The Importance of Economic Freedom

In order to determine whether there is a connection between economic freedom and economic growth, a metastudy of all empirical research involving economic freedom was undertaken, via Google scholar citation service, covering 2428 studies. There were 92 studies detected that dealt with this topic, out of which 86 reported positive connection between these phenomena, and only 1 reported a negative, while 5 others were less conclusive. This shows an unusually high level of agreement among economists that economic freedom indeed has a significant positive impact on the level of economic growth. Policy recommendations would, therefore, be to put all efforts to maximize the level of economic freedom in all ways possible in order to utilize to the maximum this potential. This result is especially important for Serbia, as a country with low overall level of economic freedom (so there is a lot space for improvements), sluggish growth rates and low level of economic development.

The importance of economic freedom for economic growth and other important development indicators was long ago proposed in economic theory stressing the entrepreneurial activity and the process of trial and error as the main source of growth. However, for quite a long time this was disregarded since it was impossible to precisely measure economic freedom and its level: growth assumptions were then more attributed to macroeconomic policies and technical expert knowledge possessed by economists. This problem was overcome with the invention of the Economic Freedom in the World Index in 1996 by the Fraser Institute. This methodological tool, the production of which included several Nobel laureates for economics, such as Milton Friedman, Douglass North, and Gary Becker, was the first methodological tool that measured intrusion in functioning of the market process by government entities, either directly through government intervention or indirectly though regulation and market institutions. A similar index, Index of Economic Freedom, produced by the Wall Street Journal and the Heritage Foundation soon followed, with some methodological changes.

Since this very successful tool was invented, it has been widely employed in empirical studies covering a range of topics. However, the most important were concerning the role of economic freedom in fostering economic growth. Conducted empirical studies mostly concluded that there is a significant connection between economic freedom and economic growth, but this was not really widely acknowledged outside the relatively narrow audience of economists. There were also very few metastudies conducted regarding this phenomenon, that would provide a more definite answer for this question. Precisely, there was only one metastudy: Hall, Joshua C, and Robert A. Lawson. "Economic Freedom of the World: An Accounting of the Literature." Contemporary Economic Policy (2013).

This study found that Economic Freedom of the World was used in 402 research articles, out of which 198 articles used it as an independent variable. Only 8 studies (or less than 4% of the sample) found that economic freedom was connected to a ‘’negative’’ outcome, such as rising inequality or obesity, while other connected it to a range of ‘’positive’’ outcomes, proving that economic freedom is not good only for economic, but also for wider social and development outcomes. However, this research took into account only Fraser Institute data, and did not focus on economic growth per se, and there was also new research that came up since its publication in 2014. Therefore, it is important to create another metastudy.

Libek conducted a metastudy regarding economic freedom in December 2017, with the aim to reexamine the connection between economic freedom and economic growth in published empirical studies. The difference between this and other metastudies concerning economic freedom is:

1. Longer time frame (1994 – 2016)
2. Broader scope – it included not only economic freedom defined by Fraser Institute, but also definitions provided by other sources, such as the Heritage Foundation
3. Narrow focus – covering only the connection between economic freedom and economic growth

Using Google scholar mechanism in order to find studies that cited economic freedoms, total of 2 428 studies were identified. Distribution of these studies by the year of its publishing is as follows:

Year	Number of studies
1994 – 2009	412
2010	345
2011	444
2012	320
2013	265
2014	239
2015	189
2016	214

Out of this number, only 92 studies (or than 4%) consider the connection between economic freedom and economic growth. Out of these, a predominant majority of 86 studies (93.5%) finds a positive correlation or connection between them, while only 6 studies (6.5%) have less positive results. Of these, De Haan and Sierman (1998) report that robustness of the results depends on the way economic freedom is measured; Heckelman and Stroup (2002) that there are parts of economic freedom that are growth friendly and growth unfriendly; Ismail and Hook (2012) that results for developing countries are inconclusive, while only Ekrem and Tugcu (2012) find a clear negative relationship between economic freedom and economic growth. Two other studies (Cohen 2011; Cohen 2012) report states that proposed economic freedom indices do not measure economic freedom but institutional quality, or that changes in institutional quality happened at the same time as economic freedom.

This metastudy shows that empirical studies have predominantly found that economic freedom is associated with higher economic growth rates, while there is only one study claim otherwise and results of other 5 are less conclusive. This high rate of concurrence between economists is highly unusual, given the fact that economist tend to often disagree even among theoretically more accepted topics. Therefore, it is conclusively shown that higher level of economic freedom, ceteris paribus, leads to higher economic growth.

Economic Freedom in Serbia

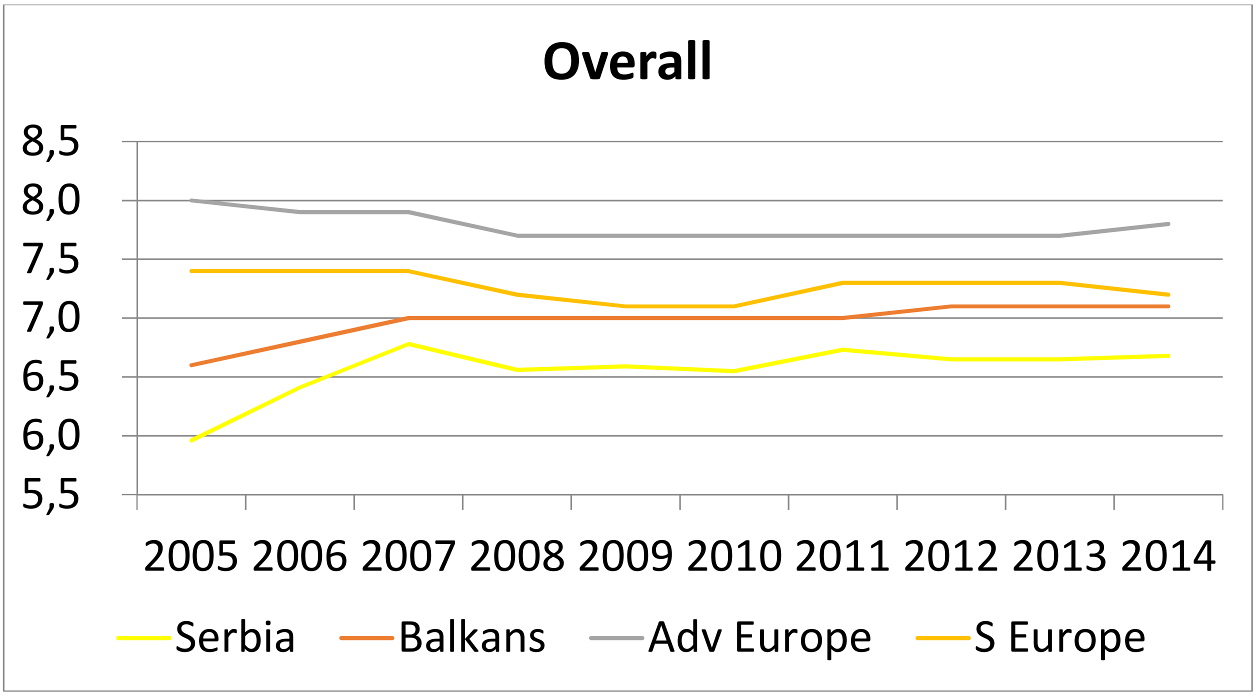
The Serbian economy is characterized by a low level of overall economic freedom, when the whole European continent is taken into account. When measured by the Economic Freedom in the World Index 2017 of the Fraser Institute, Serbia has the score of 6.75 ranking 88th on the list, somewhere in the 3rd quartile, below Zambia. In the region, Serbia surpassed only Bosnia and Herzegovina (6.61), Russia (6.60), Moldova (6.56), Greece (6.36) and Ukraine (5.38).

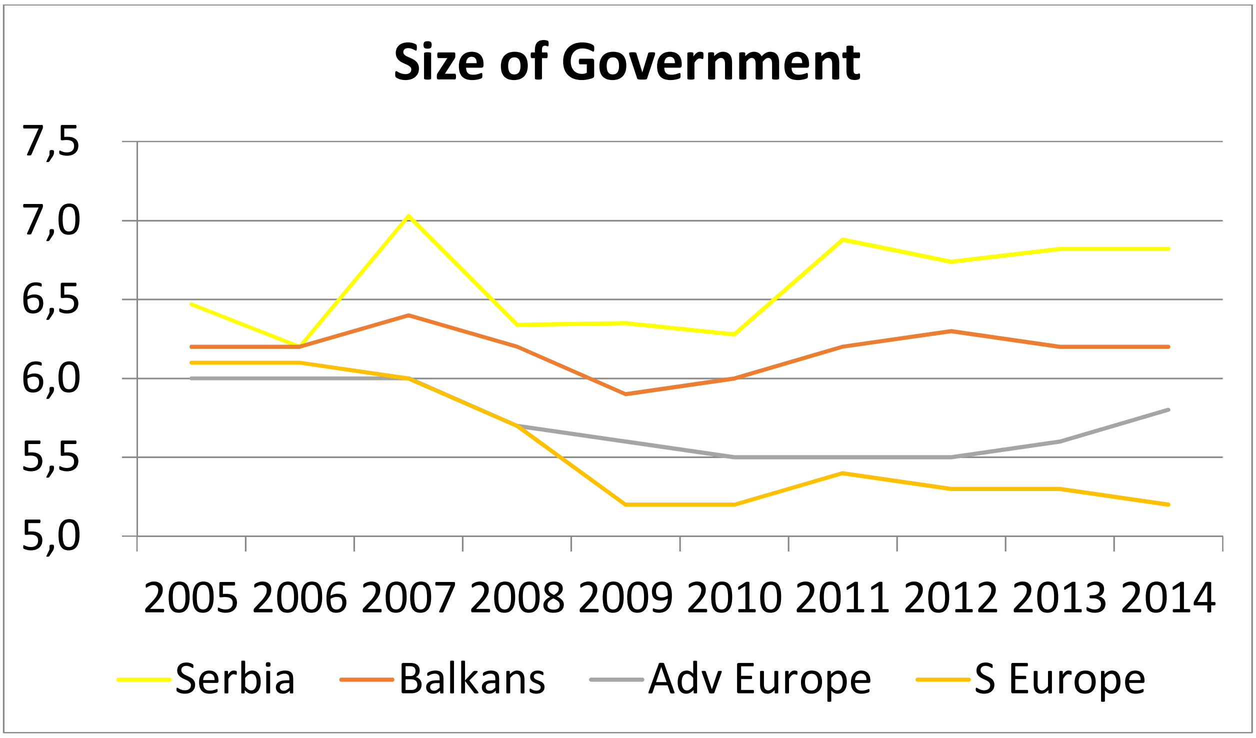
When index subcomponents are taken into account, Serbia is ranking very low in:

1. Legal System and Property Rights (score 4.89, rank 85);
2. Regulation of Credit, Labor and Business (score 7.01, rank 81);
3. Sound Money (score 7.85, rank 108).

This low level of economic freedom can be best described with comparison of Serbia with other countries from the region:

- Balkans (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania);
- Advanced Europe (Austria, Germany, Ireland, United Kingdom);
- Southern Europe (Spain, Portugal, Italy, Greece).




Size of Government
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Serbia
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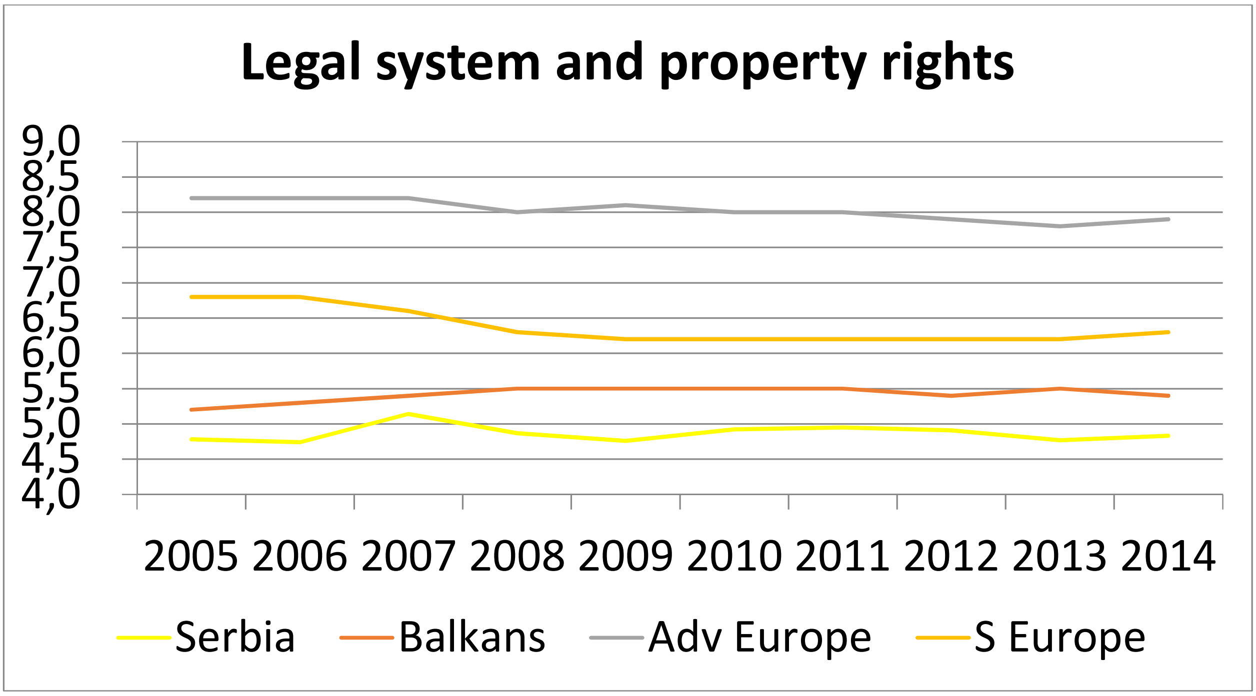
Legal system and property rights
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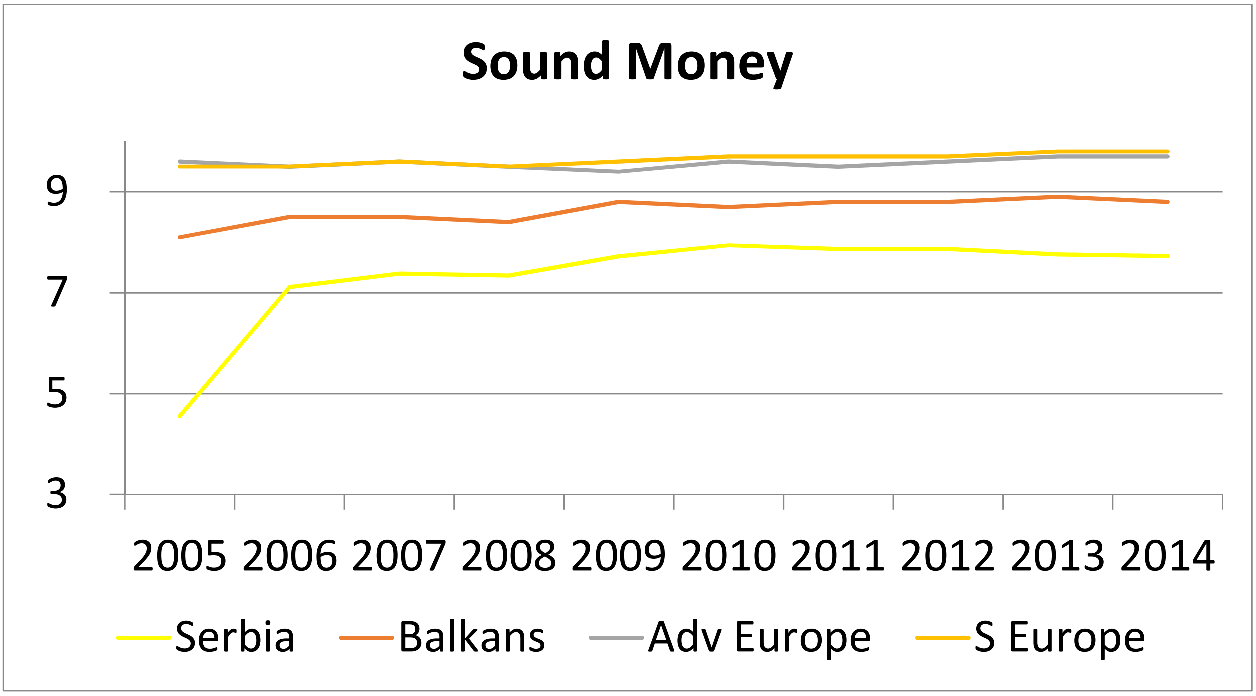
Sound Money
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Serbia
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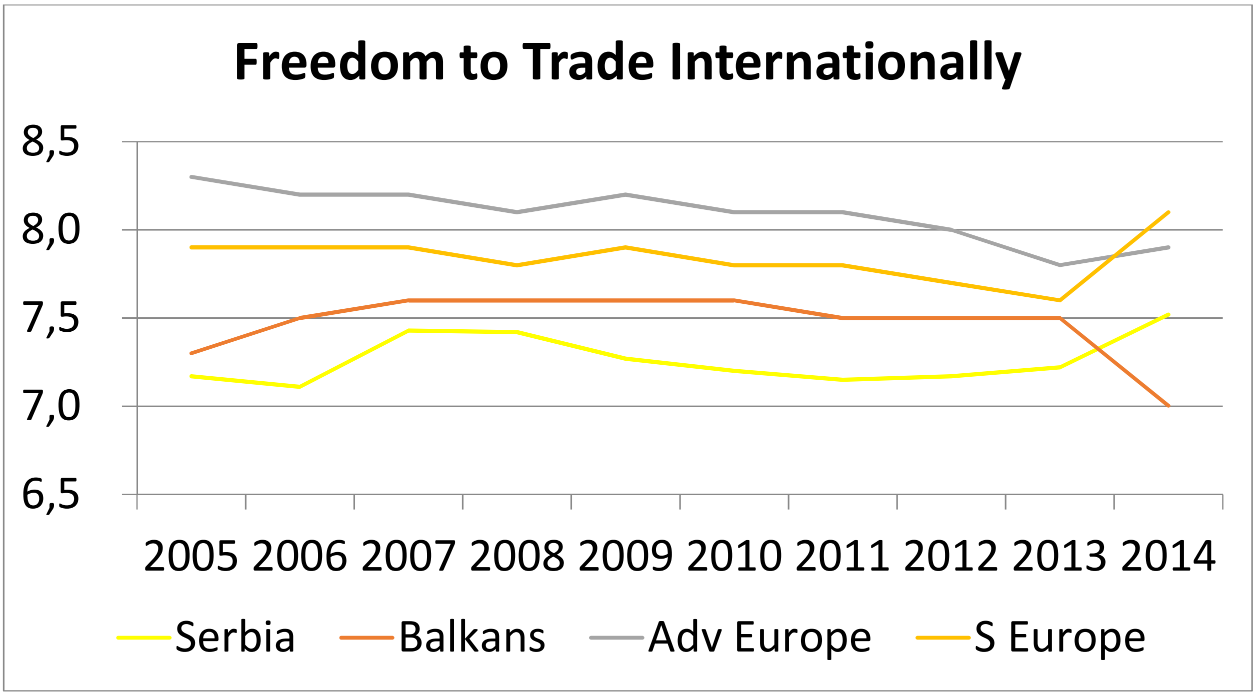
Freedom to Trade Internationally
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Serbia
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Adv Europe
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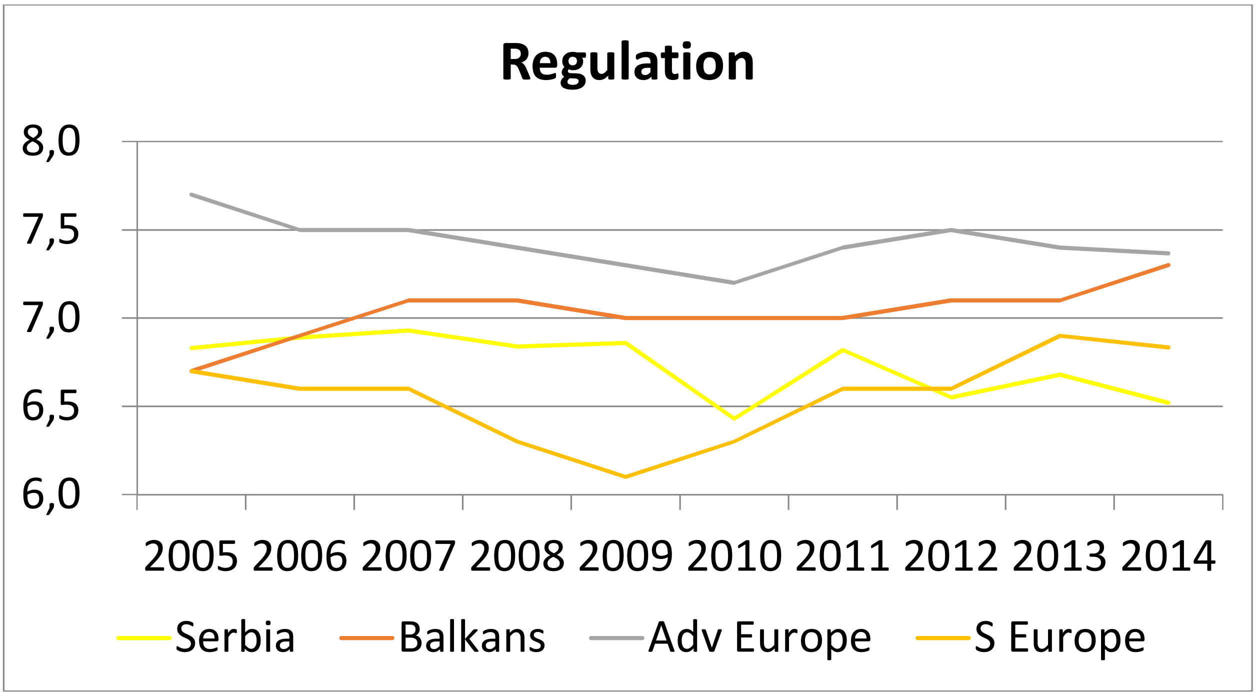
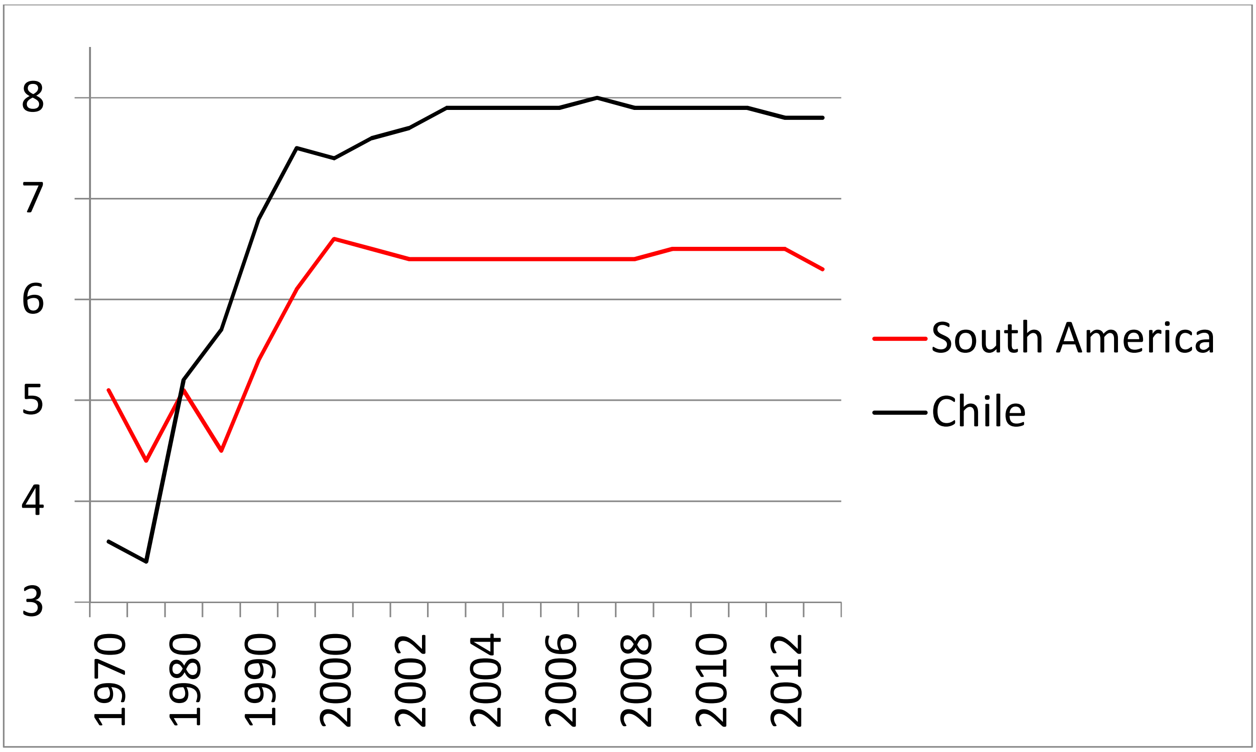
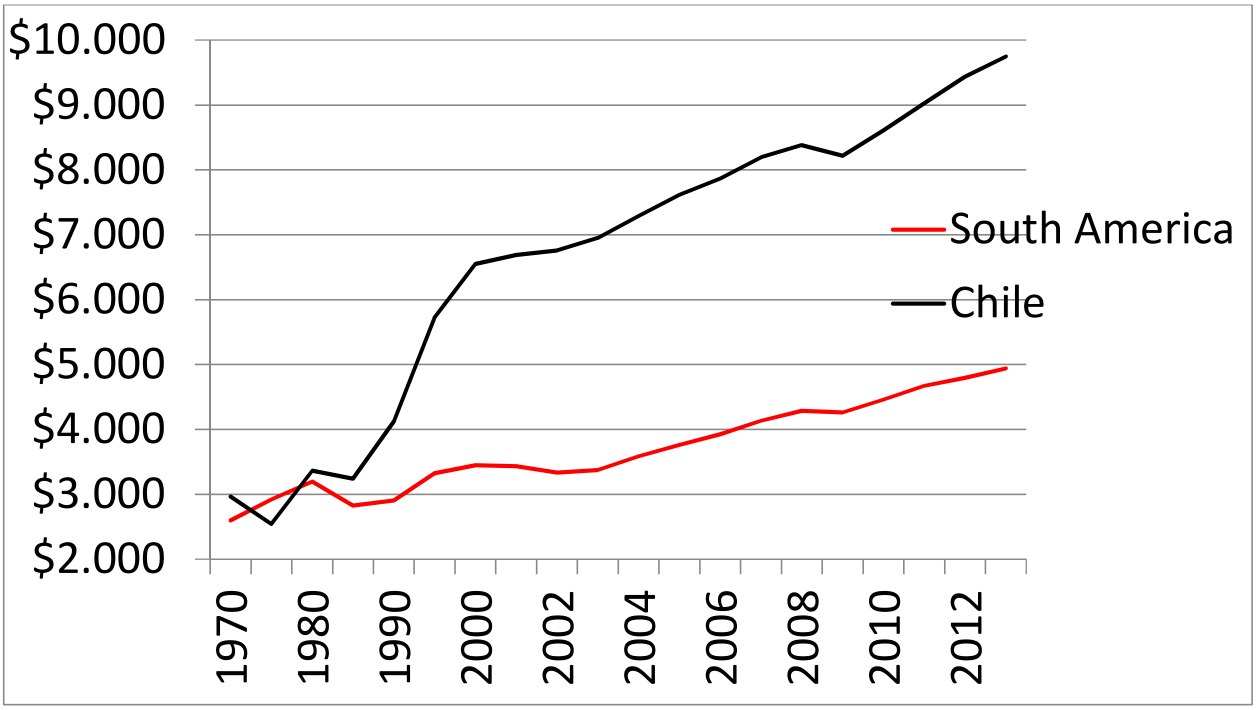


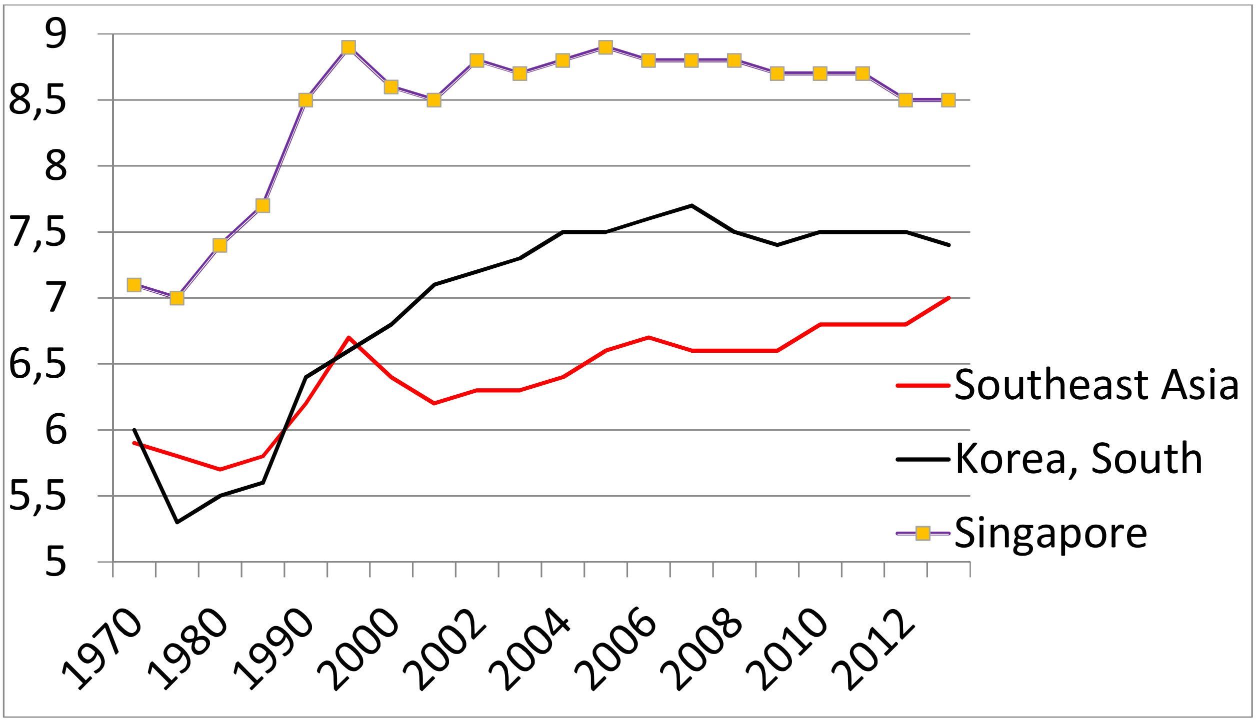
The importance of economic freedom is well shown by the most important case studies from different continents: Chile (South America), Singapore and Korea (East Asia), and Botswana (Africa). In all these prominent cases, economic freedom propelled these societies to a high and sustainable economic growth which led them to prosperity, compared to their neighbors.



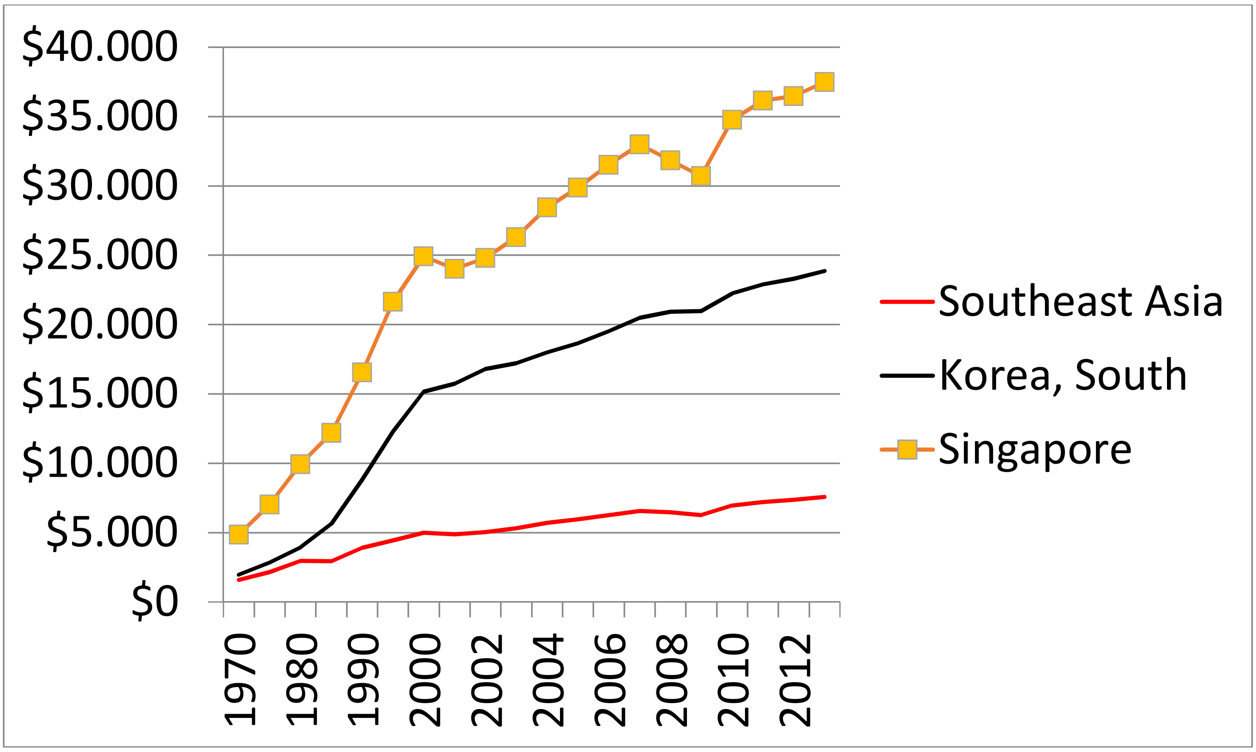
Economic freedom and in South America and Chile.



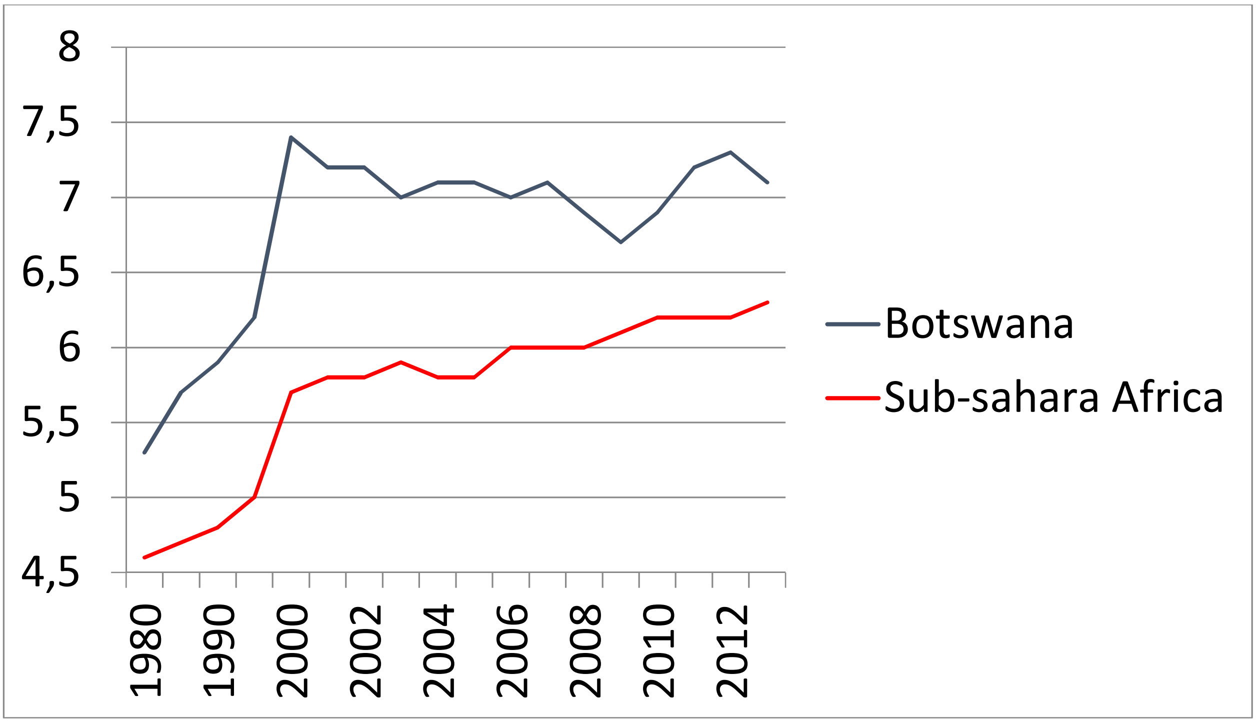
Per capita GDP in 2011 USD in South America and Chile



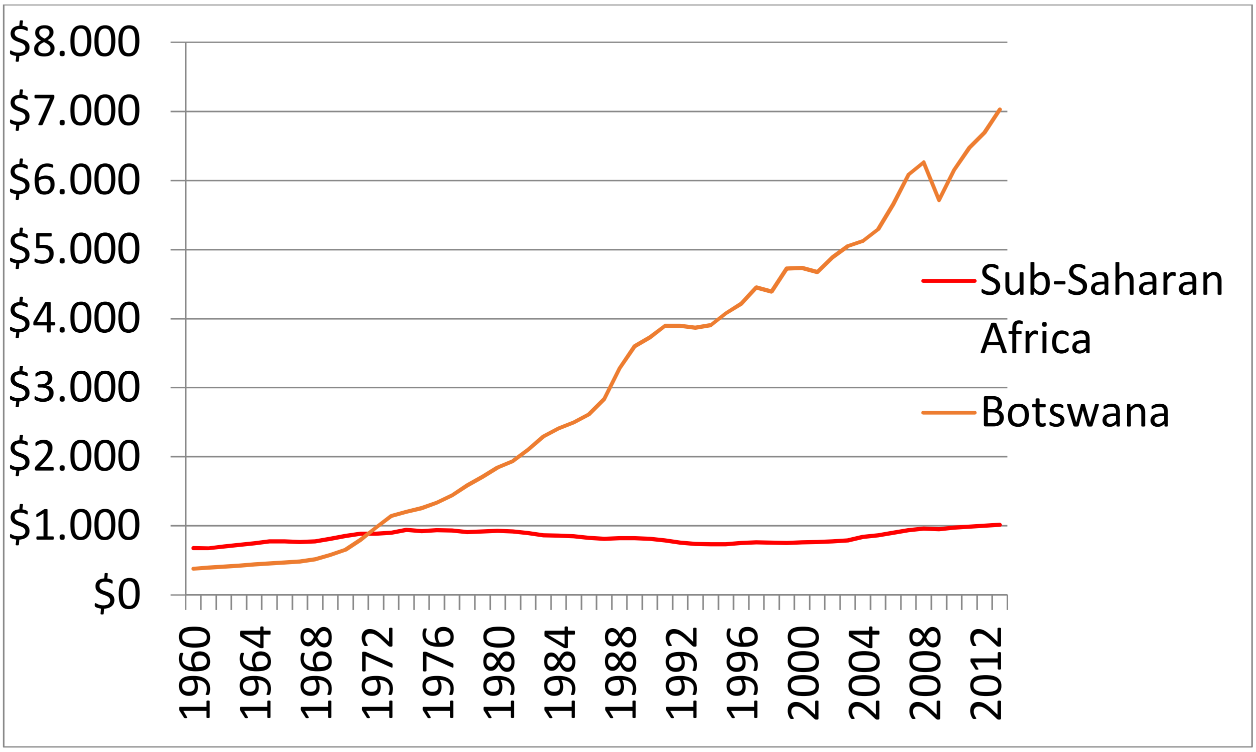
Economic Freedom in Southeast Asia, South Korea, and Singapore



Per capita GDP in 2011 USD in Southeast Asia, South Korea, and Singapore



Economic Freedom in Sub-Saharan Africa and Botswana



Per capita GDP in 2011 USD in Sub-Saharan Africa and Botswana

The increase in economic growth rates is very important for the Serbian economy. Serbia is the slowest growing economy in the Balkans: average growth rate in the decade after the recession (2008 – 2016) was only 0.83% annually. At the same time the unweighted average growth rate for other Balkan countries (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, and Romania) was double that number, reaching 1.58%.

Furthermore, Serbia remains one of the poorest countries in Europe, measured by GDP, with just 5 000 euros per capita. These low growth rates do not provide a possibility for development and closing the gap with more advanced European economies. Therefore, the most important policy goal of the country should be faster economic growth and development.

Increase in the level of economic freedom should prove as an important policy tool for reaching higher economic growth rates. A study estimated future economic gains through higher economic freedom (Gwartney and Lawson 2004) reporting that 1-point increase in economic freedom (measured on a 1 to 10 scale) would increase long term rate of economic growth for 1.24% of GDP. Therefore, if Serbia would increase its score from the current 6.75 to 7.75 points – the approximately current level of Austria or Germany, Serbian long-term growth rate would increase from the envisaged 2% in 2017 (and estimated by the IMF to stand at 3.5% in 2018 and 2019) to 5.25% in 2020 and afterwards. This growth rate would enable a fast income convergence with other European countries, with GDP level per capita doubling in 14 years and almost reaching the current levels of Baltic countries, alleviating most economic and social problems in the country.