

ECONOMIC FREEDOM THE CZECH REPUBLIC AND ITS NEIGHBORS

Lubos Marek, RNDr

Michal Vrabec, Mgr

University of Economics, Prague, Czech Republic

Abstract

We analyze the Index of Economic Freedom in Czech Republic in our article. The Index of Economic Freedom is an indicator which defines and tries to measure the economic freedom of a country or a region. The most famous are the Index of Economic Freedom created by the Heritage Foundation and the Wall Street Journal and Economic Freedom of the World published by the Canadian Fraser Institute. To analyze the Czech Republic's position it is reasonable to take into account its neighbors and Visegrad Four as the closest group. It is also insightful to compare it with other countries from the European Union (EU). According to Economic Freedom summary rating in 2011 all these countries belong to the "Top 60": Germany (19), Austria and Hungary share 27 place (before Sweden), the Slovak Republic (36), the Czech Republic (52) and Poland (59). However, remembering the fact that there were significant changes during the last 25 years, it would be very interesting to look back to previous years.

Keywords: Economic Freedom, Economic Freedom of the World Index, Heritage Foundation, Fraser Institute

Introduction

The Index of Economic Freedom is an indicator which defines and tries to measure the economic freedom of a country or a region. The most famous are the Index of Economic Freedom created by the Heritage Foundation and the Wall Street Journal and Economic Freedom of the World published by the Canadian Fraser Institute. We compare the values of this index Czech Republic and its neighbors in our article. Studies of this index is given a lot of work. We have assumed the publications listed in references that are available in the online form in this work.

Index of Economic Freedom

For above mentioned countries the Index of Economic Freedom is available for each year from 2000 till 2011. Additionally, there are data for each five years, i.e. 1995, 1990 and so on till 1970. Due to the fact that the Czech and Slovak Republics formed a unitary state Czechoslovakia till the end of the year 1992, only data from 1995 is available for both countries. Considering the fact that all countries from the Visegrad group till late 1989 were communist countries, the cut in time serious was made in the year 1985 to include the latter communist years. All available summary indices and rankings are shown in table below.

Country / Year		2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1995	1990	1985
Germany	Total Score	7.68	7.57	7.56	7.52	7.6	7.79	7.75	7.77	7.84	7.54	7.45	7.67	7.6	7.64	7.27
	Ranking	19	31	19	29	28	18	17	18	19	21	22	18	16	11	11
Austria	Total Score	7.59	7.61	7.63	7.69	7.8	7.94	7.85	7.92	8.02	7.46	7.38	7.55	7.14	6.96	6.46
	Ranking	27	27	17	17	19	15	15	13	12	28	26	22	32	24	21
Hungary	Total Score	7.59	7.3	7.17	7.16	7.12	7.19	7.21	7.35	7.22	6.69	6.9	6.56	6.16	4.89	4.48
	Ranking	27	64	52	57	62	60	52	36	42	60	46	61	59	82	87
Slovakia	Total Score	7.46	7.42	7.48	7.58	7.54	7.59	7.63	7.45	6.93	6.58	6.53	6.2	5.42	n/a	n/a
	Ranking	36	33	26	24	35	31	21	29	55	66	61	75	82		n/a
Czech Rep	Total Score	7.25	7.21	7.17	7.25	7.22	7.1	7	7.07	7.09	6.68	6.56	6.53	5.79	n/a	n/a
	Ranking	52	58	52	50	58	66	64	52	47	61	59	63	73	n/a	n/a
Poland	Total Score	7.2	7.13	7.15	7.01	6.96	7.16	6.91	6.93	6.52	6.48	6.13	6.34	5.3	3.54	3.7
	Ranking	59	48	56	64	70	62	69	57	72	71	80	72	89	104	97

Table 1: EFW for selected countries

From the table above it is clear that communist countries had less Economic Freedom. It can be estimated that the Czech Republic and Slovakia had similar results to Poland and Hungary. It is especially confirmed by taking into account the fact that they had comparable development over the years 1990-2005. All these countries became a part of European Union on the 1 of May 2004, while Austria entered on the 1 of January 1995 and Germany is one of the founders. The process for each country was different over the years. Countries from the Visegrad Four made giant improvements with regards to Economic Freedom. It is especially seen from the growth rate of summary index through the years 1985-2011 shown in table below.

The most significant rise was, probably, in the first decade after the fall of communism. Poland, for example, had shown increase by 149.7 % from 1990 with the total score of 3.54 in comparison to 5.3 in 1995. All Visegrad countries have an increase higher than 107 % between the years 1995 and 2005. With regard to the Czech Republic, in 1995 it had a worse summary ranking (5.79) than Hungary (6.16), but overtook it in the year 2007 with the score 7.22 compared to 7.12 for Hungary. It follows that Czech Republic had higher ranking till the year 2010, but in 2011 ended in the 52 position, while Hungary “jumped” to 27 (from the 64 in 2010).

Next, the more interesting development of the index was for Slovakia. In 1995 it had even lower value of the summary index (5.42) than Czech Republic. Nevertheless, it overtook Czech Republic in 2004 with the score 7.45 (compared to 7.07) and remained with better results up until the last reported year 2011. In general, the evolution of economic freedom was more unstable for the former communist countries. This result is natural not only because the economic system should change from planned to market, but also the organization of the country (including legal system) and equally important the way of thinking. Through the given period of time, the lowest score for Germany as well as for Austria was in 1985 (7.27 and 6.46 correspondingly) and the highest in 2003 (7.84 and 8.02). The development of the summary index and movements in rankings are shown in Figure 15 and Figure 16 below. From both graphs it is clear that during the whole time period 1985-2011 countries from the Visegrad Group pursued Germany and Austria and in the last years they drew closer especially in score of the index. The total scores have risen rapidly during the years 1985-2000 for the all Visegrad countries. Then from the years 2001-2002 there was still an incremental trend however with slowdowns for some years.

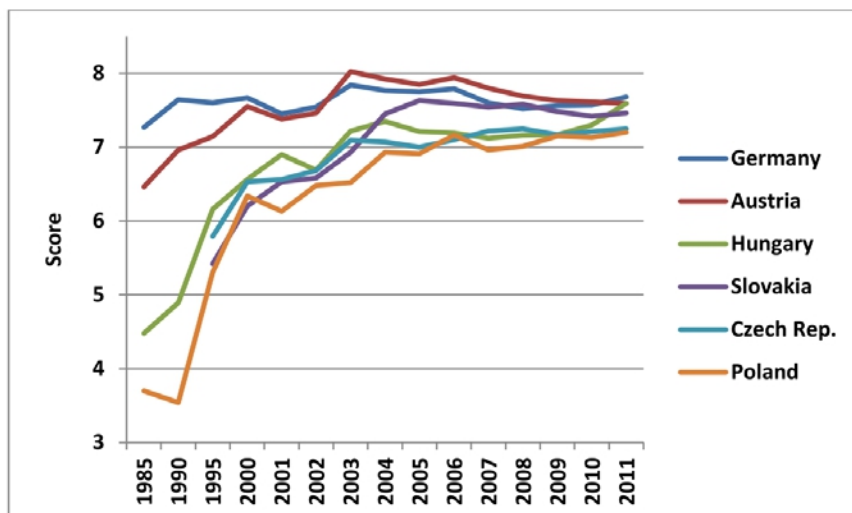


Figure 1: Score trend for selected countries

Despite the growing score, the graph of final ranking shows a very volatile process during all the years. Partially it is because the rating included more countries which could shift “competitors”. For instance, in 1990 the final rating was calculated for 113 countries, in 1995 for 123, for 2011 it contains 152 countries. However, the performance of the countries adds more fluctuation in ranking. For example, as it can be seen from the graph below, in 1990 Poland was in 104 place in comparison to 48 place in 2010. At the same time, Germany was in 11 place in 1985 and 1990, but rolled back to 31 place in 2010.

Within 42 partial indices the results are almost the same for each country with only a few exceptions. The highest value of the component 1A (Government consumption), where countries with a larger proportion of government consumption received a lower rating, is shown by Hungary (8 out of 10), while the lowest is shown by the Czech Republic (3 out of 10). Germany and Austria have 4, while Slovakia and Poland have 5. All these countries have very low results (5 or less) in components 1B (Transfers and subsidies), 1Dii (Top marginal income and payroll tax rate), in 4Dii (Capital controls) only Slovakia has 5.4, while Poland has the lowest value of 1.5; in 5Bii (Hiring and firing regulations) only Hungary has 5.3; in 5Ci (Administrative requirements) Germany and Austria have the highest values of 4. Lower values in described indicators mean that these countries have higher taxes and high regulation barriers. The same results can be found within the majority of high-income countries.

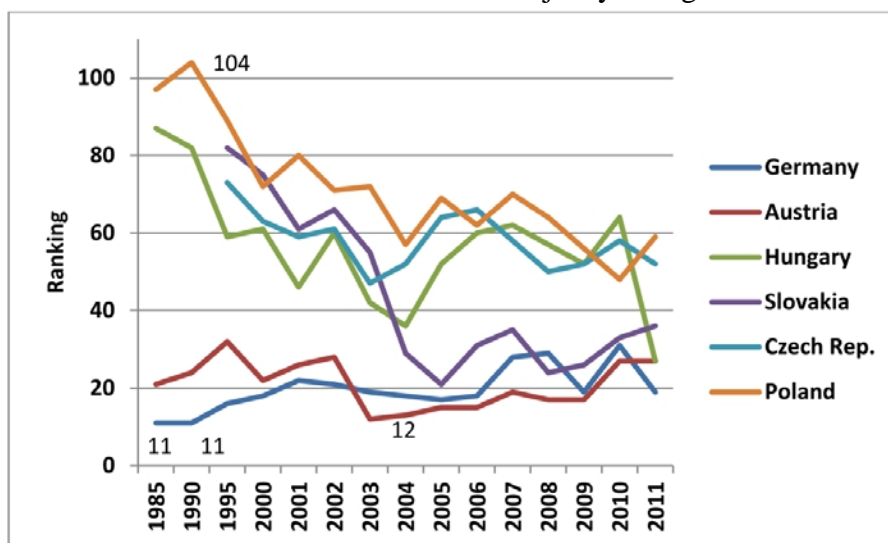


Figure 2: Ranking trend for selected countries

On the other hand, these countries have high values in 2D (Military interference in rule of law and politics), which means that military involvement in politics is rare; in comparison to 57 countries (out of 152) which have values 5 or less. With regard to Ukraine which has 8.3 (in this parameter) and Russia (7.5), it would certainly be interesting to see how these values will change taking into consideration the current situation in the region. For example, Egypt was known for its military intervention of government institution and politics. From the existed data it can be seen that Egypt had the highest score of 6.1 in indicator 2D in 1995. Then between 2000 and 2009 it had 5, with a following decrease in 2010 (4.2) and ended up with 2.5 in 2011. As a result, in comparison to the 70 place in 1995 in overall ranking or even 50 thin 2000, Egypt ended up in 108 place in 2011. Without a doubt, this result among other things is connected to the so called Arab Spring (a revolutionary wave in Arab world). Obviously, indicator 2D (Military interference in rule of law and politics) is very important not only for the foreign and domestic business and investments, but it is a basic prerequisite for the freedom of a country in general. The other indicators as it was already stated earlier, where developed countries have significantly higher values are 2C (Protection of property rights), 2E (Integrity of the legal system), 2H (Reliability of police) and 2I (Business costs of crime). All these variables only prove that these are basic requirements for the prosperity of the country. To get back to the subject, Austria and Germany significantly differ (their values lie farther from the group's mean than one standard deviation) from the Visegrad Four in protection of property rights (both have 8.1 while the mean for the Visegrad Group is 5.1 and for the current EU countries it is 6.6). It is the same for the indicator "business costs of crime", where both countries have a value of 8 in comparison to 7.4 for the EU (the mean of 28 European Union's countries), Slovakia turned out the worse (from the group of six countries) with 6.4, while the Czech Republic has 7.3. On the other hand, the Czech Republic has the lowest value in the "legal enforcement of contracts" in comparison to 5.4 for the EU or 6.6 for Germany and Hungary. Unfortunately, the Czech Republic (as well as other countries from the Visegrad Group) does not have good value in "reliability of police" indicator (4.7), while the mean for the EU is 6.8. Republic has the lowest value (5.4) among the group of six in 5Cvi (Cost of tax compliance) indicator (compared to the European Union's mean of 7.8). This means that it takes longer for businesses to prepare, file, and pay taxes on corporate income, value added or sales taxes, and taxes on labor. In addition to what already has been mentioned, the Czech Republic is far below the mean of the European Union (including the nearest neighbors) in the following indicators: Transfers and subsidies, Judicial independence, Impartial courts, Reliability of police, Capital controls, Business regulations. Below (Table 17) is a part of the table where values for the indicators are shown for the Czech Republic and its neighbors. In addition, the table contains the mean and standard deviation for given countries, as well as the mean for the 28 countries of the European Union and the difference in values between the Czech Republic and EU ("Difference CZ-EU").

The cells with light red color show countries that have a significantly higher score (lie far than one standard deviation from the mean of six countries) for the indicator. It is similar for the light green cells but with opposite meaning. The other two indicators where countries from the Visegrad Four have lower values are 5Cii (Bureaucracy costs) and 5Civ (Extra payments/bribes/ favoritism). In addition, the Czech (countries have significantly lower values). From the following table 17 it is also clear that the Czech Republic is much better (orange cells) in six indicators than the EU's average, i.e. Top marginal tax rate, Top marginal income tax rate, Centralized collective bargaining, Hours regulations, Conscription and Licensing restrictions.

	Germany	Austria	Hungary	Slovakia	Czech Rep.	Poland	Mean	Std. dev	EU 28	Difference (CZ - EU)
1B. Transfers and subsidies	2.9	2.2	4.6	4.5	2.8	5.3	3.7	1.24	4.40	-1.60
1D. Top marginal tax rate	5	3.5	6.5	6.5	7	5.5	5.7	1.29	4.66	2.34
1Di Top marginal income tax rate	5	4	10	10	10	7	7.7	2.73	6.14	3.86
2A. Judicial independence	8.7	7	4.5	2.8	4.5	5.4	5.5	2.09	6.03	-1.53
2B. Impartial courts	6.6	6.2	3	2.3	3.3	3.5	4.2	1.79	4.81	-1.51
2C. Protection of property rights	8.1	8.1	4.7	5.1	5.1	5.6	6.1	1.56	6.64	-1.54
2F. Legal enforcement of contracts	6.6	6.4	6.6	4.5	3.9	4.1	5.4	1.31	5.36	-1.46
2H. Reliability of police	8.2	8.3	5.4	4.8	4.7	5.5	6.2	1.66	6.83	-2.13
4Dii Capital controls	3.8	3.1	3.8	5.4	3.1	1.5	3.5	1.27	5.33	-2.23
5Biii Centralized collective bargaining	3.6	2.5	6.7	6.8	7	7.3	5.7	2.05	5.76	1.24
5Biv Hours regulations	8	8	4	8	10	8	7.7	1.97	7.00	3.00
5Bvi Conscription	10	3	10	10	10	10	8.8	2.86	8.39	1.61
5C. Business regulations	7.6	7.2	6.3	5.7	5.8	6	6.4	0.79	6.83	-1.03
5Cii Bureaucracy costs	7.3	7.4	4.7	4.3	4.3	5.6	5.6	1.44	5.99	-1.69
5Civ Extra payments/bribes/favoritism	7.8	7	5.2	3.9	4.4	6.2	5.8	1.52	6.29	-1.89
5Cv Licensing restrictions	9.3	7.7	9.2	6.2	8.9	5.9	7.9	1.52	7.84	1.06
5Cvi Cost of tax compliance	7.7	8.1	6.9	7.7	5.4	6.8	7.1	0.97	7.83	-2.43

Table 3: Comparison of selected countries by category

Conclusion

To conclude, according to the Economic Freedom of the World index, countries from the Visegrad Group made significant steps and improved their results in the degree of Economic Freedom. They have achieved the results close to the most economically free countries. During the last decade they solidly took place within 60 of the most economically free countries and had a higher ranking than most of the other post-communist countries. They have good prerequisites and already have high values in some indicators, but still should work on the field of regulations (including business requirements, time cost and obviously in bureaucracy costs, bribes and etc.).

Acknowledgements

This paper was written with the support of the Czech Science Foundation project No. P402/12/G097 „DYME – Dynamic Models in Economics“.

References:

- Economic Freedom of the World project. [Online] Fraser Institute, 2014.
<http://www.freetheworld.com/>.
 Defining Economic Freedom | 2014 Index of Economic Freedom | 2014 Index of Economic Freedom Book: 2014 Index of Economic Freedom. [Online]
<http://www.heritage.org/index/book/chapter-5>.
 James Gwartney, Robert Lawson, and Joshua Hall. 2013 Economic Freedom Dataset, published in Economic Freedom of the World: 2013 Annual Report. Free the World. [Online] 2013.
http://www.freetheworld.com/datasets_efw.html.
 Index of Economic Freedom. [Online] The Wall Street Journal and The Heritage Foundation, 2014.
<http://www.heritage.org/index/>.
 Ševčík, Radim. Vztah Indexu Ekonomické Svobody k Indexu Vnímání Korupce. Prague, 2007.
 Corruption and the effects of economic freedom. [Online]
<http://ideas.repec.org/a/eee/poleco/v29y2013icp54-72.html>.