economic environment, to become the freest world economy by only adopting the best practices of the continent. Additionally, another hypothesis was set out of this research, namely that it is possible to achieve the status of the freest world economy with high taxing policies, as in the wealthy European Union economies.

To achieve these goals, a number of tasks were set. These tasks, in the order of sequence, are as follows:

- To review the literature on competitiveness and economic freedom
- To look at the most popular economic freedom indices
- To find the reasoning for economic freedom and its components
- To examine the benchmarking practices in each of the economic freedom components
- To make the necessary calculations from the summarised data in order to test both of the set hypotheses

To achieve the above-mentioned tasks, mainly descriptive, analytical, mathematical and comparative methods were used.

Accordingly, to find out the benchmarking practices of the economically freest countries, the remainder of this paper is structured as follows. Section No. 1 provides a brief review of the literature about this topic, section No. 2 covers The Index of Economic Freedom and other indexes measuring economic freedom, section No. 3 explains the reasoning for economic freedom and its components, section No. 4 looks at the benchmarking practices in each of the Index of Economic Freedom components, section No. 5 summarizes the gathered information and tests the hypothesis; finally, the conclusions section looks at the conclusions and interpretations derived from this article.

## 1. Brief review of the literature

Definitions of competitiveness differ on the context in which they are described in. Given that in this article competitiveness is looked at in the context of national competitiveness, the author went through some of the definitions that exist for explaining it.

Some of the most prominent researchers on competitiveness, Mercedes Delgado, Christian Ketels, Michael Porter and Scott Stern, in their joint research about the defining factors of national competitiveness also accentuate that the definitions of national competitiveness definition are very different, depending on the point of focus. Some equate competitiveness with ability to achieve certain overall outcomes, such as a high standard of living and economic growth. Other definitions focus on the ability to achieve specific economic outcomes such as job creation, exports, or FDI. Yet other definitions see competitiveness as defined by specific local conditions such as low wages, stable unit labour costs, a balanced budget, or a competitive exchange rate to support the current account surplus (Delgado et al., 2012).

Possibly the most well-known researcher of competitiveness, Harvard University professor Michael Porter, when speaking on the matter of national competitiveness, has stated that a nation's prosperity depends on its competitiveness, which is based on the productivity with which it produces goods and services. Sound macroeconomic policies and stable political and legal institutions are necessary, yet not sufficient enough as conditions to ensure a prosperous economy. Competitiveness is rooted in a nation's microeconomic fundamentals – the sophistication of company operations and strategies and the quality of the microeconomic business environment in which companies compete. An understanding of the microeconomic foundations of competitiveness is fundamental to national economic policy (Porter, 2014).

Looking from this perspective, competitiveness becomes strongly jointed with productivity. There is a wide belief that productiveness is one of the central aspects to explain differences in wealth of the nations, backed up by numerous research.

Such structural policy documents as the Growth Agenda, published by the Organization for Economic Co-operation and Development (OECD, 2005) and the European Commission 2020 strategy (EC, 2010) are largely based on the competitiveness enhancing activities which promote productivity.

Largely based on the beliefs of already mentioned 18<sup>th</sup> century philosopher and economist Adam Smith on the benefits of the free market, written in his famous book, titled "An inquiry into the nature and causes of the wealth of nations", and already published in 1776, well before the industrial revolution, competitiveness is looked up from the standpoint of economic freedom. In the years to follow, it has been backed up by countless studies, showing the contribution of economic freedom on the wealth of nations.

In the era of mercantile economic thinking, Smith came up with revolutionary and novel ideas. He argued that regulation of commerce is unproductive, hindering people

from investing their own resources into actions where they see the best economic use. By not developing free trade and competition, introducing tariffs, establishing monopolies and subsidy systems, consumers eventually are forced to pay a bigger price than they would under free competition conditions.

Given these reasons, Smith believed that a state role has to be limited, in order to not distort the free market economy. Its biggest role is to ensure external and internal safety of a state, the rule of law, development of infrastructure and promotion of education. That, of course, can be done through taxation, which Smith doesn't deny, but at the same time putting emphasis that the level of taxation should be at the level that citizens can afford. However, he would still oppose capital taxation, because capital availability is one of the pillars of productivity.

Concerning productivity, Smith also believed that for productivity in working conditions, work specialization is critical, which through economic profit making leads to the accumulation of capital, which in turn allows to invest in even more productive devices and processes.

Many of our contemporary economists have also tried to explain the concept of economic freedom. Definitions of this concept also vary, just like for the concept of competitiveness. Nevertheless, the common thing here is that they all put emphasis on the principles of free market trade and private property rights.

Such economists as Lawrence McQuillan, Michael Maloney, Eric Daniels and Brent Eastwood, who themselves have introduced an index of economic freedom for the US in the past, describe economic freedom as the right of individuals to pursue their interests through the voluntary exchange of property which is subdued to the rule of law. It is this kind of economic freedom that lays sound foundations for an economy. Economic freedom ought to come under minimal state interference in order to ensure safety and reliability of a legislative basis; judicial or court rules are critically important, for otherwise it would only serve as a hindrance to economic freedom. State rules that ensure these rights promote economic freedom.

Nevertheless, there are researchers that cast doubt on the special merits of economic freedom in the global economy. One of the most prominent of them is Paul Krugman. He argues that when we compare countries, the level of productivity is the thing that really matters, not competitiveness measures, because countries don't compete with each other in any relevant manner and focusing on competitiveness leads only to destructive state policies.

One can agree to such statement only partially. Like previously stated, undoubtedly there is a correlation between competitiveness and productivity improvements; considering that, it wouldn't be right for countries to not compare their competitiveness against other economies in this era of continually increasing globalisation, where economies co-operate while also competing with their goods and services in the global market. The words of the 17<sup>th</sup> century Japanese Buddhist Samurai Miyamoto Musashi, that it is hard to understand the Universe by exploring only one planet, fit in here very well.

Krugman is also critical about economic freedom, he associates it with a dominance of foreign companies in countries which are for various reasons in lower stages of economic development. Foreign companies who, given their advantage of the level of accumulated capital, can easily take over local businesses. That becomes especially evident in times of periodical economic crises, which in turn are often stimulated by asset bubbles that are partly caused by an influx of investment.

Also, in the cases of full capital liberalisation, oftenly short term speculative investments evolve in underdeveloped countries, which, without sufficiently effective regulatory framework, can provoke distress of a financial system (Stiglitz, 2000). However, in the case of foreign direct investment, risks are not as high, given that capital can't flow away just as swiftly.

Another negative aspect of increasing economic freedom in developing economies is that countries have to go through the phase of increasing inequality (Berggren, 2003), which basically is a result of decreased redistribution.

Of course, these are not the only negative effects on societies that arise from economic freedom or liberalisation. For example, the author of this article may also list such consequences of freedom or liberalisation as running local enterprises out of business, takeovers by competitive firms, enforcing the interests of foreign companies, dependence on foreign capital, deteriorating work rights, harmful manufacturing for the environment, introducing of commercial practices that are not favorable for consumers, as well as endangerment of national cultures.

All these arguments about the negative side effects of economic freedom are very solid, particularly in our global capitalism, dependent on cross-border trade and investments (EC, 2013). Nevertheless, the short term negative effects of economic freedom are outweighed by its positive long-term impact, as countless studies have shown. Economic openness and competitiveness is especially critical for small economies that can not build their prosperity on valuable natural resources, like Persian Gulf countries, or even on an historically accumulated capital, like Scandinavian countries. Here, a good example could be provided by the highly educated Baltic nations, possessing very high work ethics, who, given their tough historic legacy of regaining independence from the Soviet Union, have to objectively go through many phases of economic development to reach the level of the wealthiest countries. Regarding the Scandinavian countries, it is important to note that Norway has built its economic prosperity largely thanks to the abundance of natural resources that it possesses.

Another big factor is that despite the fact that improvements in economic freedom do not automatically mean greater output, they play a substantial role in creating a positive image about an economy, which, again, is important for the attraction of FDI (Berger and Bristow, 2009). That alone means that it is worth for countries to pay some attention to these wildly disputed indices.

What is also very important in regarding economic freedom, research shows that although it has its negative effects, overall trends are indicative that countries with higher levels of economic freedom have not only higher gross domestic product per capita and its growth rates, but also have better health care, education systems, environment protection (Roberts and Olson, 2013), as well as greater income equality (Esposito and Zaleski, 1999), and maybe, above all, happiness results (Gropper, 2011). These trends of increasing prosperity with augmenting economic freedom are confirmed even when we compare these results within the territories of countries (Stansel, 2013; Davies, 2013, among others). However, the importance of each economic freedom component in acquiring prosperity differs according to study.

## **2. The Index of Economic Freedom and other indexes measuring economic freedom**

The Index of Economic Freedom by the Heritage Foundation and The Wall Street Journal is published annually since 1995. In total, 101 countries were included in the first report of economic freedom, which currently covers 186 countries, including even the least free country in the world – North Korea. That is possible given the methodology of the index, which doesn't require direct involvement of countries to evaluate their level of economic freedom.

The authors of the index approach competitiveness through economic freedom, which, according to them, is the most important precondition of competitiveness. The less countries are regulated by their governments, enhancing economic freedom, the more competitive and wealthier they will be. Economic freedom is defined as the core right of individuals to manage their own work and property. In an economically free society individuals are free to work, produce, consume and invest as they like, economically free countries let the workforce, capital and goods move freely, abstaining from interference and restrictions more than it is necessary for ensuring freedom as such. (The Heritage Foundation, 2014; Vanags, 2005).

The methodology of the Index of Economic Freedom is based on 10 components that make up economic freedom, which all are grouped in 4 pillars where countries perform some kind of regulating functions:

- Rule of Law (property rights, freedom from corruption)
- Limited Government (fiscal freedom, government spending)
- Regulatory Efficiency (business freedom, labour freedom, monetary freedom)
- Open Markets (trade freedom, investment freedom, financial freedom)

In order to achieve a more comprehensive outlook in these four categories of economic freedom, the index evaluates all 10 components on a scale from 0 to 100. All 10 components are weighted equally, given that there hasn't been conclusive evidence about which of them play a bigger or lesser role in ensuring economic freedom (Gwartney and

Lawson, 2003), as well as for enhancement of economic prosperity (Diaz-Casero et al., 2012; Carlsson and Lundstrom, 2001; Heckelmann and Stoup, 2000), giving both surprising and contradictory results, e.g., that trade freedom is not an important factor for the growth, which is contrary not only to countless other research, but also to contemporary mainstream teachings about the benefits of free market trade.

Like any indices measuring economic competitiveness and freedom, this index is not ideal and perfectly suited to explain the whole complexity of the subject. Authors of the index admit it themselves, stressing that it has never been their goal. Rather than that, their goal is to give data for exploration of interconnections that exist regarding this matter.

For example, the famous American economist Jeffrey Sachs, in his book “The end of poverty: Economic Possibilities of our Time” has shown that a correlation between economic freedom and GDP growth doesn’t always exist. This was illustrated by comparing, despite their high economic freedom scores, the sluggish economic growth results of Switzerland and Uruguay with China, which, despite its relatively low scores of economic freedom, experienced unprecedented economic growth (Sachs, 2005). The same truth – that improvements in economic freedom do not necessarily mean higher economic growth – has been concluded by other research as well (The Left Business Observer, 2005).

For the sake of objective index advocacy, here we have to remind that authors of the index are not attempting to explain every case of economic growth, since the science of economics is very complex and many other factors come in to equation while explaining economic growth, like, in this instance, the Chinese comparative advantage of using economies of scale. Also, we have to keep in mind the dynamic and static growth factors. Countries like China, which are in the dynamic growth phase, have a higher potential for GDP growth than countries like Switzerland, which is in the static growth phase. We have to keep this too in mind as we look at the other indices of competitiveness when trying to explain economic growth.

Shortages of The Index of Economic Freedom have been investigated by Stefan Karlsson, a researcher of the Ludwig von Mises Institute, showing a number of deficiencies in its methodology, its components, and their choice as such. The IEF has been heavily criticized by state officials as well (The Business Intelligence, 2008), casting doubt on some of the appraisals by contradicting them with appraisals in other indices and surveys. Another common criticism that the index receives is that given their authors, representing the Heritage Foundation and The Wall Street Journal, they are openly lobbying interests of the private sector. Also, this index gathers its information to give appraisals for various components pretty much only from US institutions or international organisations that are based in this country.

Without the already reviewed Index of Economic freedom, published by the Heritage Foundation and The Wall Street Journal, there currently exist and have existed before

several other indices to measure economic freedom. Another of the most well-known indices that measure this matter is the Economic Freedom of the World index, established by the Canadian based Fraser Institute (Gwartney and Lawson, 2013), and, its structure being very similar to The Index of Economic Freedom, it is no surprise that also it yields very similar scores (Hanke and Walters, 1997). The EFW report has been in print since the 1980; in difference to the IEF, it is using more quantifiable data (Gwartney and Lawson, 2003), and acquires most of its information from third parties, i.e., mainly international organisations. Currently, it compares economic freedom data from 152 countries, which is less than covered in the IEF.

The authors of the EFW define economic freedom as the right of individuals to have personal choice, voluntary exchange, freedom to compete, as well as personal and property safety. When economic freedom exists, people decide by choice what goods and services will be produced. Clearly, people will take part in exchanges that are beneficial for both sides. Personal property is the foundation for economic freedom; thus, individuals have the right to choose how they will use their time and skills, meanwhile not possessing rights on the time, skills and resources of others, meaning that they are not in a position to demand from others (Gwartney and Lawson, 2003).

The index itself consists from 42 factors, which are divided into 5 economic freedom pillars – 1.) Size of Government; 2.) Legal Structure and Security of Property Rights; 3.) Sound Money; 4.) Freedom to Trade with Foreigners; 5.) Regulation of Credit, Labour, and Business.

Just like in the case of the IEF, the EFW also counts all the component scores together to conclude the average score, not putting any additional weight on any of the components or factors.

Without the aforementioned, other indices to measure economic freedom do exist, although not very popular. Some extend global measure, and others, as in cases of bigger countries, measure on a national scale. For example, some are used in North America, and two indices have been used to measure the level of economic freedom in India, one of them using the methodology obtained from the Fraser Institute.

### **3. The reasoning for economic freedom and its components**

The vital positive impact of economic freedom for the growth has been proved by a wide number of empirical surveys (Kim, 2014, Berggren, 2003, De Haan and Sturm, 2000, among others). However, opinions differ in whether economic freedom explains economic growth in the initial stage of economic development. Many researches show that its positive contribution can be felt only at the latter stages and in longer term. Also important, by comparing the Index of Economic Freedom data, growth follows after improvements in economic freedom (Heckelman, 2000) and not vice versa, as in preceding it.

This growth can be explained in many ways thanks to the positive contribution of economic freedom in attracting foreign direct investment (Choong, 2010), which is very

important for productivity improvement – this as well basically meaning improvement in competitiveness and granting greater opportunity for growth, what eventually allows to raise capital savings that can be used to invest in further productivity enhancing activities.

We must reiterate that attraction of the FDI doesn't automatically guarantee economic growth (Azman-Saini et al., 2010). By attracting these investments, very important is the level of economic freedom, since it allows a better absorption of the benefits from a presence of multinational corporations that transfer technologies and processes, raise workforce qualification, attract arising economic opportunities from global value chains, reorient a country from a raw materials producing state to final product manufacturing country and offers a number of other positive contributions for economic development. Results show that in countries where economic freedom is higher, positive effect from the FDI is higher than in countries with lesser extent of it.

Like covered before, methodologies and components of the both most well-known indices of economic freedom are very similar, thus giving very similar results. (Hanke and Walters, 1997). For that reason, the author of this publication, becoming acquainted with the reasoning of component choice for the IEF and the EFW (Miller and Kim, 2011, Gwartney and Lawson, 2003), which basically relies on the famous Scottish philosopher's and economist's Adam Smith's teachings about the free market principles, as well as on work of other scientists, has summoned why these particular components have been chosen for measuring the economic freedom, at the same time looking at the scientific reasoning for their necessity to achieve economic prosperity.

#### ➤ Property rights

The property rights component is important for economic freedom, given that property obtaining is one of the main motivating incentives for people to get involved in economic or intellectual activities. If a physical or legal person can't be sure about an ability to manage their produced property or resources, it will diminish the person's motivation to put effort and resources to acquire it, in the case of both material and intellectual property. In order for the subject to feel safe about his property, according legislation is needed, which has to be both introduced and implemented through transparent, independent, honest, and accessible for all judicial system. It is not only important from an economical point of view, but also from the standpoint of human rights. It is also very important that the court system offers equal attitude, no matter from which country one comes. This becomes even more important in our increasingly globalised economy, just given how crucial it is for the attraction of foreign resources.

The importance of this component has been proven by various surveys. For example, it has been shown that growth in countries with strong property rights, when compared with countries where property rights are weak, is twice as high (Weimer, 1997). It is widely believed that one of the reasons that that is a hindrance for African countries to

fully develop is the lack of appropriate property rights system, one such as in the Western world (De Soto, 2003). By comparing results from countries who had been occupied by the Soviet Union and its satellite countries in Eastern Europe, results show that weak intellectual property rights protection scares away potential investors in technologically intensive sectors, impeding the takeover of the benefits associated with the presence of multinational corporations, that are, in the best case scenario, involved in projects that deal with distribution of produce, not the manufacturing (Javorcik, 2004).

➤ Freedom from corruption

The freedom from corruption component is important for economic freedom since corruption wastes state resources by circumventing principles of competition and effectiveness. Besides, corruption doesn't end with plain bribery and bribe-taking to achieve some certain favorable outcome, it comes in various shapes and forms, as embezzlement, extortion, nepotism etc. As a consequence, all these actions privilege narrow groups of people at the expense of others, and eventually at the expense of the society as a whole. Threats of corruption are especially acute in economically and politically unfree and constrained countries, where private initiatives have limited opportunities to acquire resources, placing big authority and power in the hands of state officials to acquire them. If this environment is supplemented by low levels of transparency, which usually is the case, it creates very fertile grounds for corruption.

The significance of the freedom from corruption component has been justified by a wide number of surveys, showing its negative role on economies. It has been discovered that one standard point deterioration in corruption index, lowers investments at the rate of 2.46%, which in turn diminishes growth by 0.34 % (Pellegrini and Gerlagh, 2004). That in turn decreases absolute public expenditure, including expenditure in such important fields for long-term economic development as education and infrastructure (Mauro, 1997). Also, for example, it has been shown that the risk of corruption becomes more acute in countries where there is an established higher than 50 days mandatory period to register the commencing of a business (Dreher, 2013), signifying about deficiencies in a state regulatory environment and giving incentives to accelerate juridical registering of an enterprise with bribes or not registering it at all, possibly adding even more negative impact to the well-being, and in many cases even safety, of the society.

➤ Government expenditures and fiscal freedom

The government expenditures component has been included in the measuring of economic freedom since an oversized government share of gross domestic product impedes private initiative, and with that productivity, which arises as a result of competition. However, the positive effect from state expenditures that promote quality of infrastructure, education, the rule of law, etc., is acknowledged, where through the means of free market forces it is not possible to get the best outcome, and which eventually supports

growth and efficiency of the private sector. Looking from a fundamental point of view pertaining to economic freedom, the argument would be that the bigger share of countries resources go through state budget, the lesser is the economic freedom of its society, which in turn raises many risks from the political and civil freedom perspective.

Another of the government size pillars is the fiscal freedom component, which has very similar reasoning as the government size component, namely, that a state interference in the free market economy with too big of a taxation level hinders economic growth, not only decreasing motivation for the society to involve in commerce, but also impeding productivity and growth, since increasing the overall tax burden decreases entrepreneurship, encouraging consumption and lowering the amount of total capital that can be reinvested back into economic development. Once again, looking from a fundamental point of view pertaining to economic freedom, governments restrict the economic freedom of their people by levying taxes on earned income from one part of the society to later transferring it to another part of it.

Given that both of these government size components are hard to separate from one another, results of empirical surveys about them were approached together. Although the inclusion of these components for achieving economic prosperity can be most disputable of all, just by primitively looking at the bottom and top of scores of these components, where, according to the methodology of The Index of Economic Freedom, we can see that the lowest scores have been received by countries that are relatively very prosperous, and the highest ones have been received by countries that are relatively poor. Nevertheless, research shows that an oversized government role in its economy decreases economic activity (Diaz-Casero et al., 2012), thus negatively impacting growth (Bergh and Karlsson, 2010), followingly increasing unemployment (Feldmann, 2006). Though regarding growth, it has been mentioned that countries can diminish the negative effect from taxation on enterprises through properly functioning institutions, or even eventually gain from it through successful redistribution, promoting economic growth in a longer term, thus positively affecting economic growth and employment.

#### ➤ Business freedom

The business freedom component is important for economic freedom given that excessive regulatory rules for business impede its development, consuming resources, which in turn lower productivity. In the case of overcomplicated and difficult regulatory requirements, in relation to various kind of economic activity, many malign economy risks arise, for example, an increasing risk of corruption in the public sector; since incentives for corruption arise, yet the private sector increases the size of unregistered shadow economy, in turn it becomes much easier to not register economic activity at all.

The importance of business freedom is proved by vast amounts of literature. One of the studies demonstrated that improving national positions in the Doing Business index from the lowest performing quartile to the highest performing averagely gives 2.3 %

better annual gross domestic product growth (Djankov, 2006), providing an even bigger positive effect for economic growth than increasing a number of pupils that have received the basic and high school education. Summarising the complex insolvency factor influence, there is a wide consensus that a well functioning insolvency system affects economic dynamism of a private sector in a positive way (Klapper, 2011), through a faster return of funds, saving of businesses, accessibility of funds and other factors. Another of the business freedom composing indicators is dealing with construction permits, for not only it is important for the safety of people, given that excessive requirements enhance overlooking of the rules (Moullier, 2009), but also from the economical point of view: for example, the attracting foreign direct investments that advance economy.

➤ Labour freedom

Labour freedom is important for economic freedom on the basis that the labour force market, in its essence, is just like other markets of resources, and just like in any other market, artificial regulating of it through means of setting minimum wages, centralised salary setting, hiring and dismissal conditions, unemployment allowances and other regulations that are not based on the principles of free market exchange are not the desirable solutions for productivity and development of an economy. Looking from a perspective grounded in the rudiments of economic freedom, people have the right to work where and how much they like, if their economic freedom is not restricted.

This component has been justified by various surveys. It has been shown that excessive workforce market regulation decreases employment and increases unemployment, both in Europe (Munkhammar, 2011), and in OECD member countries as a whole (Siebert, 1997). In the case of Europe this is very important, considering the globalisation and the ageing populations. Besides the fact that excessive workforce regulation hinders the attraction of foreign direct investment, the shifting between enterprises from one where new knowledge has been acquired to a local other is made more difficult, making the transfer of knowledge from multinational corporations a troublesome procedure (Fosfuri, 2001), which is not positive for the development of a knowledge based economy.

➤ Monetary freedom

Monetary freedom is important for economic freedom given that money is an instrument of value exchange and accumulation, one which loses its value with inflation, taking away the incentive from an individual to acquire it. If inflation is not constrained and is too high, it makes long-term planning harder, raising expenses, distorting comparative prices, etc. A controlled and desirably low level of inflation allows better long-term planning, sustaining of price stability, competitiveness, etc. Also, there is a wide belief among liberal approach economists that the control of prices worsens market effectiveness, also leading to deficits and shortages, as well as promoting longer term inflation;

given these reasons, direct or indirect price controlling through various subsidies and state enterprises is not considered desirable.

Reasoning for the role of this component in achieving economic development can be found in vast amounts of literature. One study accentuates that monetary freedom is one of the most critical components for economic freedom (Ayal and Karras, 1998), which promotes accumulation of capital and growth through successful containing of inflation and a restricted role that state enterprises play in an economy. By regulating prices, countries are taking away motivation from individuals to invest their resources in the development of certain industries and satisfaction of their demand (Filson, 2007), in this way, as a result of restricted supply, enhancing further increase of price for product or service, which may also, in many cases, eventually force economic activity into shadow economy. Affecting of prices through state owned enterprises that don't operate on the principles of free market is not welcomed (Filipovic, 2005), since through investments it doesn't enhance the introduction of new technologies, processes and structural reforms, which all are crucial for productivity and competitiveness of an economy.

#### ➤ Trade freedom

Trade freedom is one of the other critically important components for economic freedom, given that global trade is one of the main forces that allows the globalised economy to evolve. From a perspective of economic development, the role of foreign trade can not be underestimated when we look at its impact on productivity and competition, ensuring development through export and import of products and services. Export gives a chance to expand markets, use economies of scale advantages, widen capacity etc. Import provides a chance to access to the most updated technology, most effective producing devices, cheapest resources, etc. Various restrictions, such as tariffs, quotas, export duties, non-tariff regulatory and technical barriers or total bans of trade, promote uncompetitive manufacturing, which serves as a hindrance for successful long-term development of countries. An outlook of fundamental economic freedom tells us that by denying the right of people to exchange with their products and services in international market, countries restrict their economic freedom.

The positive contribution from trade freedom has been justified by countless research. For example, for every two new job positions created in some European Union country, another one is created in some other member country (Sousa, 2012), confirming the significance of global trade for a well-being of nations. Here we can make parallels with the already observed example of *Iphone*, which, despite being designed in USA and assembled in China, provides most of its value through manufacturing of components in enterprises of Japan, Germany, Korea (Xing and Detert, 2010); in turn, the process of manufacturing of these components uses products and services that are offered in other countries, thus globally creating new jobs and income as well as good quality product at accessible price for consumers. That again reminds us of the significance of imports

in sustaining competitiveness and productivity (Romer, 1990) through importing raw materials as well as importing manufacturing devices.

➤ Investment freedom

Investment freedom is significant for economic freedom given that it is one of the main ways to attract resources that, by flowing to the most attractive places, promote the creation of jobs, the transfer of knowledge and experience, the takeover of innovative processes and competitiveness of products and services. In our globalised economy, it is very important to not put restrictions on the attraction of investments, especially in economies where, for reasons objective or subjective, the level of accumulated capital is low and there isn't any substantial income per person from highly demanded valuable natural resources.

The importance of this component has been already outlined in the beginning of this research with an emphasis on how vital investment freedom is for productivity and competitiveness, and that it results in the attraction of new funds and knowledge, necessary for development. However, given their inseparability in a very large extent, significance of attracting investment will be discussed further when we will look at the only economic freedom component that hasn't been covered yet – the financial freedom. In general, commonly accepted importance of the investment climate can be even proved just by looking at how much resources countries devote for the attraction of investments (Dadush, 2013), as in establishing one stop investment agencies or different incentives of fiscal and financial nature, like tax discounts and state guarantees.

➤ Financial freedom

Financial freedom is crucial for economic freedom since it gives access to resources that can enable growth and development. The bigger the competition and development of the financial market, the bigger and more versatile are the opportunities to access financial resources, providing a chance to invest in development, the examples of which can be mentioned as material resources, like manufacturing devices, or intangible resources, like raising worker qualifications, thus improving productivity and competitiveness. State interference in the financial sector is necessary only as much as to ensure transparency of financial institutions, so that market players can objectively make decisions about the stability of the financial system and possible risks. Looking from an economic freedom perspective, we deduce that the state role should be limited, because when countries interfere in the free competition in one way or another, i. e. holding majority voting right over some financial bank, free market principles are distorted.

The significance of this component has been justified by empirical surveys (Alfaro et al., 2010; Alfaro et al., 2004), showing that access to outside resources is critically important for takeover of the newest technology, at the same time ensuring that the productivity competitiveness race is not being lost. It even has been more important

than the development level of human capital, however, one can assume that these aspects ought to go hand in hand to obtain the best possible outcome. Also, supplementing the already mentioned information, many researches have shown (Carkovic and Levine, 2003; Hermes and Lensink, 2000), among others, that both the banking sector and the stock market play a very important role in acquiring the positive spillovers associated with foreign direct investment, and that in countries where the financial system is comparatively more developed they receive more of these positive spillovers than in countries with a less developed financial system.

#### **4. Benchmarking practices in each of the Index of Economic Freedom components**

##### ➤ Intellectual property

For countries to achieve the best relative assessment in the intellectual property rights component, they ought to reach the same appraisal as New Zealand, which has been evaluated with 95 points by the index authors. However, here we encounter one of the biggest drawbacks of the IEF, being that it doesn't give precise information to justify its assessment, as in the mentioned instance, with 5 points being higher than other highest performing countries. It doesn't even become clearer by looking at the sources used for estimations (U.S. Department of Commerce, 2013; U.S. Department of State, 2013, among others). 90 points have been earned by a dozen of European countries, i.e., Austria, Denmark, Estonia, Finland, Germany, Iceland, Ireland, Luxembourg, Norway, Sweden, Switzerland, Netherlands, Great Britain, and four more countries outside of Europe, namely Canada, Chile, Hong Kong and Singapore. According to the index methodology, such appraisal is earned by countries where private property is guaranteed by the government, the court system enforces contracts efficiently, the justice system punishes those who unlawfully confiscate private property, corruption is nearly nonexistent and expropriation is highly unlikely.

##### ➤ Freedom from corruption

In order to achieve the highest score from all countries in the freedom from corruption component, countries ought to achieve a level of such prosperous countries as Denmark and New Zealand (Transparency International, 2014). These countries have implemented the best legislative practices to counter corruption and reached very high transparency levels, e.g. in public procurement, abstaining from state cooperation with enterprises that are accused of bribery, society involvement, guaranteeing the anonymity of whistle blowers, etc. However, it's important to note that none of the countries are perfect in this area and even the very highest performing countries, according to the Corruption Perception Index methodology, which is also used here for the IEF, basically earn only 9 out of 10 possible points.

### ➤ Fiscal freedom

In order for countries to obtain the very best global score in fiscal freedom, they would pretty much have to abolish taxes at all, like in Qatar and Bahrain, where individual and corporate taxes are nonexistent and the total tax burden in these countries respectively is 2.9 % and 3.1 % from the gross domestic product (GDP); nevertheless, the very lowest total tax burden can be found in Kuwait, with 0.8 % from the GDP, but its 15 % marginal corporate income tax rate, according to the index methodology, doesn't let it earn the title of the fiscally freest economy. In total, 9 countries have 0 % top marginal tax rate on individual income – Kuwait, Bahrain, Qatar, UAE, Oman, Bahamas, Maldives, Brunei, Vanuatu, and 6 countries have 0 % top marginal tax rate on corporate income – Bahrain, Qatar, UAE, Bahamas, Maldives, Vanuatu. As can be observed, the mentioned countries are either oil rich Persian Gulf countries or tax heaven islands, and regular economies, except in the case of discovering a substantial amount of very valuable natural resources, would find it to be next to impossible to achieve such tax policies without catastrophic or serious implications for their societies.

If we look at this matter more realistically – from a European perspective – we can see that in regards to tax policies, countries would have to follow the example of Lithuania in order to set the goal of earning the title of the fiscally freest economy in the continent. The top marginal and corporate tax rates for income are set at 15 %, with the total tax burden being only a bit higher – 16 %. The very lowest top marginal and corporate tax rates for income can be found in Montenegro, set at only 9 % each. However, its total tax burden is 24.2 %. The very lowest total tax burden with only 12 % is in Azerbaijan, a country abundant with oil and gas.

Nevertheless, just by simply looking at the highest score earning countries, where, after Lithuania, 22 Eastern European less developed and free economies follow, i.e. Albania, Kosovo, etc., and the very lowest scores earning wealthy countries, such as Denmark, Sweden, Belgium, etc., we must raise the question of whether the countries, in contrary to the index methodology, ought to rather follow these countries in a long-term run.

The very lowest result, according to the index methodology, goes to Denmark, where the total tax burden is 48 %, the top marginal tax rate on individual income is 56 %, the top marginal tax rate on corporate income is 25 %. In the list of European countries, the very highest top marginal tax rate with 57 % on individual income is in Sweden, and the top marginal tax rate with 34.3 % on corporate income is in France. However, these rates are not the very highest in the world: Eritrea has 50 % of the biggest total tax burden, Chad has the biggest set top marginal tax rate on individual income at 60 %, and Bangladesh has the biggest set top marginal tax rate on corporate income at 45 %. All of these countries are very poor, which again shows us the complexity of this matter and emphasises the economic doctrine that countries should gradually raise their taxes, preferably as they advance through their stages of economic development, otherwise it's very likely that consequences will be adverse for a long term development.

### ➤ Government spending

It is a very similar situation regarding the government spending component, where developing economies show the highest scores, i.e. Guatemala (14.6 % of government expenditure per cent from the GDP), Turkmenistan, Central African Republic, Bangladesh, Dominican, Madagascar and Philippines. Only then the very economically open Singapore comes in with 17 % of government share from the GDP. Similarly in Europe, the lowest government expenditures percentage from the GDP is posted in for continent standards poor countries, i.e., Armenia (25 % from the GDP), Albania, Kosovo, Macedonia and Georgia. These countries are followed by Switzerland with the total government expenditures from the GDP reaching 33.8 %.

The very lowest scores from the European countries in this component are again earned by wealthy European Union economies, i.e. Denmark (58 % government expenditure % from the GDP), France, Finland, Belgium, etc. However, these are not the biggest percentual government shares from the GDP worldwide; those are even higher in half a dozen of relatively poor countries, i.e. Timor-Leste, Kiribati, Cuba, Libya, Micronesia and Lesotho.

### ➤ Business freedom

In the business freedom component, the very highest scores are shown by Honk Kong and Denmark. Nevertheless, these countries do not show the benchmarking practices in each of the business freedom composing factors – for that reason we will look at some of the best practices in each of them.

It only takes 1 procedure to start a business in New Zealand and Canada and it also requires only 1 day. Slovenia is the only country in the world where it costs nothing, but for the paid-in minimum capital percentually of the monthly income per capita, there are 99 countries worldwide, where it is at 0.0 %. On average, to start a business in the OECD countries, it takes 5 procedures, 11.1 days, costs 3.6 % of the income per capita, and the paid-in minimum capital is 10.4 %.

Only 6 procedures are required to obtain a license for a building permit in Honk Kong. However, in terms of the necessary days spent for acquiring it, the very best result, with only 26 days, is in Singapore. In Qatar, it costs only 1.1 % of the monthly income of capita, which, given its abundance of valuable natural resources for its relatively small population, is not surprising. It provides the possibility of not charging high fees for administrative and budgetary reasons. If we look at the OECD countries, we can see that the average costs and time required for these activities is much higher: averagely, these countries require 13 procedures, 147.1 days, and cost 84.1 % from the monthly income per capita. In Europe, the very best results for these factors are 7 procedures (Sweden), 66 days (Finland), and costs making 6.6 % from the monthly income per capita (Slovakia). The situation is even grimmer if look at the average results in Europe and Central Asia, where the mentioned operations require 18 procedures, 192.2 days, and costs deriving 327.1 % from the monthly income per capita.

Closing of a business, from the resolving insolvency perspective, takes only 0.4 years in Ireland, and in the not very populous, yet abundant with valuable natural resources Norway it costs only 1 % of estate. The highest recovery rate can be observed in Japan, where it adds up to 92.8 %. In the OECD countries, averagely, it takes up to 1.7 years, costs 9 %, and the recovery rate is 70.6 %, which, comparingly, are very good results.

➤ Labour freedom

In the labour freedom component, according to the index methodology, the very best score is obtained by USA. From the European countries, the best result is acquired by Denmark. However, the data used in the index doesn't depict the true situation in this country, given that labour force there, like in many countries in this region, is regulated through influential labour unions, and although formally the state legislation is very liberal, in reality potential employers can face very burdensome regulation in this area.

Nevertheless, if we look at what reforms would countries have to commit to have similar work rights regulations as in USA, also noting how many countries already implement such policies, we have to conclude that work rights as such would have to dramatically deteriorate for the benefit of a longer term economic development.

For the difficulty of hiring, the ratio of minimum wage to value added per worker could be 0.2. However, in total of 36 countries, including Denmark, a centrally set minimum wage as such doesn't exist. Like in 71 countries worldwide, fixed-term contracts shouldn't be prohibited for doing permanent tasks. The maximum length of a single fixed-term contract and the maximum length of fixed-term contracts, including renewals, shouldn't be limited (104 countries).

For the rigidity of hours, the standard workday in manufacturing should be 8 hours (148 countries). A 50-hour work week, allowed for 2 months a year in the case of a seasonal increase in production, would have to be adopted (177 countries). The maximum working days per week should be 6 (152 countries). The premium for night work (% of hourly pay), in the case of continuous operations, would have to be set at 0 % (103 countries), and the premium for work on a weekly rest day (% of hourly pay), in the case of continuous operations, would have to be at 0 % (69 countries). Major restrictions on night work, in the case of continuous operations, shouldn't exist (155 countries), and the same could be said for major restrictions on weekly holiday if in case of continuous operations (151 countries). Any obligation for paid annual leave for a worker with 1, 5 or 10 years of tenure would have to be nonexistent (6 countries).

For the difficulty of redundancy, dismissal due to redundancy has to be allowed by law (186 countries). Third-party notification shouldn't be necessary if 1 worker (96 countries), or 9 workers (76 countries) are dismissed. Consequently, third-party approval shouldn't be necessary if 1 worker (153 countries), or 9 workers (148 countries) are dismissed. Retraining or reassignment obligations shouldn't exist before redundancy (141 countries), the same being said for the priority rules of redundancies (113 countries), and

the priority rules for reemployment (143 countries). For the redundancy costs, the notice period for redundancy dismissal for a worker with 1, 5 or 10 years of tenure shouldn't exist. The same goes for the severance of pay for redundancy dismissal – for a worker with 1, 5 or 10 years of tenure it should also be nonexistent.

➤ Monetary freedom

The very best monetary freedom score in Europe is achieved by Switzerland, where the 3-year average inflation rate has been very minimal and close to zero. Despite that, the highest score worldwide in this economic freedom component has been earned by the African country of Niger. Although Niger has had a bigger inflation rate than many countries including Switzerland, according to the index methodology, it earns a higher outcome given that it is not subsidising as much of its economy with direct subsidies or state-run enterprises to influence prices, like, for example, most of the European countries do with their agricultural subsidising policies. Nevertheless, another thing that has to be taken into account here is that in the case of Niger and the majority of other African countries, these countries don't subsidise their economies not by their own choice, but because of their lack of possibilities to do so, given the underdeveloped stage of their economies.

➤ Trade freedom

In regards to trade freedom, according to the index methodology, two European countries – Switzerland with its neighboring dwarf country Liechtenstein – and three tiny South East Asian port countries – Singapore, Hong Kong, Macao – have been the most prominent economies regarding this component. Although, like all other countries, including European Union member states with their common trade policy, these mentioned economies also impose various non-tariff barriers, they are the only ones that have entirely abolished tariffs.

➤ Investment freedom

In order to receive the very best appraisal in the investment freedom component, in this area countries would have to adopt the same policies as the EU member state of Luxembourg. The only reason why this country doesn't have a perfect score is because it imposes restrictions on investments in communal services and activities directly involved with state security, but other than that it doesn't have any discrimination regarding national treatment of foreign investment, foreign investment code, restrictions on land ownership, expropriation of investments without fair compensation, foreign exchange controls or capital controls.

➤ Financial freedom

In the financial freedom component, the very best appraisals have been earned by Denmark, Australia and Honk Kong. According to the index methodology, such assess-

ment has been acquired by countries where minimal government interference exists, regulation of financial institutions is minimal, but may extend beyond enforcing contractual obligations and preventing fraud. In the instance of the EU member state of Denmark, looking into the resources used for such evaluation (OECD, 2014; IMF, 2012; Miller et al., 2011), the financial sector has to have a very high competition and diversification level. None of the banks can be owned by a state and central bank has to be independent. Supervision and regulation has to comply with all the EU standards. The securities market also has to be very developed, with a preferably large bonds market.

## 5. Summary

In the final part of this paper we will test the formulated hypothesis of this research: given the different economic environment of the European countries, it is possible for the economic or national image purposes to reach the result of the freest economy worldwide just by overtaking the benchmarking practices of European economies.

The scores of all the benchmarking practices of European and global economies, according to the index methodology, are summarised in the table below. Taking into account this gathered data, all the necessary calculations are made to examine the hypothesis.

TABLE 1. The benchmarking practices

Economic freedom components	Achievable result – worldwide	Achievable result – Europe
Intellectual property	95 (New Zealand)	90 (Estonia)
Freedom from corruption	94 (New Zealand)	93.7 (Denmark)
Fiscal freedom	99.9 / 39.3 (Qatar / Denmark)	92.9 / 39.3 (Lithuania / Denmark)
Government spending	93.6 / 0.5 (Guatemala / Denmark)	81.3 / 0.5 (Armenia / Denmark)
Business freedom	98.9 (Honk Kong)	98.1 (Denmark)
Labour freedom	97.2 (USA)	91.2 (Denmark)
Monetary freedom	88.3 (Niger)	85.2 (Switzerland)
Trade freedom	90 (Switzerland)	90 (Switzerland)
Investment freedom	95 (Luxembourg)	95 (Luxembourg)
Financial freedom	90 (Denmark)	90 (Denmark)
calculations	$941.9 / 10 = 94.19 / 788.2 / 10 = 78.82$	$907.4 / 10 = 90.74 / 773 / 10 = 77.3$

As can be observed in Table No. 1, where along with every of the 10 economic freedom constituting components, the scores of European and global benchmarking practices and their respective countries in the brackets are being mentioned, if a country overtakes all of the best European benchmarking practices, it would be enough to earn the result of the very freest world economy. By adding up all the scores, it totals to 907.4 points, and by dividing it by 10, which corresponds with the number of the IEF components, the final result of 90.7 would be obtained, surpassing the freest economy in the world, i.e., Hong Kong, which in this index has obtained 90.1 points. If a country could manage to overtake all of the benchmarking practices in the world, it would get the rounded-off result of 94.19 points.

In relation to the already investigated government share components, where it was suggested that countries in a long-term process, while advancing through the economic development phases, contrary to the index methodology, should follow the practices of the high taxing countries, another hypothesis was set, namely that it is possible to achieve the result of the freest world economy with high taxing policies. If a country would implement the same taxing policies as the country with the lowest scores in the fiscal freedom and the government spending components – Denmark – it wouldn't be possible to acquire the score of the freest economy in the world even by overtaking the very best benchmarking practices of European countries in every single of the other economic freedom components, in this case, acquiring only 77.3 points. In fact, it wouldn't be possible even by overtaking the very best global benchmarking practices in every single of the other economic freedom components, obtaining only 78.8 points. Moreover, it wouldn't even be possible to get the best score from all of the European economies given that it would be less than the Switzerland score of 81.6 points, which, in turn, differently from the prevailing majority of most developed countries in this continent, shows relatively low government share results.

## **Conclusions**

In our increasingly globalised economy, global competitiveness of countries and the means to measure it are gaining increasing significance, with countries, institutions and researchers paying more and more attention to it, by analysing the matters and devoting resources for the necessary improvements, which usually require mid-term and long-term policy planning.

One of the ways to measure economic competitiveness is by comparing an extent of economic freedom that countries have, which, as surveys show, can also largely explain differences in economic well-being across the world. Generally, countries with higher economic freedom have higher gross domestic product per capita and its growth rates, as well as better health care, education quality, environment protection, income equality, and happiness results. These trends of increasing prosperity are confirmed even when we compare these indicators within the territories of countries.

Approaching the issue from a perspective of a European country, which likens to most of the Western world capitalist economies for a number of reasons (e.g. the stage of economic development tax policies, availability of valuable natural resources, state involvement, etc.) and has economic policy traditions very different compared to many other parts of the world, we can see that the main hypothesis of the work can be confirmed, and that it is possible to earn the result of the freest world economy by adopting the benchmarking practices of the continent.

Nevertheless, the other hypothesis of the work is not fulfilled – by adopting taxing policies of some of the wealthiest European Union economies, it is not possible anymore to reach the result of the freest economy, both in the world and Europe. By looking at the components of the Index of Economic Freedom its scores, it becomes apparent that the inclusion of government share components in its methodology is very controversial, even by merely observing the results that show us the wealthy, high tax countries earning the worst results and the poor, low tax countries earning the best results. Similarl is the as labour freedom component, which drives down labour rights and, albeit in lesser extent, monetary freedom.

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