

Evaluating the Index of Economic Freedom

Project Overview

The U.S. government wants the United States to become more attractive to foreign investors. The aim of this data analysis at The Heritage Foundation is to

- evaluate which focus The Heritage Foundation would recommend for attracting foreign investors in this legislative period.
- provide an indication if The Heritage Foundation should expand their consultancy division (especially the consultancy activity based on the Index of Economic Freedom)

The Index of Economic Freedom provides reliable information about which states invest in 12 indicators of economic prosperity and security. Foreign governments and investors can assess the reliability of these states by looking at their overall score.

But is the Index of Economic Freedom also a reliable tool for advising the U.S. government in their economic policy for this legislative period?

Data Analysis

In an exploratory data analysis we found out that property rights* shows the strongest correlation to the overall score of a country. So our first analysis step was to test the hypothesis “The higher the scoring for Property Rights, the higher the Overall Score for Economic Freedom”.

A regression analysis showed that the relationship between Property Rights and Overall Score that although there is a connection between these two variables, the regression line is only a fairly moderate fit which means that the relationship between them is not really linear but more complicated.

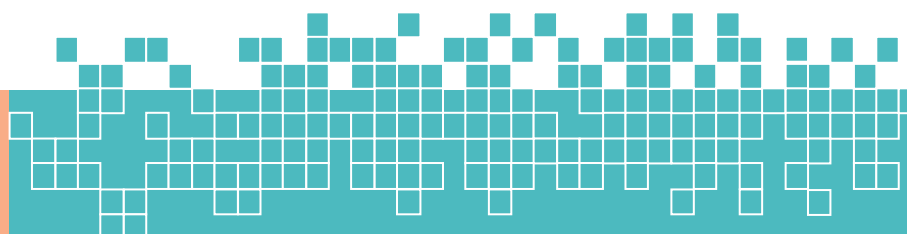
* Property rights is defined as the extent to which a country’s legal framework allows individuals to acquire, hold, and utilize private property and the extent to which these rights are secured by clear laws that the government enforces effectively. Relying on a mix of survey data and independent assessments, it provides a quantifiable measure of the degree to which a country’s laws protect private property rights and the extent to which those laws are respected. It also assesses the level of state expropriation of private property.

After we saw that we couldn't prove our hypothesis using only a test for a linear relationship, we decided to use a more non-traditional approach – Cluster Analysis.

Clustering analysis uses mathematical calculations to estimate how all points could be summarized into categories most sensibly. Based on these categories, we could then compare the split data and uncover patterns that we haven't thought of.

The cluster analysis showed that Property Rights contribute to a high Overall Score. The data points of both variables are grouped around central values which are close to each other. Where there is a high Overall Score there is a high Property Rights score. Where there is a medium Overall Score there is a medium Property Rights score. Where there is a low Overall Score there is a low Property Rights score.

This proves that the Property Rights score is correlated with Overall Score and impacts it. However, Property Rights is just one factor of twelve factors which the Index of Economic Freedom takes into account.



Results and Recommendations

The Index of Economic Freedom is a valuable tool to gather information about the economic policies and politics of the countries of the world but not a suitable tool für consultancy or prognostics. Its purpose is to provide a broad range of information and not detailed causations.

We would recommend to use different research materials for consultancy and to focus more on research that is informing the general public than political consultancy.