THE INTERDEPENDENCY OF ECONOMIC FREEDOM AND ECONOMIC GROWTH IN V4 COUNTRIES

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Abstract: *Economic Indicators such as Index of Economic Freedom and Gross Domestic Product are interrelated, thus it is interesting to observe their trend as well as to measure their mutual influence separately. The Index of Economic Freedom is a composite index being compiled from the assessment of ten categories within the four key domains. Countries with higher Economic Freedom Index have higher economic performance as well as faster gross domestic product growth, and higher gross domestic product per capita.*
We observe the development analysis of both indicators within the V4 countries in a wider context of European countries. Within the period under review, the best values within the surveyed indicators of V4 countries were reached by Czech Republic, relatively the worst values were obtained by Poland. The GDP growth rate in V4 countries was highest in Slovak Republic and Czech Republic within the observed period, meanwhile a decline in GDP growth was observed by all V4 countries that experienced a strong financial crisis in 2009. Czech Republic has been reaching the highest GDP per capita values within the V4 countries during the whole period under review.
Time series analysis, comparison and correlation analysis are the basic methods of finding and assessing the issue. The processing data were obtained from the Eurostat database, Fraser Institute, and The Heritage Foundation.

Keywords: *Gross Domestic Product, Economic Growth, Economic Freedom, Index of Economic Freedom, Economic Freedom of the World, V4 Countries.*

1. INTRODUCTION

States seek to implement economic policy measures which would increase economic performance and bring economic success. In addition to the economic development of a particular country also other factors such as social and environmental affect the quality of life in general and overall welfare of the country.

The core indicator of the country's performance is the gross domestic product (GDP). This indicator measures the economic performance of the country over a certain period. In the last few decades Gross Domestic Product indicator is linked to other indicators that complement this indicator and are more focused on other determinants of economic development such as economic freedom, competitiveness, investment, consumption, and so on.

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Economic freedom is essential to achieving economic progress and economic growth. The expression of economic freedom is freedom of each individual, property right and freedom and competition in the markets without excessive interference by state institutions. An economic policy that increases economic freedom creates the foundation for higher economic growth and higher living standards in the country.

The aim of our contribution is to evaluate the development of GDP and economic growth and economic freedom and their interdependence in the states of the Visegrad Group. In this paper, we used the time series analysis, comparison and correlation analysis, based on the statistics provided by Eurostat [1], The World Bank [2], The Heritage Foundation [3], and the Fraser Institute [4].

2. THE THEORETICAL BACKGROUND OF ECONOMIC GROWTH AND ECONOMIC FREEDOM

Economic growth is the most important parameter contributing to development of the economy. It is a process through which the production capacity of the economy is increased [5]. As Habánik and Koišová [6] show, increasing economic growth also means increasing the supply of products and services the economy is capable of providing. Every economy seeks to achieve long-term growth respectively sustainable growth. In order to maintain the growth in the economy, it is necessary to support it through the use of new technologies, their development and the use of new knowledge in economic practice.

This results in a long-term increase in the ability of the economy to provide its people with more products and services and to contribute to their better lives.

Economic growth is most often measured by the indicator of the rate of economic growth expressed by the percentage growth of the real gross domestic product in a given year compared to the previous year. Economic growth is closely linked to economic freedom. Economic freedom is generally characterized by a state in society where there are no government interventions, restrictions on production, distribution and consumption of goods and services. In this context, the primary function of the government should be the protection of private property and the provision of basic infrastructure for the smooth implementation of the exchange of goods and services.

The liberal view of economic freedom has been developing since the 16th century in the works of J. Lock, later A. Smith and other economists. Today's understanding of economic freedom stems from these theories and can be understood as a continued development of Smith's principles. [7] The basis for economic freedom is private ownership, freedom in the provision of services and the ability to make own decisions about own resources [8].

In current scientific works, individual authors define economic freedom differently. Miller and Kim [9] define economic freedom as a state in which each individual can act with maximum autonomy and independence with minimal barriers to seeking his economic livelihood and greater prosperity.

Lawson [10] perceives economic freedom as an economic system of private ownership and a free market, with its core elements being personal choice, voluntary exchange, freedom to compete on the market and protection of person and property. Gwartney, Lawson and Hall [11] understand economic freedom as a condition where individuals have the option of choosing and entering into voluntary exchanges to the extent that they do not harm individuals or property of other individuals. Lisý et al. [12] note that the level of economic freedom in the country significantly affects economic growth and economic levels. Economic freedom affects the level of foreign direct investment, employment, rate of disputes, the distribution of pensions, the degree of poverty, but also the development of the economic cycle.

Although each of the perceptions of economic freedom is slightly different, what they have in common is the principle of protection of private ownership i.e. the right of the owner to dispose of their property according to their interests, the recognition of the existence of the free market where the role of the state is to secure the rights of owners.

As already mentioned, economic freedom is closely linked to economic growth, essentially economic freedom fosters economic growth. Moers [13] embraces economic freedom along with the protection of property rights and a sound legal system as the pillars of economic growth. Webster [14] explored the relationship between economic freedom and economic growth, and concluded that economic freedom is a predicament for sustainable economic growth.

Similarly, North [15] and Sen [16] emphasize the importance of economic freedom for economic progress. North argues that one of the main reasons for slower economic development of Spain, Portugal and their colonies in South America (compared to the United Kingdom and its colonies in North America) was the lack of economic freedom, low protection of private property against expropriation by the state.

Moravčík [17] states that the level of economic freedom in the country significantly affects economic growth and economic level. Economic freedom is influenced by the level of foreign direct investments, employment, rate of disputes, distribution of pensions, the degree of poverty, and the development of the economic cycle.

Interactions between economic freedom, income inequality and economic growth were examined by Ismail and Hook [18]. Their empirical results show that economic freedom and income inequality are statistically significant determinants of economic growth, improved economic freedom and income equality lead to economic growth.

Kešeljević [19], in connection with the importance of economic freedom, also maintains that a private initiative in a well-protected property environment and a good legal system, high quality institutions, clear playing rules and consensus building can lead to significant differences in economic development across countries.

Gwartney and Lawson [20] have found in their research of economic freedom that in freer economies the rate of economic growth is higher, there is more investment, the productivity of investment is higher, there is less poverty, the distribution of income is more equal, people live longer and there is less corruption in business and government. They also proved a high degree of dependence between economic freedom and political rights and civil liberties. Economic freedom raises incomes and improves living standards. The freer the economy the higher is the rate of economic growth, and the wealth of people. Moreover, economic freedom clearly increases life expectancy, improves the lives of the poor, improves the lives of children and supports democracy and many other desirable aspects of healthy societies. [21]
Diaz a Montes [22] examined by means of a structural equations model, an account of the economic freedom factors and their importance. According to them economic freedom

manifests through: business freedom, trade freedom, fiscal freedom, government size, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption and labour freedom. Their results show that all the considered freedoms have statistical significance. The most influential freedoms are the ones related to the property rights and the freedom from corruption, showing that a sense of safety is of the utmost importance for the economic freedom. There is a negative correlation between the economic freedom and the fiscal freedom and between the economic freedom and the government size. Based on their findings, they created their own economic freedom index.

3. ECONOMIC FREEDOM ASSESSMENT

Economic freedom as a complex of individual partial freedoms is quantifiable by measuring these partial components. The measurement and evaluation of economic freedom has been done by several institutions as well as by independent researchers. Among the world's most significant indicators, the Index of Economic Freedom and Economic Freedom of the World can be included in the assessment of economic freedom.

Index of Economic Freedom

The US Heritage Foundation, in collaboration with The Wall Street Journal, is compiling an Index of Economic Freedom (IEF) study each year. This indicator has been showing since 1995, within the economic freedom assessment in more than 170 countries. The Index defines economic freedom as "the limitation of governmental influence on decision-making process on production or consumption of goods and services beyond being necessary to preserve the freedom by itself" [23]

The Heritage Foundation [3] states on its website, that 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. 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.

The assessment of economic freedom by Economic Freedom Index is based on partial components, which consist of other quantifiable indicators.

The Index of Economic Freedom focuses on four key aspects of the economic environment over which governments typically exercise policy control: Rule of law, Government size, Regulatory efficiency, and Market openness. These aspects consist of components such as Property Rights, Judical Effectiveness, Government Integrity, Tax Burden, Government Spending, Fiscal Health, Business Freedom, Labor Freedom, Monetary Freedom, Trade Freedom, Investment Freedom and Financial Freedom. Each of the twelve economic freedoms within these categories is graded on a scale of 0 to 100. A country's overall score is derived by averaging these twelve economic freedoms, with equal weight being given to each. The resulting index ranges from 0 to 100, where 100 represent the highest number of points. [3]
Based on the number of points earned, a ranking of rated states is compiled and the states are divided into five groups: free (score 80-100), mostly free (score 70-79.9), moderately free (score 60-69.9), mostly unfree (score 50- 59.9), repressed (score 0-49.9).

Within the economic freedom assessment, the Heritage Foundation builds on the databases and findings of many institutions and international organizations, such as World Economic Forum, World Bank, International Monetary Fund, World Competitiveness Report; Doing Business; Country Risk Assessment and many more.

Economic Freedom of the World

Canadian think-tank Fraser Institute is another institution dealing with the economic freedom assessment. Since 1986, this institute has been organizing an international conference on economic freedom with the participation of major world economists (Michael Walker, Milton Friedman, Rose Friedman, Douglass North, Gary Becker, William Niskanen and Gordon Tullock), culminating in issuing the publication titled the Economic Freedom of the World [24]. The basis of economic freedom by Fraser Institute is: personal choice, voluntary exchange coordinated by markets, freedom to enter and compete in markets, and protection of persons and their property from aggression by others. Individuals have economic freedom when property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and they are free to use, exchange, or give their property as long as their actions do not violate the identical rights of others. Individuals are free to choose, trade, and cooperate with others, and compete as they see fit. [25]

Since 1996, Fraser Institute has set up the Economic Freedom of the World (EFW), being designed to measure the extent to which state institutions and policies are consistent with the protection and freedom of individuals to make their own economic decisions. According to Fraser Institute [4], crucial elements for freedom are following aspects are: private property protection, a fair legal system, equal treatment of agreements, a stable monetary environment, a low tax burden, free foreign trade, and a low degree of state interference.

On the basis of the stated above, the Economic Freedom Index of the World consists of five major areas: government size, law and security of property rights, money, and free foreign trade regulation. Within the five major areas, there are 24 components in the index. Many of these components are themselves made up of several sub-components. In total, the index consists of 42 distinct variables [4]. Values for all variables are retrieved from external sources to avoid subjectivity from index creators. Data from the International Country Risk Guide, the Global Competitiveness Report, the World Bank's Doing Business project, etc. is used. The index for previous years is updated by each new release in order to take into account the revision of basic data. For some countries the data is recalculated back to 1970.

Each component and sub-component is placed on a scale from 0 to 10 that reflects the distribution of the underlying data. When subcomponents are present, the sub-component ratings are averaged to derive the component rating. The component ratings within each area are then averaged to derive ratings for each of the five areas. In turn, the five area ratings are averaged to derive the summary rating for each country. [4]

However, in relation to the economic freedom assessment, it should be noted that there are also various negative aspects of its measurement (suitability and accuracy of data used) and some authors reject the economic freedom assessment as such because they claim that economic freedom is not the only thing that matters, there are many other things being seen by people as more important [26] - [28]. As Kešeljevic [19] points out, economic freedom indexes may have certain shortcomings, as they are based on the idea of absolute, individual and objective economic freedom. His detailed political and economic analysis of economic freedom has shown that economic freedom is collective, relative and subjective issue. Moreover, according to the author cited above, these indexes do not pay attention to different cultures, norms and values that undoubtedly have a strong influence on understanding the economic freedom issue.

4. THE ANALYSIS OF ECONOMIC GROWTH AND ECONOMIC FREEDOM IN VISEGRAD GROUP COUNTRIES

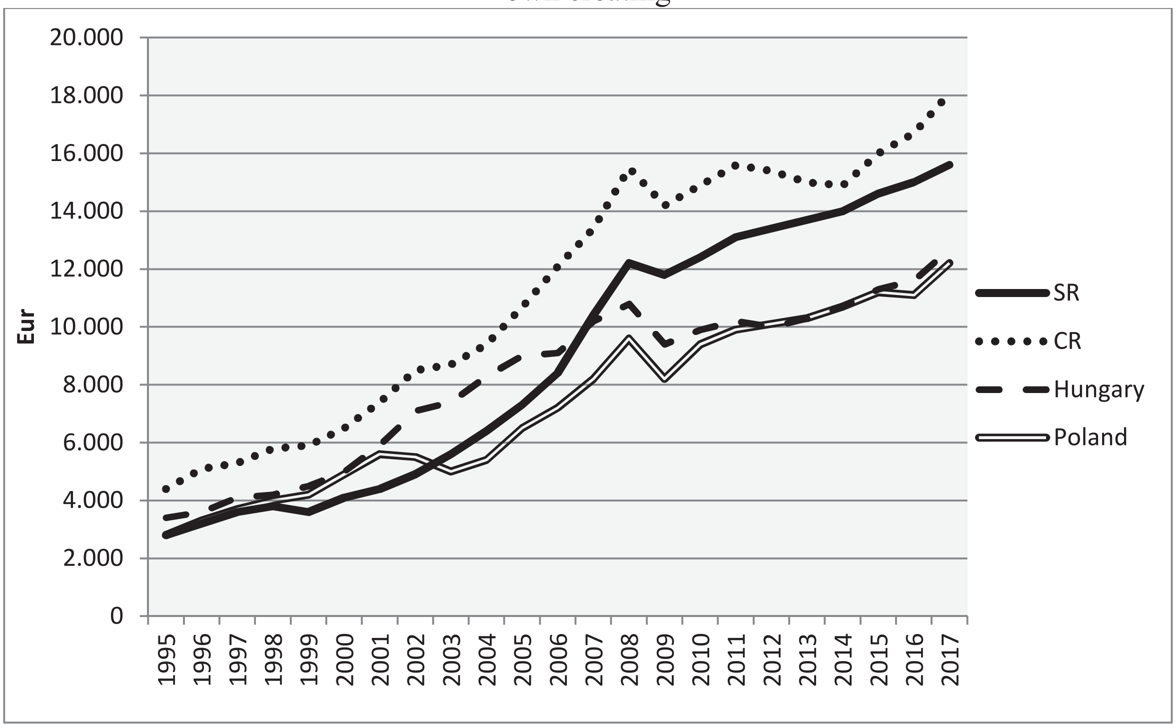
The Visegrad Group is an informal block of four Central European post-communist countries: Slovak Republic, Czech Republic, Hungary and Poland. It was formed during a meeting of representatives of the Czech and Slovak Federal Republic, Hungary and Poland on 15 February 1991 in Vyšehrad, northern Hungary, with the goal and vision of closer cooperation in the region of Central Europe. [29]

The Visegrad Group wants to contribute to building a European security architecture based on effective, functionally complementary and mutually reinforcing cooperation and coordination within existing European and transatlantic institutions. In order to preserve and support cultural cohesion, the cooperation within the Visegrad Group will be promoted by the dissemination of values in the field of culture, education, science and information exchange. All activities of Visegrad Group are aimed at strengthening stability in Central European region. The participating countries perceive their cooperation as a challenge and its success as the best proof of their ability to integrate into structures such as European Union. [30]

4.1. THE ECONOMIC GROWTH ANALYSIS IN V4 COUNTRIES

The assessment of economic growth is measured by using the Gross Domestic Product indicator. GDP as a traditional indicator of the performance of economies; it evaluates the result of the activity of economic entities located in the territory of a country. The development of GDP per capita in Visegrad Group countries in 1995-2017 is shown in Graph 1.

Figure 1: Development of GDP per capita in V4 countries (Eur, market prices) Source: [1], own creating



GDP per capita in the V4 countries was increasing year by year, with the exception of 2009 when also the V4 countries experienced an economic crisis resulted in a decline of GDP per capita. In Czech Republic, GDP per capita was slightly decreasing even after 2011, in Poland in 2002 and 2003, in SR in 1999.

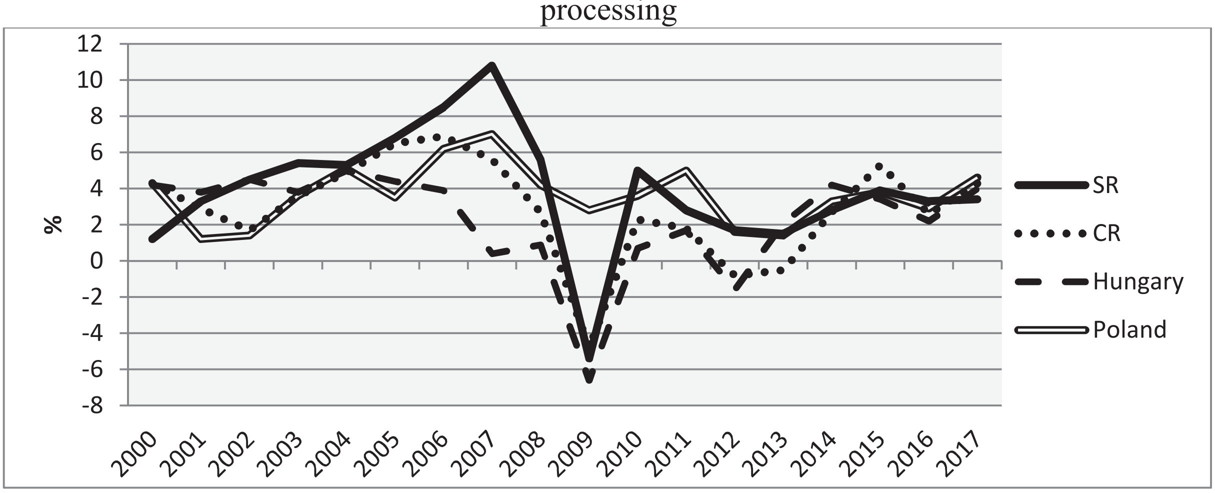
During the whole observed period, the highest GDP per capita was reached in Czech Republic, in 1995 it was 4400 EUR, and in 2016 it was already 16500 EUR, being a significant increase by 275%. By 2006, the second highest GDP per capita among the V4 countries was recorded in Hungary, but in 2007 Slovakia got ahead of Hungary and Poland also in 2012-2015. In Hungary, GDP per capita moved up from € 3400 in 1995 to € 11500 in 2016, i.e. more than 238%. During the observed period, the biggest leap in GDP per capita was recorded in Slovakia - from EUR 2800 to EUR 14900 in 2016, i.e. by 432%. In Poland, a positive GDP per capita development can be observed, especially after 2003. Overall, GDP per capita increased from EUR 2800 in 1995 to EUR 11000 in 2016, an increase of almost 293%.

Real Gross Domestic Product, i.e. GDP, being expressed in constant base prices, is the basis for determining the growth rate of GDP (the economic growth rate), which is one of the key indicators of a successfully performing economy and favorable economic growth achievement, and is one of the basic macroeconomic objectives. Habánik [31] argues that while GDP is the basic parameter of economic prosperity, GDP growth is an indicator of economic development. Figure 2 shows the evolution of economic growth rate in V4 countries.

The GDP growth rate in Visegrad group countries in the years of 2000-2016 was developing variably. In Slovak Republic, significant growth 10.8% can be observed in 2007, which is the highest GDP growth rate in whole observed period in all V4 countries. However, in 2009, the economic crisis in Slovak Republic showed a significant decline in GDP (by 5.4%). In upcoming years, Slovak economy has achieved lower GDP growth than in the pre-crisis period.

The GDP growth rate in Czech Republic was similar to the one in Slovak Republic with the difference that not such big values of economic growth were achieved as they were in SR, the highest growth in Czech Republic was recorded in 2006, 6.9%. Also Czech economy was hit hard by the crisis, GDP dropped by 4.8% in 2009. In the next two years, GDP growth was positive, but in 2012 and 2013, GDP growth rates were negative.

Figure 2: The real GDP growth rate development in V4 countries (%) Source: [2], own processing



The GDP growth rate in Hungary was different. The transformation of economy, associated with liberalization, privatization and tax reforms, started the economic growth that helped Hungary join European Union. However, government indebtedness and termination of some reforms have gradually led to economic problems, and since 2005 there has been a slowdown in economic growth. Economic problems have been fully visible during the financial and economic crisis, with GDP drop by 6.6% in 2009. Although in the following two years Hungary experienced a slight recovery, another decline in gross domestic product can be seen in 2012 (by 1.6%). Since then, Hungary has experienced moderate GDP growth, real GDP has been moving up by 4% in 2014 and by 2% in 2016.

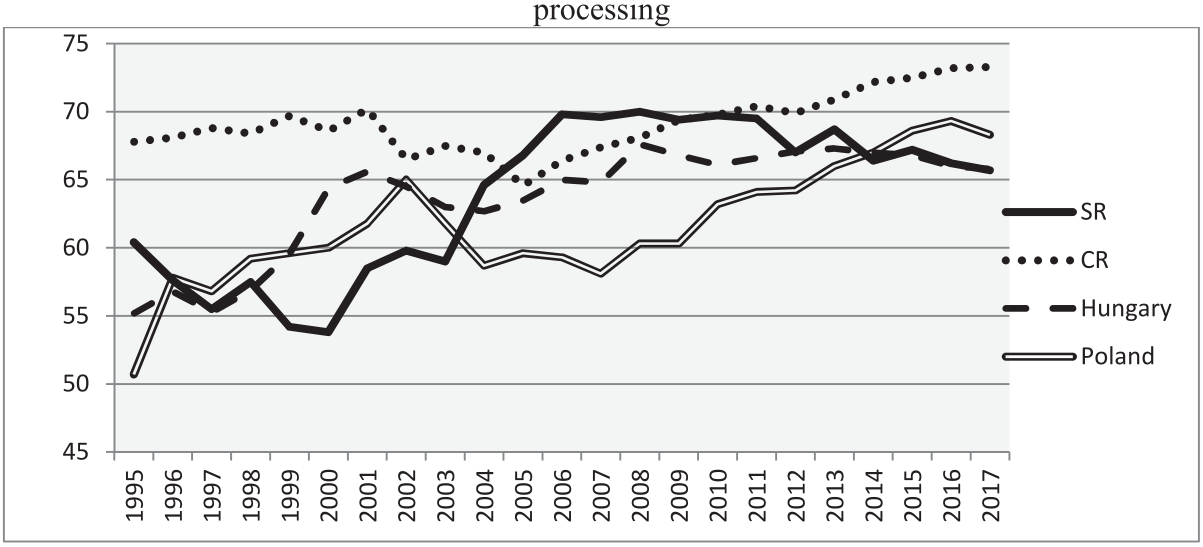
In Poland, annual real GDP growth can be seen (at most in 2007: 7%). Poland, as the only economy among the V4 countries, was not so badly affected by recession, and the economic crisis caused a slowdown only in the real growth of gross domestic product. In 2016, the real GDP increased by 2.7%.

4.2. DEVELOPMENT OF INDEX OF ECONOMIC FREEDOM IN V4 COUNTRIES

The Heritage Foundation reports an Index of Economic Freedom, already issuing an assessment for the year of 2017. The development of Economic Freedom Index in V4 states is shown in Figure 3.

The Index of Economic Freedom in V4 countries had a positive development in the period under review. In Slovak Republic, the Economic Freedom Index was increasing significantly in 2000-2006 when it reached the value of 69.8 in 2006. In 2005-2008 even Slovakia achieved the best results among the V4 countries. However, the results got worse and the index dropped to 65.7 in 2017, being the worst value among the V4 countries.
In most years during the observed period, Czech Republic has reached the highest value within the Economic Freedom Index, with an annual growth since 2005, and in 2017 the Index reached 73.3. Poland had the worst results in 2003-2013, but the index was rising gradually from 58.1 (2007) to 69.3 in 2016, making Poland rank second among the V4 countries after Czech Republic. The development of Economic Freedom Index in Hungary was fluctuating, the highest value was reached in 2008, 67.6.

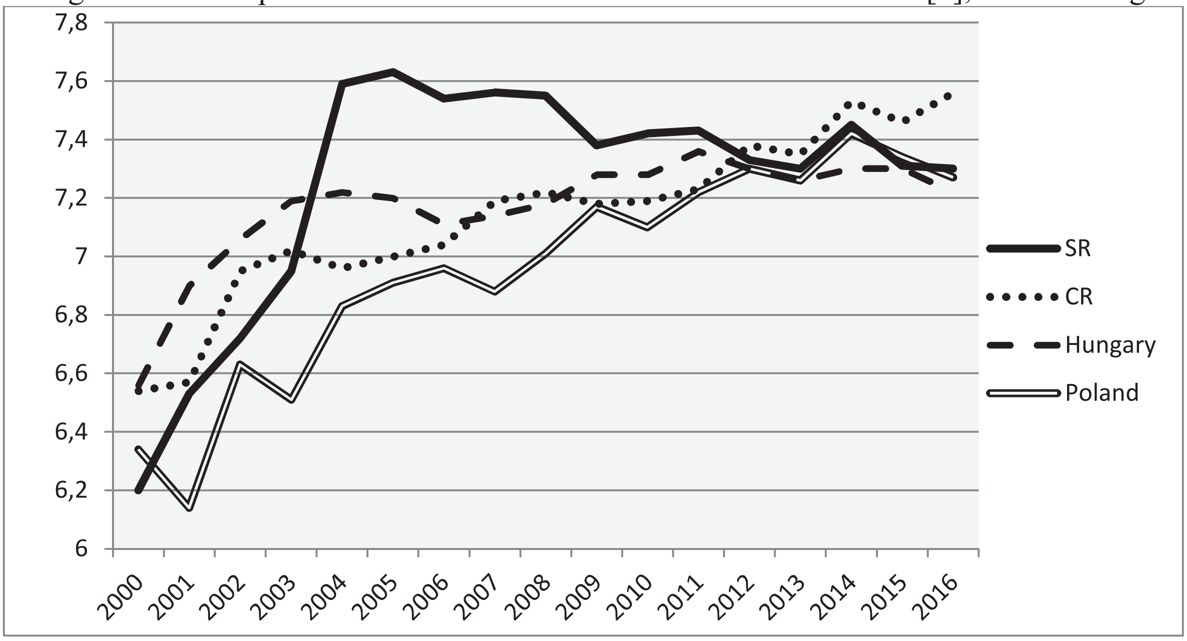
Figure 3: The Index of Economic Freedom Development in V4 countries. Source: [3], own processing



4.3. DEVELOPMENT OF ECONOMIC FREEDOM OF THE WORLD IN V4 COUNTRIES

A complete time series, in which the Fraser Institute is assessing the economic freedom in Visegrad Group countries, has been in action since 2000. Figure 4 shows the development of EFW by 2015, based on the 2017 annual report.

Figure 4: Development of Economic Freedom of the World. Source: [4], own creating



The graphical representation shows that the values of economic freedom in V4 countries have improved over the period under review. The most significant improvement within the index is observed in Slovak Republic in 2000-2004 (from 6.2 to 7.59) and Slovakia has become the most economically free country of V4 and was keeping this position until 2011. After 2004, however, the economic freedom index in Slovak Republic generally got worse, dropping to 7.31 in 2015.

Czech Republic achieved a score of 6.54 in 2000; making the EFW the second best among the V4 countries. Gradually, the EFW Index of Czech Republic improved, when Czech Republic topped the Visegrad countries, and the value of the index increased at 7.53 in 2014.

In the first years of the period under review, Hungary has been the most economically free country among V4 countries, but the slowdown in 2006 and in the last three years and the current improvement within the economic freedom in other V4 countries were the reasons why Hungary fell down to the last position among V4 countries in 2014, with the index value 7.3.

The development of the EFW index in Poland can be described as fluctuating, jumping, with a significantly increasing tendency, having the second highest growth after Slovakia. Although in 2001 the Index fell to 6.14; in the following years, it was gradually increasing to 7.42 in 2014. In 2015 the EFW index slightly dropped to 7.34.

4.4 ECONOMIC FREEDOM AND GDP DEPENDENCE

In this section, we will figure out the dependence of assessed indicators and gross domestic product per capita by means of Pearson correlation coefficient. This dependence was assessed for the 2000-2017-time series (for EFW 2000-2016). The correlation coefficient values being found are shown in Table 1.

Table 1: Dependence of economic freedom indexes and GDP. Source: own calculations

Indicator/Country	***SR***	***CR***	***Hungary***	***Poland***
IEF	0.71	0.64	0.39	0.71
EFW	0.60	0.91	0.81	0.89

The results of the correlation analysis show the different values of GDP and the assessed indicators in individual countries of Visegrad Group.

The highest dependence between economic level and economic freedom (IEF and EFW) is in Poland. In CR and Hungary there is a strong dependence between GDP per capita and EFW, the moderate dependency between GDP per capita and IEF. In case of SR, we found a slight dependence between the economic level and both indexes of economic freedom.

CONCLUSION

In many scientific studies and publications, the economic freedom and its relationship to economic performance and other socio-economic indicators is being assessed. Studies show that economic freedom positively influences the level of well-being of the nation. The level of economic growth is the basis of prosperity. In terms of economic growth development in V4 countries, the best results in the whole observed period are reported by Czech Republic, both in terms of economic growth and GDP per capita. Hungary has been achieving good results in this indicator, after the crisis Czech Republic was followed by Slovak Republic. In Poland, the positive development of GDP per capita can be observed after 2003, but Poland is still ranked as the last within the V4 countries. Within the Economic growth rate indicator, the best results were obtained by Slovak Republic from 2004 till 2009. However, in average, Poland has relatively achieved good results during the whole observed period; after 2015 the development in this indicator in the V4 countries is becoming balanced.

Economic freedom values in V4 countries during the period under review are achieving good values. The most significant improvement within the index is observed in Slovak Republic in 2000-2004 (from 6.2 up to 7.59) and Slovakia was the most economically free country within the V4 countries, and was keeping this position until 2011. After 2011 Slovakia was replaced by Czech Republic, the other V4 countries have a balanced development after 2011.

The values of dependence between economic growth and economic freedom differ in V4 countries. Relatively highest dependence is shown by Poland and the least dependence by Slovak Republic. In Czech Republic and Hungary, the economic freedom indicators (IEF and EFW) have significantly different values.

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