



Short Article

Economic Freedom and Social Mobility: What Does It mean for Puerto Rico?

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Takeaways

Economic freedom tends to matter for social and income mobility.

Specifically, reliable legal systems, the protection of property rights, and less burdensome regulations increase the chances for one to improve their economic standing.

Puerto Rico ranks very low in registering property and paying taxes and are clear areas of improvement that can raise income mobility.

Article

Economic freedom, or the ability to engage in voluntary exchange, is vital for economic development throughout the world. An abundance of academic studies has already shown that countries with higher levels of economic freedom have better overall living standards.¹

The relationship between economic freedom and income inequality is perplexing. Conceptually, we care about income inequality because it speaks about the barriers in place for people to better their situation in life: social mobility. Social mobility, according to the World Economic Forum,² “can be understood as the movement in personal circumstances either ‘upwards’ or ‘downwards’ of an individual in relation to those of their parents.” Little to no work had previously ever directly linked economic freedom to social and income mobility.

I, along with Vincent Geloso, sought to test the relationship between economic freedom and social mobility in a chapter of the Fraser Institute’s *Economic Freedom of the World 2021* (EFW) Annual Report.³ We use the World Economic Forum’s *Global Social Mobility Index* (GSMI) to measure mobility. The GSMI is split into ten pillars seen as important for overall social mobility. These pillars focus on health outcomes, education access and quality, technology access, work opportunities and conditions, social protection, and inclusive institutions. The EFW index, our measurement of economic freedom, is similarly split into five areas: size of government, legal system and protection of property rights, sound monetary policy, freedom to trade internationally, and regulatory quality.

I provide a summary of the results from our chapter in Figure 1. We find that economic freedom as a whole matters for overall mobility, but more specifically education, technology, and inclusive institutions. Taking a closer look at the five areas of economic freedom is where the results get more interesting. Legal system and property rights (Area 2) is the strongest predictor of upward social mobility of the five, closely followed by regulation (Area 5) and freedom to trade internationally (Area 4).

High quality legal systems and the protection of private property increases all but two pillars of social mobility. Flexible regulations that do not unnecessarily burden businesses and entrepreneurs correspond to higher mobility, such as better health, higher quality education, better working conditions, and inclusive institutions.⁴ Figure 2 reveals a scatter plot, showing a negative relationship between economic freedom and income *immobility*.

So, what exactly does this mean for Puerto Rico and its citizens? To first answer this question, we need to discuss the institutional barriers put in place by Puerto Rico’s government and how this can influence social and income mobility for its citizens.

¹ See Hall and Lawson (2014), for a summary. <https://onlinelibrary.wiley.com/doi/full/10.1111/coep.12010>

² <https://www.weforum.org/reports/global-social-mobility-index-2020-why-economies-benefit-from-fixing-inequality>

³ This Fraser Institute study can be found at <https://www.fraserinstitute.org/studies/economic-freedom-promotes-upward-income-mobility>.

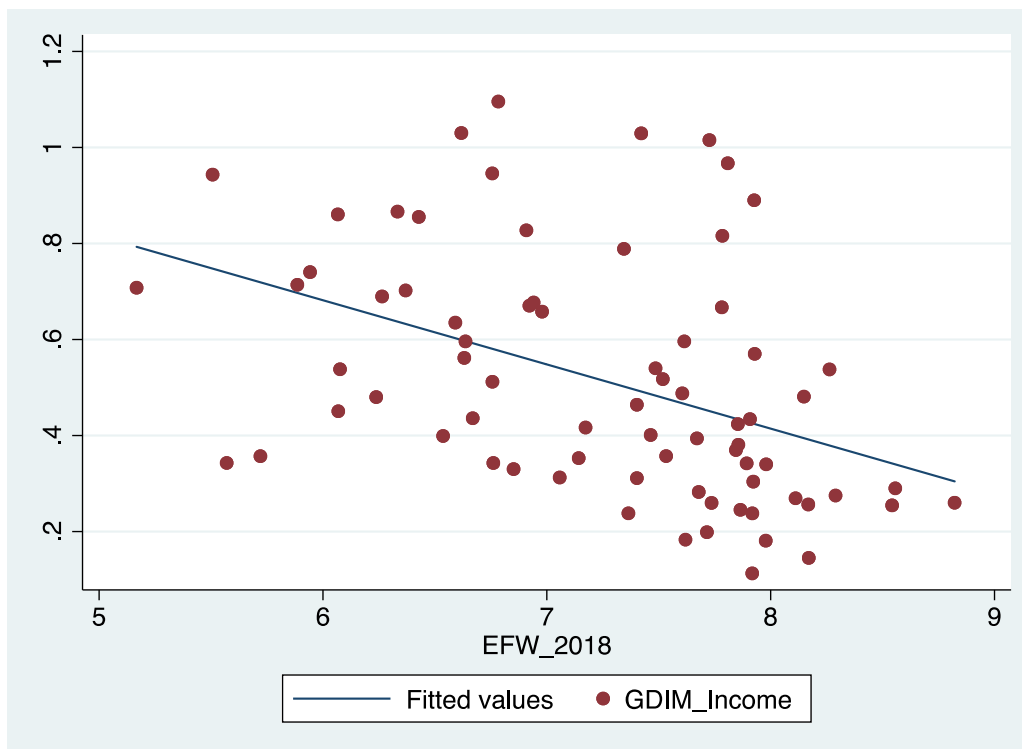
⁴ Geloso and I have also tested the link between economic freedom and *income* mobility in another article. See Callais, J. T., & Geloso, V. (2022). Intergenerational income mobility and economic freedom. *Southern Economic Journal*, 1–22. <https://doi.org/10.1002/soej.12611>.

Figure 1: Linking Economic Freedom to the Pillars of Social Mobility⁵

Pillar	Economic Freedom	Area 1 Size of Government	Area 2 Legal System and Property Rights	Area 3 Sound Money	Area 4 Freedom to Trade Internationally	Area 5 Regulation
Social mobility	+		+			+
[1] Health			+		+	+
[2] Education Access			+			+
[3] Education Quality and Equity	+		+		+	+
[4] Lifelong Learning	+		+		+	+
[5] Technology Access	+		+			
[6] Work Opportunities		+				
[7] Fair Wage Distribution						
[8] Working Conditions			+			+
[9] Social Protection		-	+			
[10] Inclusive Institutions	+		+		+	+

Note: *** p < 0.01, ** p < 0.05, * p < 0.1.

Figure 2: Economic Freedom and Intergenerational Income Mobility



⁵ Callais, J., & Geloso, V. (2021). Economic freedom promotes upward income mobility. In Gwartney, Lawson, Hall, & Murphy, *Economic freedom of the world 2021: Annual report*. Fraser Institute. <https://www.fraserinstitute.org/studies/economic-freedom-promotes-upward-income-mobility>

Here, I specifically focus on the two areas that have the strongest relationship to mobility: legal system and property rights and regulation. The World Bank's *Doing Business Report* is one of the major data sources for these two areas in the Fraser Institute's EFW index and the report features Puerto Rico. For the purposes of this study, this is fortunate since I can directly link aspects of economic freedom that matter for mobility with data on Puerto Rico.

Within legal system and property rights, the *Doing Business* reports information on the (i) legal enforcement of contracts (the time and monetary cost associated with collecting owed debts) and (ii) the regulatory costs of the sale of real property. Both are conceptually important for mobility, as those at the bottom of the income ladder are most impacted by excessive "waste" in retrieving owed debts or purchasing and selling property, as the marginal value of those "wasted" dollars are higher for a poor, budding entrepreneur than a larger business or well-off individual. Within regulation, the report has information on labor market regulations, with different aspects including hiring regulations and hours regulation, as well as mandated cost of worker dismissal. The World Bank also collects data on business regulations, measured through starting a business, licensing regulation, and cost of tax compliance.

According to the most recent *Doing Business* report, Puerto Rico ranked 65th out of 190 with a score of 70.1 (out of a possible 100). This positions Puerto Rico slightly higher than Colombia (67th), but noticeably better than countries like Panama (86th), Dominican Republic (115th), Haiti (179th), and Venezuela (188th). Compared to this set of countries, Puerto Rico scores relatively well. This speaks to the opportunities that Puerto Ricans have in improving their economic and social status; however, ranking just 65th in the world suggests plenty of room for improvement. When looking at the specific areas relevant to economic freedom (and therefore, mobility), we see a few clear mechanisms of potential reform.

On the positive side, Puerto Rico scores extremely well (when compared the five countries listed above) on enforcing contracts (70th overall, 1st within group) and starting a business (59th overall, 2nd within group). Being able to successfully enforce contracts is crucial for small businesses who need funds to operate. Most small businesses fail quickly, so being able to cheaply retrieve owed funds are vital for entrepreneurs who, on the margin, are constantly a rough quarter or so away from closing. Before one can even enforce a business contract, a business must be started. This aspect is crucially important, as the riskiness associated with a new company is exactly the type of venture that can propel those at the bottom out of a bad situation. If the barriers to entry are unnecessarily high, only those with economic or political means can have a chance of prospering. These types of regulations would protect those at the top, effectively ending a poor persons' chances to raise their own economic standing.

All is not entirely well, though. Puerto Rico ranks close to the bottom of the world in registering property (161st overall, 5th within group) and paying taxes (163rd overall, 4th within group). Registering property and starting a business, while measured as distinct aspects in the *Doing Business* report, are closely intertwined. Being able to easily transfer property is one way in which business can expand, so Puerto Rico clearly has a long way to go in this regard. Paying heavy amounts of taxes on the other hand, can discourage entrepreneurs by lowering the gains of their rewards in the marketplace. Being so low in the world harms small businesses and lowers the chances of people improving their economic situation.

Overall, Puerto Rico is in a decent position in terms of providing the institutional structures that allows for entrepreneurship and marketplace activity, which can increase social and income mobility; however, if Puerto Rico wants to provide even more opportunities for its citizens, it should focus mainly on improving

the easiness of registering and transferring property, as well as lowering their taxes and making tax compliance simpler.

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