

Shandong Economic University  
**English Translation**

**ECONOMIC FREEDOM IN CHINA AND  
THE EUROPEAN UNION**

*Seminar Paper*

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## **1 Introduction**

One of the ways to compare life situations in two different countries is to compare the freedom in each of the societies. Various indices exist to show such comparisons. Two main indices of the economic freedom in the world exist. It is the *Index of Economic Freedom* published yearly by the Heritage Foundation and Wall Street Journal and the *Economic Freedom of the World* published yearly by Fraser Institute.

In this paper, I present some data from the *Index of Economic Freedom*; I compare the member states of the European Union and for the People's Republic of China. Furthermore, I occupy myself with the question if China should be given only place in the index while the EU has as much as 27 places. Finally, I question the results of the index.

## **2 Index of Economic Freedom**

There are ten factors for each country in this index. These factors consist of further subfactors. For each of these factors, every country receives a value between 0-100. These ten values are averaged to make up the final score. The higher the score, the freer the country. The factors are: Business Freedom, Trade Freedom, Fiscal Freedom, Government Spending, Monetary Freedom, Investment Freedom, Financial Freedom, Property Rights, Freedom from Corruption, Labor Freedom.

The Heritage Foundation explains the index:

*“Economic freedom is the fundamental right of every human to control his or her own labor and property. In an economically free society, individuals are free to work, produce, consume, and invest in any way they please, with that freedom both protected by the state and unconstrained by the state. In economically free societies, governments allow labor, capital and goods to move freely, and refrain from coercion or constraint of liberty beyond the extent necessary to protect and maintain liberty itself.”* (Heritage Foundation, b 2010)

The Index of Economic Freedom 2010 is topped by Hong Kong which is followed by Singapore, Australia, New Zealand, Ireland and Switzerland. Heritage Foundation labels these countries “free”.

There are 36 countries labeled “repressed” with Cuba, Zimbabwe and North Korea ranking lowest.

Let us take a look at how the European Union is doing in this index. The champion is Ireland. However, the data does not include the recent economic and monetary crisis when Ireland had to be bailed out by the European Union and the International Monetary Fund because it was unable to finance its debts.

The countries of the European Union are divided equally into labels “mostly free” and “moderately free”. The least free countries are Greece, Italy and Bulgaria. Greece, of course, is the same case as Ireland. It had to be bailed out of its debts in 2010.

I present the data for the European Union in the following table:

Ireland	<b>81.3</b>	Germany	<b>71.1</b>	Hungary	<b>66.1</b>
Denmark	<b>77.9</b>	Cyprus	<b>70.9</b>	Slovenia	<b>64.7</b>
United Kingdom	<b>76.5</b>	Lithuania	<b>70.3</b>	Portugal	<b>64.4</b>
Luxembourg	<b>75.4</b>	Belgium	<b>70.1</b>	Romania	<b>64.2</b>
The Netherlands	<b>75.0</b>	Czech Republic	<b>69.8</b>	France	<b>64.2</b>
Estonia	<b>74.7</b>	Slovakia	<b>69.7</b>	Poland	<b>63.2</b>
Finland	<b>73.8</b>	Spain	<b>69.6</b>	Greece	<b>62.7</b>
Sweden	<b>72.4</b>	Malta	<b>67.2</b>	Italy	<b>62.7</b>
Australia	<b>71.6</b>	Latvia	<b>66.2</b>	Bulgaria	<b>62.3</b>

(Heritage Foundation, d 2010)

## ***2.1 European Union***

The average value (not weighted) of these countries is 69.56. A figure that puts the European Union into the label “moderately free”, below its median value which happens to be the Czech Republic.

Because the Czech Republic represents the median and because it is my country, I will use it as the proxy for the whole European Union. (Heritage Foundation, a 2010) The Heritage Foundation gives the Czech Republic 65.5 for Economic Freedom saying the “*regulatory environment remains somewhat inefficient*” and criticizes the number of licenses needed to start a business as well as the difficulties when closing the business.

87.5 for the Trade Freedom which is mostly affected by the European Union tariffs and non-tariff barriers. 80.1 for the Fiscal Freedom. Tax revenues account for 36.9 % of the GDP. 45.6 for the Government Spending that is high according to the Heritage Foundation.

75.6 for Monetary Freedom where the Czech Republic is criticized for various kinds of price floors and price ceilings. It is worth noting here that the Czech Republic is not member of the Eurozone.

70.0 for Investment Freedom. *“Slow legislative and judicial reform, uneven contract enforcement, bureaucracy, and corruption are continuing obstacles.”* 80.0 for Financial Freedom – the impacts of the global financial turmoil were modest in the Czech financial sector.

65.0 for Property Rights. The Czech Republic is criticized for slow judicial system where judgments vary from court to court and where it is difficult to enforce judgments. 52.0 for Freedom from Corruption is the lowest score in the Czech Republic’s index. Just last month, one of the ministers resigned because of a corruption scandal. 76.4 for Labor Freedom stating that *“dismissing an employee is relatively easy and inexpensive”*, a statement that comes as a surprise to me.

## ***2.2 People’s Republic of China***

Although China’s administrative regions of Hong Kong, Macau and Taiwan do quite well in the index – occupying the first, the 20th and the 27th place respectively –, the mainland is ranked 140th and labeled “mostly unfree”.

China is not a monolithic country. I will comment on this issue later. Now, I will present the data for Mainland China as provided by the Heritage Foundation. (Heritage Foundation, c 2010)

China receives 49.7 for Business Freedom and is criticized for the number of procedures required to start a business. 72.2 for Trade Freedom where it is criticized for *“import and export bans and restrictions, import and export licensing, non-transparent tariff classifications, complex regulations and standards, subsidies, state trading in certain goods, services market restrictions, issues involving the protection of intellectual property rights, and inconsistent and corruption-prone customs administration”*.

70.2 for Fiscal Freedom. China is praised for low corporate tax rate. Tax revenues account for 18.3 percent of the GDP. Remember, it is one half of what they account for in the Czech Republic.

The highest figure, 88.1, receives China for Government Spending which accounts for 19.9 % GDP. Remember again, that in the Czech Republic it is the double of this figure.

70.6 for Monetary Freedom. China is criticized for distorting domestic prices. Not related to this index, but many sources in the West, including the USA government, criticize the People’s Bank of China for the exchange rate regime under which it operates the *renminbi*. This logic, however, is flawed. (Boudreaux 2010)

20.0 for Investment Freedom. There are industries where investment is encouraged, permitted, restricted and prohibited. Furthermore, *“investors face regulatory non-transparency, complex and inconsistently enforced laws and regulations, weak protection of intellectual property rights, corruption, industrial policies protecting local firms, and a legal system that cannot guarantee the sanctity of contracts.”*

30.0 for Financial Freedom where it says that China is opening itself to foreign banks but only slowly. 20.0 for Property Rights where China is criticized for owning all land that is only subject to long-term leases. 36.0 for Freedom from Corruption that is *“perceived as widespread”*. And finally, 53.2 for Labor Freedom saying that dismissing an employee may require consultations with the local bureau.

## 2.3 Overview

	Czech Rep.	China	Difference
Business Freedom	65.5	49.7	<b>15.8</b>
Trade Freedom	87.5	72.2	<b>15.3</b>
Fiscal Freedom	80.1	70.2	<b>9.9</b>
Government Spending	45.6	88.1	<b>-42.5</b>
Monetary Freedom	75.6	70.6	<b>5.0</b>
Investment Freedom	70.0	20.0	<b>50.0</b>
Financial Freedom	80.0	30.0	<b>50.0</b>
Property Rights	65.0	20.0	<b>45.0</b>
Freedom from Corruption	52.0	36.0	<b>16.0</b>
Labor Freedom	76.4	53.2	<b>23.2</b>
mean	69.8	51.0	<b>18.8</b>

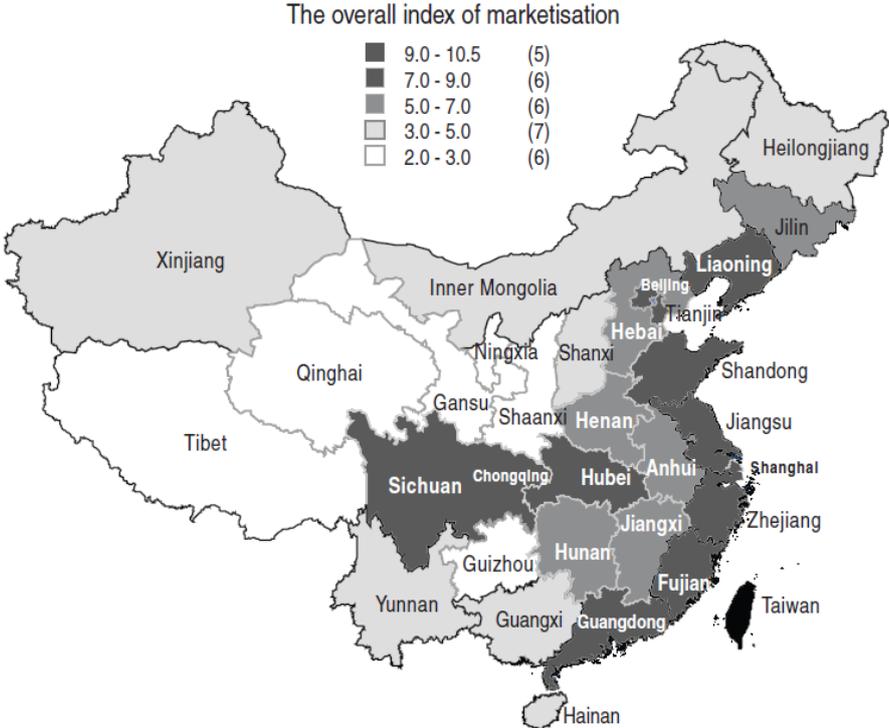
## 3 China's Provinces

As I have already said, China is not a monolithic country. Although usually it is considered to be the modern-day Soviet Union where everything is the same, the reality proves otherwise.

In fact, the European Union is economically much more homogenous than China. Disregarding Luxembourg because it is a very small country with a lot of foreign labor (which sky-rockets all per-capita measures), the country with the highest GDP per capita (PPP) in the EU (The Netherlands – 40,777 USD) is 3.47 times as productive as the one with the lowest (Romania – 11,766 USD). Not disregarding Luxembourg, the most productive country would produce 6.82 times as much as the least productive one. (IMF 2010)

As for China, if we count only proper provinces (省), the highest GDP per capita (PPP) is in Zhejiang (11,591 USD), the lowest in Guizhou (2,682 USD). Zhejiang is thus 4.32 times more productive in per-capita terms. Counting all administrative regions, Hong Kong is 15.9 times as productive or Shanghai 7.82 times as productive.<sup>1</sup> (National Bureau of Statistics 2010)

The closest statistic to the Index of Economic Freedom that I have found for China’s Provinces is Marketisation in China (Wang, Fan and Zhu 2007). They use different methods to establish their index but basically we can say that it is similar.



I argue that it is academically dishonest to treat China as a monolith and attribute only one number for the whole republic whereas treating the European Union as 27 independent countries still remains the case.<sup>2</sup>

<sup>1</sup> I wanted to make my argument short and clear. The fact is that EU25 (without Bulgaria and Romania) is much more homogenous than EU27. This would be seen from another statistic, for example the standard deviation of the GDP per capita. But because my argument holds even with this simple relation of GDP per capita, I do not think it is necessary to compute the deviation.

<sup>2</sup> And doing so despite the fact that the European Union has all attributes of one state – it has a President, a Diplomatic Service, a common currency, common borders, and it is claiming a seat in the United Nations.

Although, of course, many things would remain the same, it would be interesting to see the Heritage Foundation provide rankings for China's administrative regions separately using the same method it uses for the entire world.

There can be no doubt that the situation of freedom in China is improving. It is admitted in the Heritage Foundation report and in their paper Wang, Fan and Zhu come to a conclusion that reads:

*"Marketisation in China accelerated during the period from 2001 to 2005 that is, the period after China's WTO accession. The basic framework of a market economy has been established, although there are still bottlenecks in further development of market mechanisms, due mainly to lack of government sector reform and an undesirable legal environment for a market economy. [...] marketisation made a significant contribution to economic growth during the period from 1997 to 2005, especially in recent years."* (Wang, Fan and Zhu 2007)

#### **4 On the Other Hand**

Although China ranks 140th out of 179 nations (21st percentile) in the Index of Economic Freedom as published by the Heritage Foundation, it ranks 82nd out of 141 (41st percentile) in a very similar index called *Economic Freedom of the World* that is published by the Fraser Institute. China scores 6.54 out of ten. (Fraser Institute 2010)

The median EU country in this index is Cyprus on the 36th place (74th percentile) which scores 7.36. This makes a difference of 0.82. Remember, the median EU country in the *Index of Economic Freedom* was the Czech Republic on the 34th place (81st percentile) and the difference between this country and China was 18.8 on a one-hundred scale. This index seems not to be as harsh towards China as the previous one.

On a less academic note, I want to say a few words for which I have only weak academic evidence and therefore the reasoning may not be too convincing. After having spent 23 years of my life in what is now known as the European Union (22 of those years in Czechoslovakia and the Czech Republic and one year in Germany), I have spent five months in China, almost exclusively in the richest provinces (namely Shandong, Shanghai, Jiangsu, Zhejiang, Guangdong, Hainan and Fujian in that order).

I cannot comment on the poor provinces like Guizhou, Gansu or Tibet that gets lots of media attention in the West. I also cannot comment on the macro-situation any better than the two indices mentioned above.

But I can say with confidence that I have never seen such a density of small businesses in my entire life, not even in the (in)famous Chinatown in Soho, London. Having so many businesses on every street does not quite fit into the image of a Soviet-Union-style unfree society that is still supported – to a great extent – by the *Index of Economic Freedom*.

When one considers the sheer number of absurd restrictions or bans in the EU trade (light bulbs, cucumbers, bananas, cigarettes, petrol, cheap candles from China, LCDs, telephone chargers, and so on...), one has to ponder if it is not the other way round with freedom for small businesses and their customers between the EU and China.

## ***5 Conclusion***

In this paper I have compared the economic freedom in the European Union with the economic freedom in the People's Republic of China. Using the Index of Economic Freedom published by the Heritage Foundation, I have shown that the economic freedom is greater in the EU in all regards but government spending.

I have expressed my doubts about the usefulness of regarding China as a unified country and I have shown the differences between China's provinces. I have also used Economic Freedom of the World and anecdotal evidence to question the harshness of the Index of Economic Freedom.

## 6 References

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