THE LIES OF THE FRASER INSTITUTE

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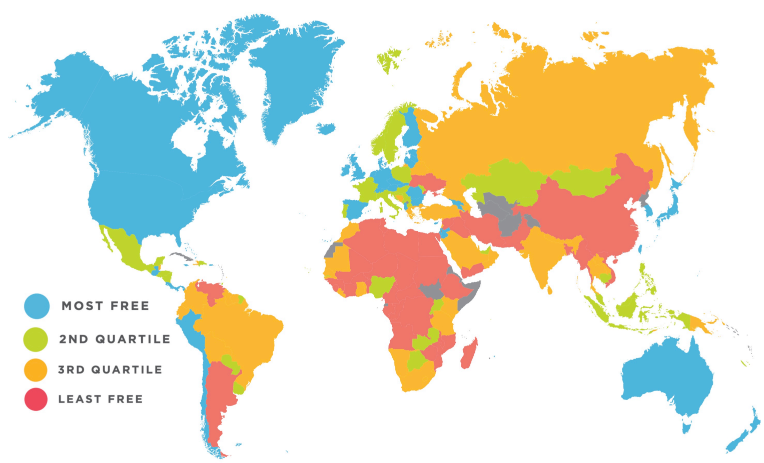
A Canadian conservative think tank called the Fraser Institute released the 2020 revision of the *Economic Freedom of the World* report in September, their version of an “economic freedom index”[1]. Fraser’s index is often used by Fraser staff and by opinion columnists to denigrate socialism and leftism, with lower scores taken to indicate more socialistic countries and higher scores taken to indicate more free market capitalist countries.

> *The [Fraser] economic freedom index… is probably the best way to measure whether a country has a more capitalist or socialist system. The index uses a zero-to-ten scale, with higher scores indicating a more capitalist system.*
>
> -Robert Lawson (Fraser employee and coauthor of the 2020 index) and Ben Powell, from *Socialism Sucks and Beer is Freedom*

> *One measure of capitalism is the rank of a country on the Fraser Economic Freedom Index, which is a composite of indexes that reflect the use of markets, the lack of regulation, the openness of the economy, and private ownership of capital.*
>
> -Edward Lazear, National Review

> *We can also… [look] at a comprehensive measure of capitalism relative to socialism. The Fraser Institute, a Vancouver-based, pro-free market think tank, compiles a worldwide ranking of countries called the Economic Freedom Index.*
>
> -Jeffrey Dorfman, Forbes

This is incorrect. Most of Fraser’s index has nothing to do with left-right policy divides in government. In this paper, I will show what the index actually measures.



Fraser’s Economic Freedom of the World map, colour-coded to reflect differences in economic freedom score.

[1] Similar indexes are published by the Heritage Foundation and Freedom House.

FRASER'S METHODOLOGY

Here are the elements of Fraser's index:

Section	Components	Summary (mine)
(1) Size of Government	- Government consumption - Transfers and subsidies - Government investment - Top marginal tax rate - State ownership of assets	The extent to which the state redistributes incomes, plus state ownership and investment.
(2) Legal System and Property Rights	- Judicial independence - Impartial courts - Protection of property rights - Military interference in rule of law and politics - Integrity of the legal system - Legal enforcement of contracts - Regulatory costs of the sale of real property - Reliability of police	Measures of good governance.
(3) Sound money	- Money growth - Standard deviation of inflation - Inflation: most recent year - Freedom to own foreign currency bank accounts	Measures of good governance.
(4) Freedom to Trade Internationally	- Tariffs - Regulatory trade barriers - Black-market exchange rates - Controls of the movement of capital and people	Measures of good governance.

(5) Regulation	- Credit market regulations - Labour market regulations - Business regulations	The extent to which banks are controlled (via ownership or interest rate controls), the extent to which the labour market is controlled (via labour regulations like the minimum wage, limits on hours worked, and limits on firing ability), and the extent to which business is controlled by regulation and tax compliance.

The components in each section are scored from 0-10 using formulas that are based on statistics and social science data and then averaged to produce a section score; the section scores are then averaged to produce a final *Economic Freedom* score. All components and sections are weighted equally when averaging.

Three out of the five sections (sections two through four) are essentially measures of good governance, having to do with price inflation, trading restrictions, judicial effectiveness, police effectiveness, and other measures mostly unrelated to the partisan political choices made in a given country. 60% of the final *Economic Freedom* score comes from these sections.

The remaining two sections (sections one and five) are responsible for 40% of the *Economic Freedom* score. These sections do seem to reflect partisan political choices. Section one purports to measure the “size of government”, while section five is broadly dubbed “regulation”.

However, there are two components of section one that are heavily flawed:

STATE OWNERSHIP OF ASSETS

Fraser's state ownership metric is produced by a calculation based on the *State Ownership of the Economy* score published by the Swedish research institute V-Dem. The problem with this score is that it does not correspond to actual state ownership in any meaningful way. From V-Dem:

This question gauges the degree to which the state owns and controls capital (including land) in the industrial, agricultural, and service sectors […]
0: Virtually all valuable capital belongs to the state or is directly controlled by the state. Private property may be officially prohibited.
1: Most valuable capital either belongs to the state or is directly controlled by the state.
2: Many sectors of the economy either belong to the state or are directly controlled by the state, but others remain relatively free of direct state control.
3: Some valuable capital either belongs to the state or is directly controlled by the state, but most remains free of direct state control.
4: Very little valuable capital belongs to the state or is directly controlled by the state.

It ends up producing poor results as V-Dem seems to have assigned their scores without concern for statistical metrics of state ownership. This produces the following scoring from Fraser:

Country	**Fraser "state ownership of assets" score (lower score = higher ownership)**	**National wealth owned by government (as % GDP) [OECD, 2018]**
France	6.54	-77%
Finland	7.09	55%
Norway	8.14	280%
Canada	8.28	-38%
Germany	9.02	-31%

According to the final Fraser calculation[2], France has higher "state ownership of assets" than Norway, a country with a dramatically higher level of asset ownership. This metric is virtually useless as the judgement calls used to generate it are flawed.

TOP MARGINAL TAX RATE

Including the top marginal tax rate as the sole measure of taxation is misleading. The relationship between top marginal tax rates and overall taxation is limited.

Country	**Fraser "top marginal tax rate" score (lower score = higher tax rates)**	**Government taxation as % GDP [OECD, 2018]**
Sweden	1.00	43.9%
France	3.00	45.9%
Ireland	3.50	22.7%
United Kingdom	4.00	32.9%
Germany	5.00	38.5%
Hungary	7.00	37.5%

This measure also has the unfortunate outcome that countries with very low or no income and payroll tax (like the Bahamas and United Arab Emirates) are recorded as having essentially no taxation (a score of 10.00).[3]

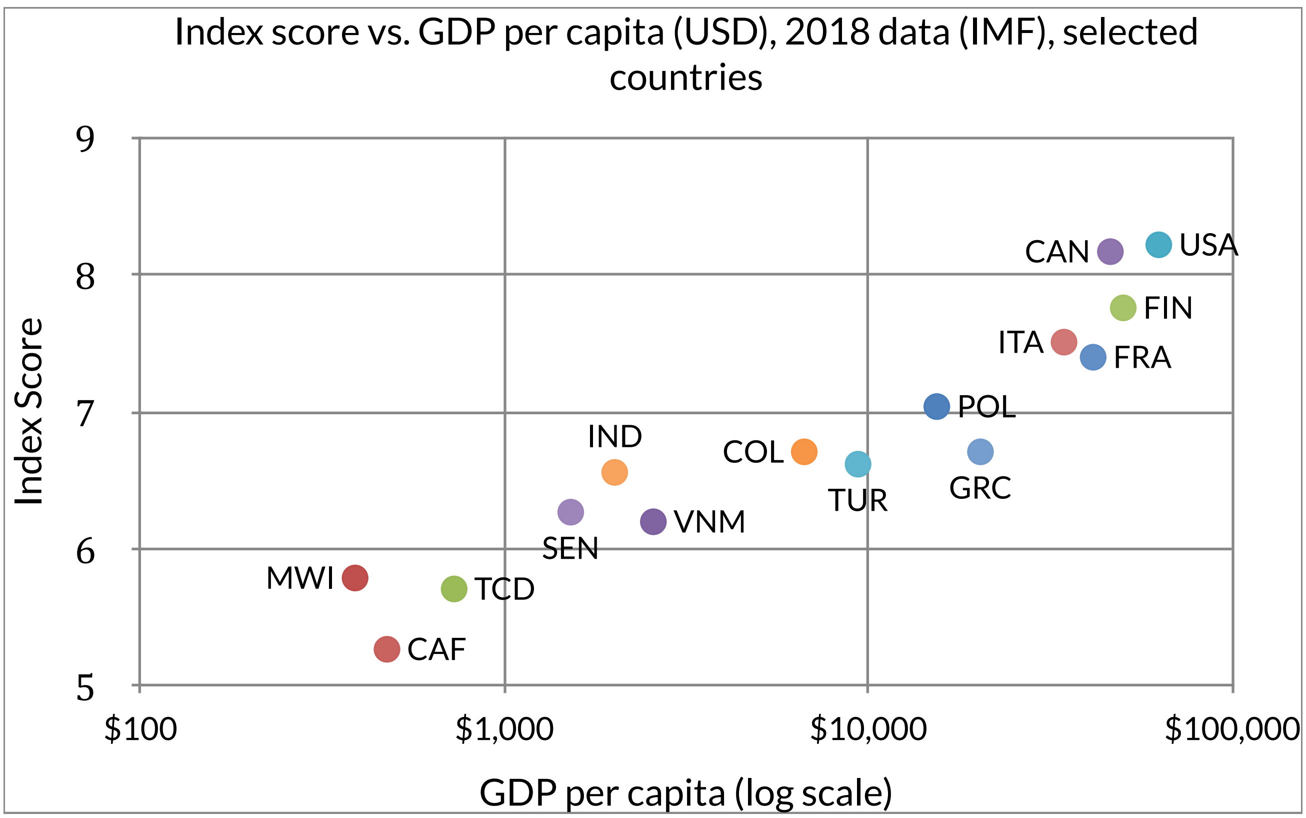
[2] Heritage uses a comparable statistic to partly compose the "fiscal health" component of their competing index, *The Index of Economic Freedom*, albeit using government debt and deficits instead of government assets. Both statistics are misleading - Heritage's debt measure does not include a consideration of assets, so a country with moderate debt but high assets is not valued as a net asset-holder as it should be, and Fraser's measure is just not meaningful period.

[3] Heritage's *Index of Economic Freedom* uses tax as a percentage of GDP to partly compose the "tax burden" component of their scores. This is a more representative measure of general taxation.

Methodology used elsewhere in the index seems technically reasonable at a glance, although some of the components of sections one and five are framed very aggressively against egalitarian policy.[4]

ANALYSIS

Because of the heavy weighting towards measures of good governance, as well as the failure of the index to effectively account for state ownership and government taxation, Fraser's index mostly ends up reflecting differences in country development. We can observe this in the following plot[5] and tables:



[4] In the "labour market regulations" component of the "regulations" section of the index, for example, countries are penalized for having limits on when and how workers can be fired, having collective bargaining in sectors and in firms, having limits on how long workers can continuously work, having paid vacation, and mandating severance pay when firing workers.

[5] MWI = Malawi, CAF = Central African Republic, TCD = Democratic Republic of the Congo, SEN = Senegal, IND = India, VNM = Vietnam, COL = Colombia, TUR = Turkey, POL = Poland, GRC = Greece, ITA = Italy, FRA = France, FIN = Finland, CAN = Canada, USA = United States of America

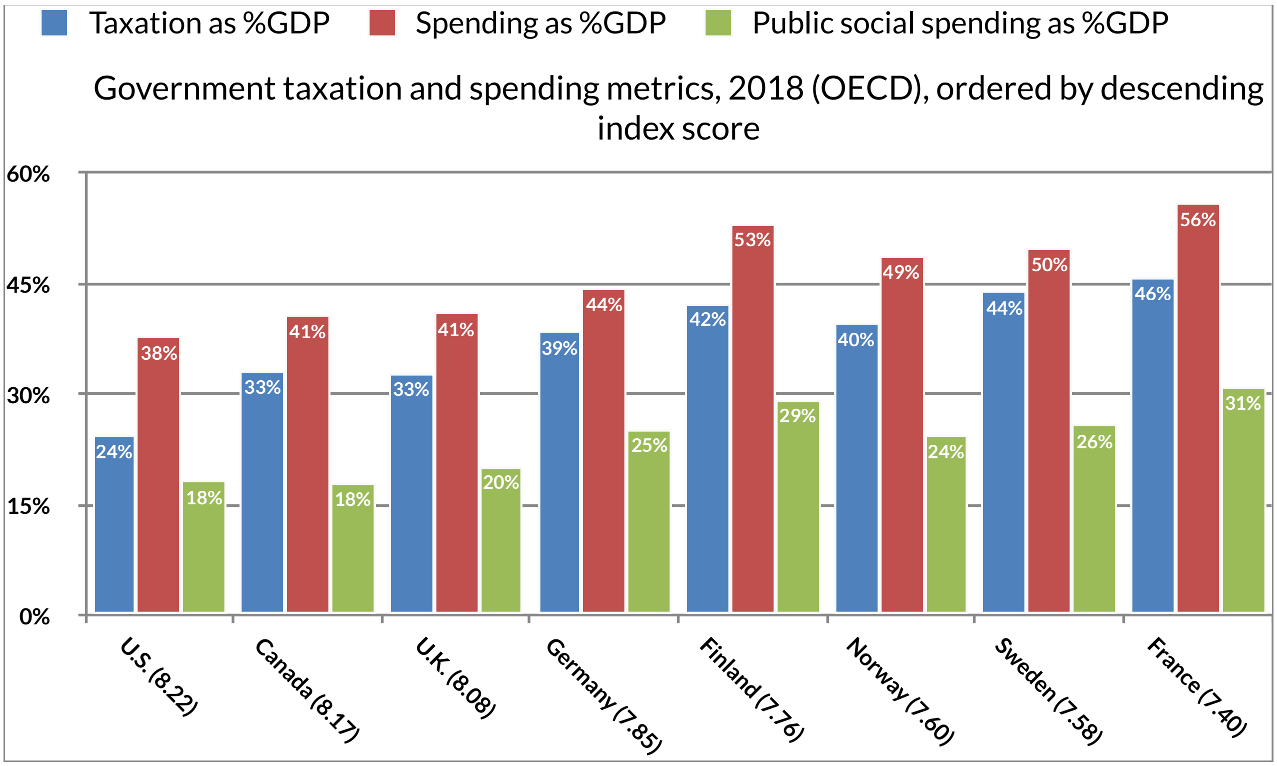
Five highest scoring countries in the index	GDP per capita (2018, USD, IMF)
1. Hong Kong SAR (8.94)	$48,676
2. Singapore (8.65)	$64,582
3. New Zealand (8.53)	$41,945
4. Switzerland (8.43)	$82,797
5. Australia (8.23)	$57,374

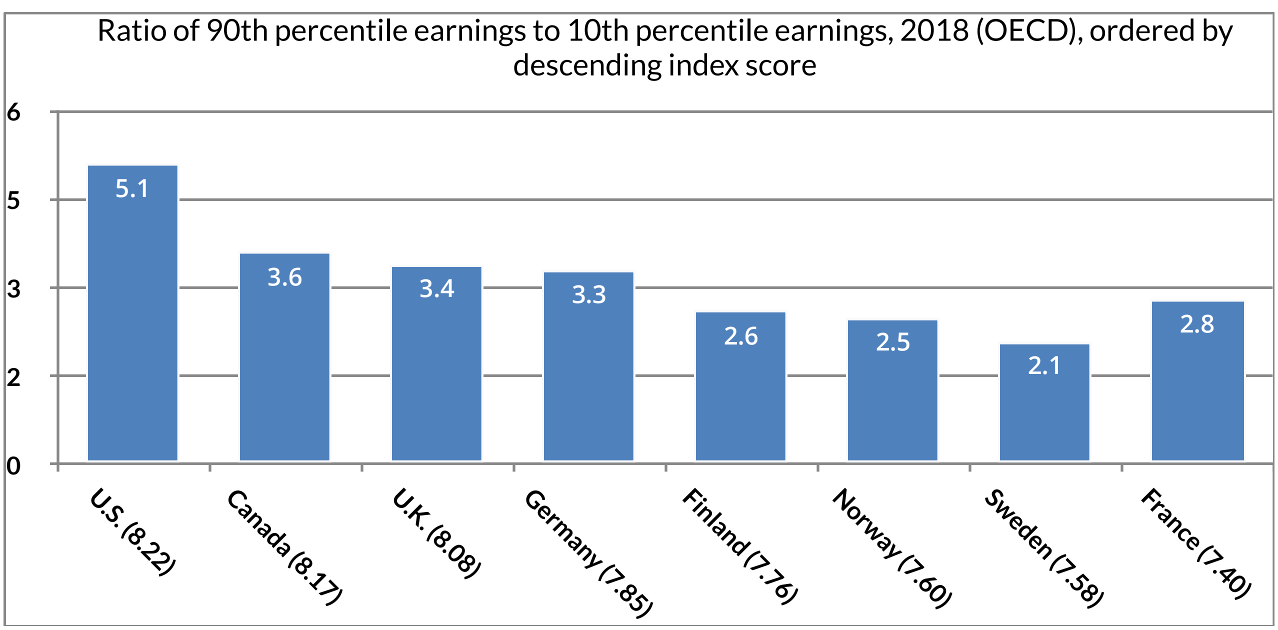
Countries[6] that enjoy high levels of development tend to have much higher scores than countries that have lower levels of development. The good governance criteria in sections 2, 3, and 4 mostly select for more developed, higher income countries. This is reflected in the close relationship between GDP per capita and index score.

Five lowest scoring countries in the index	GDP per capita (2018, USD, IMF)
158. Iran (4.80)	$5,417
159. Angola (4.75)	$3,432
160. Libya (4.72)	$7,242
161. Sudan (4.21)	$977
162. Venezuela (3.34)	$3,411

[6] Hong Kong is not a country, and is the only non-country region included in Fraser's index, although Fraser refers to it as a country in the preamble to their index. For simplicity's sake I have referred to it as such here.

With respect to countries that are similarly developed, more left wing countries score somewhat lower than more conservative countries in the index, but not by much.





There is a negative relation between index score and wage equality, and a negative relation between index score and spending, taxation, and public social spending. Within a cohort of similarly developed countries, higher scoring countries tend to be less equal and spend less and vice versa. But the actual differences in index score are low as most of the score is determined by measures of government effectiveness.

For example, the United States has perhaps the most conservative economic policy of any first-world nation, with extremely low taxation, very high inequality, relatively low spending, and low union density, but it only scores 0.46 index points above Finland which is economically its opposite in every respect (and even has high levels of state ownership).

Again, this is because of two simple factors: most of the index score is determined by non-partisan factors related to good governance, and the parts of the index score that are determined by partisan factors are partially faulty because of poor methodology.

To summarize,

The Fraser *Economic Freedom* score is not:

- a measure that reliably takes government ownership of assets or government taxation into account.
- a measure of socialism versus capitalism or left wing politics versus right wing politics.

The Fraser *Economic Freedom* score is:

- highly dependent on indicators of good governance
- In broad strokes, basically a measure of development, not "economic freedom".

The Fraser index tells us developed countries are more stable environments for commerce. This is not a compelling insight. I don't think the index is particularly useful to anyone, except to be used as a proxy for something it isn't.