

# Appendix Explanatory Notes and Data Sources

## Area 1 Size of Government

### A Government consumption

This component is measured as general government consumption spending as a percentage of total consumption. The rating for this component, as with many of the following components, is designed to mirror the actual distribution of the raw data but on a zero-to-10 scale. The rating is equal to:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10. The  $V_i$  is the country's actual government consumption as a proportion of total consumption, while the  $V_{\max}$  and  $V_{\min}$  were set at 40 and 6, respectively. The 1990 data were used to derive the maximum and minimum values for this component. Countries with a larger proportion of government expenditures received lower ratings. In contrast, as the ratio approaches the maximum value, the ratio moves toward zero.

*Sources* World Bank, *World Development Indicators*; International Monetary Fund, *International Financial Statistics*; United Nations National Accounts.

### B Transfers and subsidies

This component is measured as general government transfers and subsidies as a share of GDP. The rating for this component is equal to:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10. The  $V_i$  is the country's ratio of transfers and subsidies to GDP, while the  $V_{\max}$  and  $V_{\min}$  values are set at 37.2 and 0.5, respectively. The 1990 data were used to derive the maximum and minimum values for this component. The formula will generate lower ratings for countries with larger transfer sectors. When the size of a country's transfer sector approaches that of the country with the largest transfer sector during the 1990 benchmark year, the rating of the country will approach zero.

*Sources* International Monetary Fund, *Government Finance Statistics Yearbook*; World Bank, *World Development Indicators*; International Monetary Fund, *International Financial Statistics*; United Nations National Accounts.

### C Government enterprises and investment

Data on government investment as a share of total investment were used to construct the zero-to-10 ratings. Countries with more government enterprises and government investment received lower ratings. When the government investment share was generally less than 15% of total investment, countries were given a rating of 10.

When government investment was between 15% and 20% of the total, countries received a rating of 8. When government investment was between 20% and 25% of the total, countries were rated at 7. When government investment was between 25% and 30% of the total, countries were assigned a rating of 6. When government investment was generally between 30% and 40% of the total, countries received a rating of 4. When government investment was between 40% and 50% of the total, countries were rated at 2. A rating of zero was assigned when government investment exceeded 50% of total investment. In cases where government investment data were unavailable, we used qualitative data on the scope of SOEs to assign ratings.

*Sources* International Monetary Fund, *Government Finance Statistics Yearbook*; World Bank, *World Development Indicators*; International Monetary Fund, *International Finance Statistics*; World Economic Forum, *Global Competitiveness Report*; United Nations National Accounts; European Bank for Reconstruction and Development, *Transition Indicators*.

## D Top marginal tax rate

### i Top marginal income tax rate

Countries with higher marginal tax rates that take effect at lower income thresholds received lower ratings based on the matrix below. The income threshold data were converted from local currency to 1982/1984 US dollars (using beginning-of-year exchange rates and the US Consumer Price Index). These figures include sub-national rates if applicable.

### ii Top marginal income and payroll tax rates

Countries with higher marginal income and payroll (wage) tax rates that take effect at lower income thresholds received lower ratings based on the matrix below. The income threshold data were converted from local currency to 1982/1984 US dollars (using beginning-of-year exchange rates and the US Consumer Price Index). These figures include sub-national rates if applicable.

*Source* PricewaterhouseCoopers, *Worldwide Tax Summaries Online*; PricewaterhouseCoopers, *Individual Taxes: A Worldwide Summary* (various issues).

	Income Threshold at Which the Top Marginal Rate Applies (1982/1984 US\$)			
	< \$25,000	\$25,000 – \$50,000	\$50,000 – \$150,000	> \$150,000
< 20%	10	10	10	10
21% – 25%	9	9	10	10
26% – 30%	8	8	9	9
31% – 35%	7	7	8	9
36% – 40%	5	6	7	8
41% – 45%	4	5	6	7
46% – 50%	3	4	5	5
51% – 55%	2	3	4	4
56% – 60%	1	2	3	3
61% – 65%	0	1	2	2
66% – 70%	0	0	1	1
> 70%	0	0	0	0

## Area 2 Legal System and Property Rights

*Note* The ratings for Area 2 from 1970 to 1995 are the same as the Area V ratings from *Economic Freedom of the World: 2001 Annual Report*. Please see that report for methodological details.

### A Judicial independence

This component is from the *Global Competitiveness Report* question: “Is the judiciary in your country independent from political influences of members of government, citizens, or firms? No—heavily influenced (= 1) or Yes—entirely independent (= 7).” The question’s wording has varied slightly over the years. All variables from the *Global Competitiveness Report* were converted from the original 1-to-7 scale to a 0-to-10 scale using this formula:  $EFW_i = ((GCR_i - 1) \div 6) \times 10$ .

*Source* World Economic Forum, *Global Competitiveness Report*.

### B Impartial courts

This component is from the *Global Competitiveness Report* question: “The legal framework in your country for private businesses to settle disputes and challenge the legality of government actions and/or regulations is inefficient and subject to manipulation (= 1) or is efficient and follows a clear, neutral process (= 7).” The question’s wording has varied slightly over the years. Note: The “Rule of Law” ratings from the World Bank’s *Governance Indicators* Project have been used to fill in data for countries omitted from the primary data source since 1995.

*Source* World Economic Forum, *Global Competitiveness Report*.

### C Protection of property rights

This component is from the *Global Competitiveness Report* question: “Property rights, including over financial assets, are poorly defined and not protected by law (= 1) or are clearly defined and well protected by law (= 7).” Note: This replaces previous *Global Competitiveness Report* question on protection of intellectual property.

*Source* World Economic Forum, *Global Competitiveness Report*.

### D Military interference in rule of law and politics

This component is based on the *International Country Risk Guide* Political Risk Component G. Military in Politics: “A measure of the military’s involvement in politics. Since the military is not elected, involvement, even at a peripheral level, diminishes democratic accountability. Military involvement might stem from an external or internal threat, be symptomatic of underlying difficulties, or be a full-scale military takeover. Over the long term, a system of military government will almost certainly diminish effective governmental functioning, become corrupt, and create an uneasy environment for foreign businesses.” Note: The “Political Stability and Absence of Violence” ratings from the World Bank’s *Governance Indicators* Project have been used to fill in data for countries omitted from the primary data source since 1995.

*Sources* PRS Group, *International Country Risk Guide*; World Bank, *Governance Indicators*.

## E Integrity of the legal system

This component is based on the *International Country Risk Guide* Political Risk Component I for Law and Order: “Two measures comprising one risk component. Each sub-component equals half of the total. The ‘law’ sub-component assesses the strength and impartiality of the legal system, and the ‘order’ sub-component assesses popular observance of the law.”

Source PRS Group, *International Country Risk Guide*.

## F Legal enforcement of contracts

This component is based on the World Bank’s *Doing Business* estimates for the time and money required to collect a debt. The debt is assumed to equal 200% of the country’s per-capita income where the plaintiff has complied with the contract and judicial judgment is rendered in his favor. Zero-to-10 ratings were constructed for (1) the time cost (measured in number of calendar days required from the moment the lawsuit is filed until payment) and (2) the monetary cost of the case (measured as a percentage of the debt). These two ratings were then averaged to arrive at the final rating for this sub-component. The formula used to calculate the zero-to-10 ratings was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the time or money cost value. The values for  $V_{\max}$  and  $V_{\min}$  were set at 725 days and 82.3% (1.5 standard deviations above average in 2005) and 62 days (1.5 standard deviations below average in 2005) and 0%, respectively. Countries with values outside of the  $V_{\max}$  and  $V_{\min}$  range received ratings of either zero or 10 accordingly.

Source World Bank, *Doing Business*.

## G Regulatory costs of the sale of real property

This sub-component is based on the World Bank’s *Doing Business* data on the time measured in days and monetary costs required to transfer ownership of property that includes land and a warehouse. Zero-to-10 ratings were constructed for (1) the time cost (measured in number of calendar days required to transfer ownership) and (2) the monetary cost of transferring ownership (measured as a percentage of the property value). These two ratings were then averaged to arrive at the final rating for this sub-component. The formula used to calculate the zero-to-10 ratings was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the time or money cost value. The values for  $V_{\max}$  and  $V_{\min}$  were set at 265 days and 15% (1.5 standard deviations above average in 2005) and 0 days and 0%, respectively. Countries with values outside of the  $V_{\max}$  and  $V_{\min}$  range received ratings of either zero or ten accordingly.

Source World Bank, *Doing Business*.

## H Reliability of police

This component is from the *Global Competitiveness Report* question: “To what extent can police services be relied upon to enforce law and order in your country? (1 = Cannot be relied upon at all; 7 = Can be completely relied upon).”

Source World Economic Forum, *Global Competitiveness Report*.

## I Business costs of crime

This component is from the *Global Competitiveness Report* question: “To what extent does the incidence of crime and violence impose costs on businesses in your country? (1 = To a great extent; 7 = Not at all).”

Source World Economic Forum, *Global Competitiveness Report*.

## Area 3 Access to Sound Money

### A Money growth

The component measures the average annual growth of the money supply in the last five years minus average annual growth of real GDP in the last ten years. Countries where growth of the money supply greatly exceeds growth of real output receive lower ratings. The M1 money supply (basically defined as checkable deposits plus currency in circulation) figures were used to measure the growth rate of the money supply. The rating is equal to:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the average annual growth rate of the money supply during the last five years adjusted for the growth of real GDP during the previous ten years. The values for  $V_{\min}$  and  $V_{\max}$  were set at zero and 50%, respectively. Therefore, if the adjusted growth rate of the money supply during the last five years was zero, indicating that money growth was equal to the long-term growth of real output, the formula generates a rating of 10. Ratings decline as the adjusted money supply growth increases toward 50%. When the adjusted annual money growth is equal to (or greater than) 50%, a rating of zero results.

Sources World Bank, *World Development Indicators*; International Monetary Fund, *International Financial Statistics*; United Nations National Accounts.

### B Standard deviation of inflation

The component measures the standard deviation of the inflation rate over the last five years. Generally, the GDP deflator was used as the measure of inflation for this component. When these data were unavailable, the Consumer Price Index was used. The following formula was used to determine the zero-to-10 scale rating for each country:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the country's standard deviation of the annual rate of inflation during the last five years. The values for  $V_{\min}$  and  $V_{\max}$  were set at zero and 25%, respectively. This procedure will allocate the highest ratings to the countries with least variation in the annual rate of inflation. A perfect 10 results when there is no variation in the rate of inflation over the five-year period. Ratings will decline toward zero as the standard deviation of the inflation rate approaches 25% annually.

Sources World Bank, *World Development Indicators*; International Monetary Fund, *International Financial Statistics*.

### C Inflation: most recent year

Generally, the CPI was used as the measure of inflation for this component as it is often available before the GDP deflator is available. When these data were

unavailable, the GDP deflator inflation rate was used. The zero-to-10 country ratings were derived by the following formula:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the rate of inflation during the most recent year. The values for  $V_{\min}$  and  $V_{\max}$  were set at zero and 50%, respectively—the lower the rate of inflation, the higher the rating. Countries that achieve perfect price stability earn a rating of 10. As the inflation rate moves toward a 50% annual rate, the rating for this component moves toward zero. A zero rating is assigned to all countries with an inflation rate of 50% or more.

*Sources* World Bank, *World Development Indicators*; International Monetary Fund, *International Financial Statistics*.

#### D Freedom to own foreign currency bank accounts

When foreign currency bank accounts were permissible without any restrictions both domestically and abroad, the rating was 10; when these accounts were restricted, the rating was zero. If foreign currency bank accounts were permissible domestically but not abroad (or vice versa), the rating was 5.

*Note* This component was not updated for the 2014 Annual Report.

*Sources* International Monetary Fund, *Annual Report on Exchange Arrangements and Exchange Restrictions*.

## Area 4 Freedom to Trade Internationally

### A Tariffs

#### i. Revenues from trade taxes (% of trade sector)

This sub-component measures the amount of taxes on international trade as a share of exports and imports. The formula used to calculate the ratings for this sub-component was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the revenue derived from taxes on international trade as a share of the trade sector. The values for  $V_{\min}$  and  $V_{\max}$  were set at zero and 15%, respectively. This formula leads to lower ratings as the average tax rate on international trade increases. Countries with no specific taxes on international trade earn a perfect 10. As the revenues from these taxes rise toward 15% of international trade, ratings decline toward zero.

*Sources* International Monetary Fund, *Government Finance Statistics Yearbook*; International Monetary Fund, *International Financial Statistics*.

#### ii. Mean tariff rate

This sub-component is based on the unweighted mean of tariff rates. The formula used to calculate the zero-to-10 rating for each country was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the country's mean tariff rate. The values for  $V_{\min}$  and  $V_{\max}$  were set at 0% and 50%, respectively. This formula will allocate a rating



of 10 to countries that do not impose tariffs. As the mean tariff rate increases, countries are assigned lower ratings. The rating will decline toward zero as the mean tariff rate approaches 50%. (Note that, except for two or three extreme observations, all countries have mean tariff rates within this range from 0% to 50%.)

*Sources* World Trade Organization, *World Tariff Profiles*.

### iii *Standard deviation of tariff rates*

Compared to a uniform tariff, wide variations in tariff rates indicate greater efforts towards central planning of the economy's production and consumption patterns. Thus, countries with a greater variation in their tariff rates are given lower ratings. The formula used to calculate the zero-to-10 ratings for this component was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the standard deviation of the country's tariff rates. The values for  $V_{\min}$  and  $V_{\max}$  were set at 0% and 25%, respectively. This formula will allocate a rating of 10 to countries that impose a uniform tariff. As the standard deviation of tariff rates increases toward 25%, ratings decline toward zero. (Note that, except for a few very extreme observations, the standard deviations of the tariff rates for the countries in our study fall within this 0% to 25% range.)

*Sources* World Trade Organization, *World Tariff Profiles*.

## B Regulatory trade barriers

### i *Non-tariff trade barriers*

This sub-component is based on the *Global Competitiveness Report* survey question: "In your country, tariff and non-tariff barriers significantly reduce the ability of imported goods to compete in the domestic market. 1–7 (best)." The question's wording has varied slightly over the years. Note, notwithstanding the sub-component's title, this indicator captures both tariff and non-tariff barriers.

*Source* World Economic Forum, *Global Competitiveness Report*.

### ii *Compliance cost of importing and exporting*

This sub-component is based on the World Bank's *Doing Business* data on the time (i.e., non-money) cost of procedures required to import a full 20-foot container of dry goods that contains no hazardous or military items. Countries where it takes longer to import/export are given lower ratings. Zero-to-10 ratings were constructed for (1) the time cost to export a good (measured in number of calendar days required) and (2) the time cost to import a good (measured in number of calendar days required). These two ratings were then averaged to arrive at the final rating for this sub-component. The formula used to calculate the zero-to-10 ratings was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the time cost value. The values for  $V_{\max}$  and  $V_{\min}$  were set at 62 and 80 days (1.5 standard deviations above average in 2005) and 2 days (1.5 standard deviations below average in 2005) and 0 days, respectively. Countries with values outside of the  $V_{\max}$  and  $V_{\min}$  range received ratings of either zero or 10 accordingly.

*Source* World Bank, *Doing Business*.

### C Black-market exchange rates

This component is based on the percentage difference between the official and the parallel (black) market exchange rate. The formula used to calculate the zero-to-10 ratings for this component was the following:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  is the country's black-market exchange rate premium. The values for  $V_{\min}$  and  $V_{\max}$  were set at 0% and 50%, respectively. This formula will allocate a rating of 10 to countries without a black-market exchange rate; that is, those with a domestic currency that is fully convertible without restrictions. When exchange rate controls are present and a black market exists, the ratings will decline toward zero as the black-market premium increases toward 50%. A zero rating is given when the black market premium is equal to, or greater than, 50%.

Sources *MRI Bankers' Guide to Foreign Currency*.

### D Controls of the movement of capital and people

#### i Foreign ownership/investment restrictions

This sub-component is based on the following two *Global Competitiveness Report* questions: [1] "How prevalent is foreign ownership of companies in your country? 1 = Very rare, 7 = Highly prevalent." [2] "How restrictive are regulations in your country relating to international capital flows? 1 = Highly restrictive, 7 = Not restrictive at all."

Source World Economic Forum, *Global Competitiveness Report*.

#### ii Capital controls

The International Monetary Fund reports on up to 13 types of international capital controls. The zero-to-10 rating is the percentage of capital controls not levied as a share of the total number of capital controls listed, multiplied by 10.

Source International Monetary Fund, *Annual Report on Exchange Arrangements and Exchange Restrictions*.

#### iii Freedom of foreigners to visit

This component measures the percentage of countries for which a country requires a visa from foreign visitors. It reflects the freedom of foreigners to travel to this country for tourist and short-term business purposes. The formula used to calculate the zero-to-10 ratings was:  $(V_i - V_{\min}) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the component value. The values for  $V_{\max}$  and  $V_{\min}$  were set at 47.2 (1 standard deviation above average) and 0. Countries with values outside of the  $V_{\max}$  and  $V_{\min}$  range received ratings of either zero or ten accordingly.

Source Robert Lawson and Jayme Lemke (2012). Travel Visas. *Public Choice* 154, 1-2: 17-36. Authors' calculations.



## Area 5 Regulation

The rating for Area 5 is calculated as the average of Components 5A, 5B, and 5C. When there were not enough data to generate ratings in at least two of those components, which is common especially in earlier years, the rating for Area 5 was computed to be  $2.5 + 0.50(X_i)$ , where  $X_i$  is the average of all the sub-components in Area 5. This formula was created based on a regression analysis comparing countries with and without complete data.

### A Credit market regulations

#### i. Ownership of banks

Data on the percentage of bank deposits held in privately owned banks were used to construct rating intervals. Countries with larger shares of privately held deposits received higher ratings. When privately held deposits totaled between 95% and 100%, countries were given a rating of 10. When private deposits constituted between 75% and 95% of the total, a rating of 8 was assigned. When private deposits were between 40% and 75% of the total, the rating was 5. When private deposits totaled between 10% and 40%, countries received a rating of 2. A zero rating was assigned when private deposits were 10% or less of the total.

*Sources* World Bank, *Bank Regulation and Supervision Survey*; James R. Barth, Gerard Caprio, and Ross Levine (2006). *Rethinking Bank Regulation: Till Angels Govern*. Cambridge University Press.

#### ii. Private-sector credit

This sub-component measures the extent of government borrowing relative to private-sector borrowing. Greater government borrowing indicates more central planning and results in lower ratings. If available, this sub-component is calculated as the government fiscal deficit as a share of gross saving. Since the deficit is expressed as a negative value, higher numerical values result in higher ratings. The formula used to derive the country ratings for this sub-component was  $(-V_{\max} - V_i) / (V_{\max} + V_{\min})$  multiplied by 10.  $V_i$  is the ratio of deficit to gross investment, and the values for  $V_{\max}$  and  $V_{\min}$  are set at 0 and  $-100.0\%$ , respectively. The formula allocates higher ratings as the deficit gets smaller (i.e., closer to zero) relative to gross saving.

If the deficit data are not available, the component is instead based on the share of private credit to total credit extended in the banking sector. Higher values are indicative of greater economic freedom. Thus, the formula used to derive the country ratings for this sub-component was  $(V_i - V_{\min}) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  is the share of the country's total domestic credit allocated to the private sector and the values for  $V_{\max}$  and  $V_{\min}$  are set at 99.9% and 10.0%, respectively. The 1990 data were used to derive the maximum and minimum values for this component. The formula allocates higher ratings as the share of credit extended to the private sector increases.

*Sources* World Bank, *World Development Indicators*; World Economic Forum, *Global Competitiveness Report*; International Monetary Fund, *International Financial Statistics*.

*iii Interest rate controls/negative real interest rates*

Data on credit-market controls and regulations were used to construct rating intervals. Countries with interest rates determined by the market, stable monetary policy, and reasonable real-deposit and lending-rate spreads received higher ratings. When interest rates were determined primarily by market forces as evidenced by reasonable deposit and lending-rate spreads, and when real interest rates were positive, countries were given a rating of 10. When interest rates were primarily market-determined but the real rates were sometimes slightly negative (less than 5%) or the differential between the deposit and lending rates was large (8% or more), countries received a rating of 8. When the real deposit or lending rate was persistently negative by a single-digit amount or the differential between them was regulated by the government, countries were rated at 6. When the deposit and lending rates were fixed by the government and the real rates were often negative by single-digit amounts, countries were assigned a rating of 4. When the real deposit or lending rate was persistently negative by a double-digit amount, countries received a rating of 2. A zero rating was assigned when the deposit and lending rates were fixed by the government and real rates were persistently negative by double-digit amounts or hyperinflation had virtually eliminated the credit market.

*Source* World Bank, *World Development Indicators*; International Monetary Fund, *International Financial Statistics*.

## **B Labor market regulations**

*i Hiring market regulations*

This sub-component is based on the World Bank's *Doing Business* "Difficulty of Hiring Index", which is described as follows: "The difficulty of hiring index measures (i) whether fixed-term contracts are prohibited for permanent tasks; (ii) the maximum cumulative duration of fixed term contracts; and (iii) the ratio of the minimum wage for a trainee or first-time employee to the average value added per worker. An economy is assigned a score of 1 if fixed-term contracts are prohibited for permanent tasks and a score of 0 if they can be used for any task. A score of 1 is assigned if the maximum cumulative duration of fixed-term contracts is less than 3 years; 0.5 if it is 3 years or more but less than 5 years; and 0 if fixed-term contracts can last 5 years or more. Finally, a score of 1 is assigned if the ratio of the minimum wage to the average value added per worker is 0.75 or more; 0.67 for a ratio of 0.50 or more but less than 0.75; 0.33 for a ratio of 0.25 or more but less than 0.50; and 0 for a ratio of less than 0.25." Countries with higher difficulty of hiring are given lower ratings.

*Source* World Bank, *Doing Business*.

*ii Hiring and firing regulations*

This sub-component is based on the *Global Competitiveness Report* question: "The hiring and firing of workers is impeded by regulations (= 1) or flexibly determined by employers (= 7)." The question's wording has varied over the years.

*Source* World Economic Forum, *Global Competitiveness Report*.

iii *Centralized collective bargaining*

This sub-component is based on the *Global Competitiveness Report* question: “Wages in your country are set by a centralized bargaining process (= 1) or up to each individual company (= 7).” The wording of the question has varied over the years.

Source World Economic Forum, *Global Competitiveness Report*.

iv *Hours regulations*

This sub-component is based on the World Bank’s *Doing Business* “Rigidity of Hours Index”, which is described as follows: “The rigidity of hours index has 5 components: (i) whether there are restrictions on night work; (ii) whether there are restrictions on weekly holiday work; (iii) whether the workweek can consist of 5.5 days; (iv) whether the workweek can extend to 50 hours or more (including overtime) for 2 months a year to respond to a seasonal increase in production; and (v) whether paid annual vacation is 21 working days or fewer. For questions (i) and (ii), when restrictions other than premiums apply, a score of 1 is given. If the only restriction is a premium for night work and weekly holiday work, a score of 0, 0.33, 0.66 or 1 is given according to the quartile in which the economy’s premium falls. If there are no restrictions, the economy receives a score of 0. For questions (iii), (iv) and (v), when the answer is no, a score of 1 is assigned; otherwise a score of 0 is assigned.” Countries with less-rigid work rules receive better scores in this component.

Source World Bank, *Doing Business*.

v *Mandated cost of worker dismissal*

This sub-component is based on the World Bank’s *Doing Business* data on the cost of the advance notice requirements, severance payments and penalties due when dismissing a redundant worker with 10 years tenure. The formula used to calculate the zero-to-10 ratings was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the dismissal cost (measured in weeks of wages). The values for  $V_{\max}$  and  $V_{\min}$  were set at 58 weeks (1.5 standard deviations above average in 2005) and 0 weeks, respectively. Countries with values outside of the  $V_{\max}$  and  $V_{\min}$  range received ratings of either zero or 10 accordingly.

Source World Bank, *Doing Business*.

vi *Conscription*

Data on the use and duration of military conscription were used to construct rating intervals. Countries with longer conscription periods received lower ratings. A rating of 10 was assigned to countries without military conscription. When length of conscription was six months or less, countries were given a rating of 5. When length of conscription was more than six months but not more than 12 months, countries were rated at 3. When length of conscription was more than 12 months but not more than 18 months, countries were assigned a rating of 1. When conscription periods exceeded 18 months, countries were rated zero. If conscription was present, but apparently not strictly enforced or the length of service could not be determined, the country was given a rating of 3. In cases where it is clear conscription

is never used, even though it may be possible, a rating of 10 is given. If a country's mandated national service includes clear non-military options, the country was given a rating of 5.

*Source* International Institute for Strategic Studies, *The Military Balance*; War Resisters International, *World Survey of Conscription and Conscientious Objection to Military Service*; additional online sources used as necessary.

## C Business regulations

### i Administrative requirements

This sub-component is based on the *Global Competitiveness Report* question: "Complying with administrative requirements (permits, regulations, reporting) issued by the government in your country is (1 = burdensome, 7 = not burdensome)."

*Source* World Economic Forum, *Global Competitiveness Report*.

### ii Bureaucracy costs

This sub-component is based on the *Global Competitiveness Report* question: "Standards on product/service quality, energy and other regulations (outside environmental regulations) in your country are: (1 = Lax or non-existent, 7 = among the world's most stringent)."

*Source* World Economic Forum, *Global Competitiveness Report*.

### iii Starting a business

This sub-component is based on the World Bank's *Doing Business* data on the amount of time and money it takes to start a new limited liability business. Countries where it takes longer or is more costly to start a new business are given lower ratings. Zero-to-10 ratings were constructed for three different variables: (1) time (measured in days) necessary to comply with regulations when starting a limited liability company, (2) money costs of the fees paid to regulatory authorities (measured as a share of per-capita income) and (3) minimum capital requirements; that is, funds that must be deposited into a company bank account (measured as a share of per-capita income). These three ratings were then averaged to arrive at the final rating for this sub-component. The formula used to calculate the zero-to-10 ratings was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the variable value. The values for  $V_{\max}$  and  $V_{\min}$  were set at 104 days, 317%, and 1,017% (1.5 standard deviations above average in 2005) and 0 days, 0%, and 0%, respectively. Countries with values outside of the  $V_{\max}$  and  $V_{\min}$  range received ratings of either zero or 10 accordingly.

*Source* World Bank, *Doing Business*.

### iv Extra payments/bribes/favoritism

This sub-component is based on the *Global Competitiveness Report* questions: [1] "In your industry, how commonly would you estimate that firms make undocumented extra payments or bribes connected with the following: A—Import and export permits; B—Connection to public utilities (e.g., telephone or electricity);

C—Annual tax payments; D—Awarding of public contracts (investment projects); E—Getting favourable judicial decisions. Common (= 1) Never occur (= 7).” [2] “Do illegal payments aimed at influencing government policies, laws or regulations have an impact on companies in your country? 1 = Yes, significant negative impact, 7 = No, no impact at all.” [3] “To what extent do government officials in your country show favoritism to well-connected firms and individuals when deciding upon policies and contracts? 1 = Always show favouritism, 7 = Never show favouritism.”

Source World Economic Forum, *Global Competitiveness Report*.

v *Licensing restrictions*

This sub-component is based on the World Bank’s *Doing Business* data on the time in days and monetary costs required to obtain a license to construct a standard warehouse. Zero-to-10 ratings were constructed for (1) the time cost (measured in number of calendar days required to obtain a license) and (2) the monetary cost of obtaining the license (measured as a share of per-capita income). These two ratings were then averaged to arrive at the final rating for this sub-component. The formula used to calculate the zero-to-10 ratings was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the time or money cost value. The values for  $V_{\max}$  and  $V_{\min}$  were set at 363 days and 2,763% (1.5 standard deviations above average in 2005) and 56 days (1.5 standard deviations below average in 2005) and 0%, respectively. Countries with values outside of the  $V_{\max}$  and  $V_{\min}$  range received ratings of either zero or ten accordingly.

Source World Bank, *Doing Business*.

vi *Cost of tax compliance*

This sub-component is based on the World Bank’s *Doing Business* data on the time required per year for a business to prepare, file, and pay taxes on corporate income, value added or sales taxes, and taxes on labor. The formula used to calculate the zero-to-10 ratings was:  $(V_{\max} - V_i) / (V_{\max} - V_{\min})$  multiplied by 10.  $V_i$  represents the time cost (measured in hours) of tax compliance. The values for  $V_{\max}$  and  $V_{\min}$  were set at 892 hours (1.5 standard deviations above average in 2005) and 0 hours, respectively. Countries with values outside of the  $V_{\max}$  and  $V_{\min}$  range received ratings of either zero or ten accordingly.

Source World Bank, *Doing Business*.

