Economic Institutional Class and Caliber: The Influence of Country-Level Differences on Multinational Strategic Conduct

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The relationship between institutions and multinationals is important to research and practice. In this paper, we examine the country-level effects of economic institutional class and caliber differences on the internationalization of a specific class of multinationals, those from emerging markets, specific to cross-border equity acquisition decisions. Through structural equations modeling and examining 973 cross-border acquisitions, we find that economic institutional variance related to class and caliber seems to matter. All four hypothesized relationships were found to be significant and in the predicted direction. As such, this study contributes to the broader institutions and internationalization literature regarding theory and practice.

Keywords: economic institutions, multinational strategy, internationalization, cross-border acquisitions

INTRODUCTION

Cross-border acquisitions have exhibited sustained global growth as a primary avenue for foreign direct investment (FDI) (UNCTAD, 2024). Over decades, the trended increase in frequency and value has precipitated research into associated antecedents, moderators, and consequences (Barkema & Schijven, 2008; Haleblian, Devers, McNamara, Carpenter, & Davison, 2009). This upsurge in worldwide cross-border acquisitions has been driven by industry consolidation, privatization, and global economic liberalization (Shimizu, Hitt, Vaidyanath, & Pisano, 2004). The preponderance of cross-border acquisition research has focused on multinational firms based in developed countries (DMNEs). However, the last two decades have seen an increasing number of cross-border acquisitions initiated by Emerging Market Multinationals (EMNEs). Multinationals headquartered in home emerging markets such as Brazil, Russia, India, China, and South Africa (i.e., BRICS) have spurred significant cross-border acquisitions.

While acquisitions may fail to achieve value for the acquirer because of issues with integration, cross-border acquisitions are additionally troublesome because of potential for institutional variance between the two operating environments (Shimizu et al., 2004). These differences (i.e., institutional distance) can be defined as the relative difference between and incompatibility of the institutional frameworks of home and host countries (Kostova & Zaheer, 1999; Xu & Schenkar, 2002). Home countries are those where the parent multinational is headquartered, and host countries are where targeted acquisitions are planned to occur (future subsidiary). The larger the relative difference (variance) between the two countries involved in the transaction, the lower the expectation that a multinational would be able to transfer strategic orientations and organizational practices from the parent to the subsidiary, decreasing chances of successful integration (Kostova, 1999). This is influenced by the institutionally dissimilar contexts (increased variance), which

create conflicting demands for external legitimacy or local responsiveness in the host country and internal consistency or global integration within the multinational system including the parent company and subsidiary (Xu & Schenkar, 2002).

In recent research, the effects of differences between institutions and cultures of the home and host country have been shown to influence the degree of internationalization pursued and ownership taken in cross-border acquisitions, (Malhotra, Sivakumar, & Zhu, 2011; Morschett, Schramm-Klein, & Swoboda, 2010), but findings conflict and are mostly examined in developed market contexts. The degree of internationalization and level of ownership taken in acquisitions influence many aspects of firm-specific strategy, such as control over ventures, ability to transfer tacit assets, and risk exposure (Chari & Chang, 2009; Das & Teng, 2000).

Emerging market researchers agree that EMNEs are more proactive, aggressive, and risk-taking than firms in traditional developed markets (DMNEs) when pursuing globally competitive capabilities through internationalization (e.g., Luo & Tung, 2007). Cross-border acquisitions are commonly pursued when firms seek to develop capabilities (Chen, 2011). In fact, EMNEs, which seek to acquire globally competitive strategic assets that they do not possess internally (Luo & Tung, 2007), are increasing cross-border acquirers (Hope, Thomas, & Vyas, 2011). In this paper, it is argued that EMNEs are more likely to pursue increased levels of internationalization via larger cross-border acquisition ownership shares (equity participation) in targets based in host locations that are further economically developed relatively. EMNEs may speed up internationalization and take higher ownership shares in these locations to gain greater control over the target and its assets, tangible and intangible. Greater control has been found to facilitate the transfer of tacit assets (Chari & Chang, 2009; Das & Teng, 2000), which is a key acquisition motivation of EMNEs.

Our findings support this assertion, namely that EMNEs will increase the degree of internationalization efforts when pursuing and acquiring targets based in economically distant locations, in terms of class (i.e., specific economic factors) and caliber (i.e., increased relative development) between home and host markets. This paper builds on the limited existing research on EMNE cross-border acquisitions to further our understanding of this phenomenon. Furthermore, it offers some evidence of how strategic behavior and outcomes of these firms (EMNEs) may vary based on institutional antecedents and distance-related contexts. The clearest implication is that for EMNEs the effect of institutional class and caliber "distance" may actually be increasingly positive in some cases, contrary to what is predominantly purported in the mainstream MNE distance literature.

In the coming sections we will first highlight the relevant literature on EMNE cross-border acquisitions and institutional influence on internationalization, then build support for hypothesized relationships between economic institutional class and caliber variance (distance) and EMNE internationalization degree pursued in cross-border acquisitions. We will then review methodology, results, and finalize with a discussion of limitations and implications for internationalization theory and practice.

THEORY DEVELOPMENT AND HYPOTHESES

Institutional theory (IT) provides two foundational aspects which inform cross-border acquisitions. First, IT suggests that the institutional context of the home country will influence the strategic orientation of MNEs originating there. Second, IT extends that MNEs must conform, to some degree, with the institutional context of the host country to earn legitimacy (i.e., the pressure of isomorphism). Strategic orientation (home) and strategic development (host) have a combined influence on multinational conduct. The variance between the institutional frameworks of the home and host country (i.e., institutional distance) has been shown to decrease the ability of multinationals to successfully complete acquisitions and increase the time it takes to complete announced deals (Dikova et al., 2010). Variance (institutional distance) has also been shown to decrease internationalization aggressiveness and ownership levels taken during cross-border acquisitions by traditional DMNEs (Pan & Tse, 2000), though this may not hold true for EMNEs (Aybar & Ficici, 2009).

Emerging Market Multinational Internationalization

Cross-border mergers & acquisitions continue to grow in frequency and deal value, in total and for multinationals headquartered in emerging markets (UNCTAD, 2024). EMNEs have been observed to internationalize via cross-border acquisitions in more aggressive ways that that supported by traditional internationalization theory (Aybar & Ficici, 2009; Gubbi et al., 2010; Hope et al., 2011; Luo & Tung, 2007). EMNEs are theoretically different from traditional DMNEs in that their comparative advantage is based on their latecomer status, as characterized by being a low-cost partner, not being seen as a legitimate threat by established MNEs, lacking legacy costs, and having increased organizational flexibility. These characteristics of strategic orientation are rooted in the idiosyncratic nature of EMNE home countries and manifest as having preferential access to low-cost labor, capital, and/or government policy - as opposed to the firm-specific advantages on which DMNEs rely (Mathews, 2002, 2006; Ramamurti, 2009; Rugman, 2009). Furthermore, EMNEs use these comparative advantages to acquire the targeted knowledge and capabilities strategically necessary to develop the firm-specific advantages that will facilitate their global competitiveness (Kedia, Gaffney, & Clampit, 2012). Driven by their late mover position, global competition, rapidly changing technology, and domestic home institutional constraints, Luo and Tung (2007) propose that EMNEs will systematically and recursively use international expansion as a springboard to acquire critical resources needed to compete more effectively against rivals (both at home and abroad), and to avoid institutional and market constraints (at home). EMNEs will also endeavor to overcome their latecomer disadvantage through aggressive, proactive, and risk-taking acquisitions.

Institutional Class & Caliber Variance and EMNE Internationalization

An important predictor of cross-border acquisition behavior is the concept of institutional distance (Kostova, 1996), driven by variance or differences in institutional frameworks between home and host countries involved in transactions. Traditionally, institutional differences between the acquirer's home country and that of the target company often complicate the acquisition process and make potential acquiring multinational more risk adverse. However, the EMNE internationalization literature (e.g., Luo & Tung, 2007; Mathews, 2002, 2006) largely supports the premise that EMNEs are different from traditional DMNEs and thus behave so, ceteris paribus.

As a proxy for degree of multinational internationalization, percent level of equity participation has gained increased research attention as an important aspect of cross-border acquisitions. Variations in degree of internationalization as equity share sought in acquisitions are significantly influenced by differing internationalization strategies and variance in institutions of the home and host countries (Chari & Chang, 2009; Malhotra et al., 2011). The share of equity acquired in cross-border acquisitions taken during internationalization varies widely, with a significant number being partial and not full. This is largely based on factors related to firm-specific internationalization strategy, internal capabilities related to control over the venture, the ability to transfer tacit assets, and intended risk exposure (Chari & Chang, 2009; Pisano, 1989).

Variance between institutions and cultures of the home and host country has been shown to affect the degree of internationalization and level of equity taken by multinationals in cross-border acquisitions (Morschett et al., 2010). However, relationship findings have conflicted (e.g. Malhotra et al., 2011; Chen, 2011: Chun, 2009), and the conceptualization and operationalization of institutional distance has varied as well. For example, Xu and Shenkar (2002) argue that institutional distance can be measured along Scott's (1995, 2001) three pillars of institutions: regulative, normative, and cognitive. Berry, Guillen, and Zhou's (2010) review of the institutional distance construct suggests a need to organize the research stream, since authors often use disparate proxies, most often in the form of some variation of cultural distance. One of Berry et al.'s (2010) measures, economic distance, is of particular import to EMNE cross-border acquisitions, because EMNEs are increasingly targeting firms based in economically developed locations (Elango & Pattnaik, 2011). A significant strategic motivation of emerging market multinationals (EMNEs) is to gain access to the global capabilities internally developed in target firms located is areas of heightened institutional development across economic class and caliber (Luo & Tung, 2007). As such, in this paper we

examine hypothesized relationships using institutional variance between home and host countries on a relative basis of economic differences in class and caliber.

Economic distance has been defined in relevant literature as comparative differences in economic development and macroeconomic characteristics between two geographic areas as determined by variances in incomes, inflations, exports, and imports (Campa & Guillen, 1999; Zaheer & Zaheer, 1997). It thus serves as a good dimensional proxy in the identification of amount of variance in institutional class (economic characteristics) and institutional caliber (economic development levels) between the home and host countries party to the transaction (cross-border acquisition). This economic institutional variance 'distance' dimension was partly developed over time due to convergence theory (Dunlop, Harbison, Kerr, & Myers, 1975), which proposed that the aggregate effects of economics and technology would drive countries toward analogous patterns of work organization. Economic measures of class and caliber routinely used the international business literature are income (GDP per capita), inflation (GDP deflator), and intensity of worldwide trade (exports and imports of goods and services). These class and caliber economic measures have been shown to influence outcomes such as firm performance and survival rate, as well as strategic conduct decisions such as selection of foreign market entry mode (e.g., Iyer, 1997; Yeung, 1997; Zaheer & Zaheer, 1997).

For this study, we are using The Index of Economic Freedom in operationalizing economic variance and use it as proxy for institutional differences (distance) in class (economic characteristics) and caliber (economic development levels) between home and host countries involved in cross-border equity acquisition (CBEA). The Index of Economic Freedom (IEF), published by The Wall Street Journal and The Heritage Foundation, includes ten benchmark indicators (i.e., class) which measure the economic development levels (i.e., caliber) of 185 countries globally. These ten IEF indicators – as operationalized in this study to proxy class and caliber – are grouped into four latent constructs which collectively provide a holistic country-level representation of economic development levels. And further, when examined individually, they provide a nuanced view of critical components of country level economic class and caliber, as substantiated in the research (Miller, Holmes, & Feulner, 2013).

While increased economic variance (distance) between countries is typically assumed to deter internationalization behavior, reduce ownership amounts pursued, and negatively impact associated outcomes, EMNEs may have the opposite effect. Emerging markets are argued to have developmental deficiencies in their formal institutional framework structures (i.e., institutional voids) which spur internationalization by EMNEs – external to these home markets - in order to seek safer and more developed environments for business (Khanna & Palepu, 2006, Luo & Tung, 2007). To this end, as EMNEs seek to become globally competitive, they are enticed to pursue increased internationalization via cross-border acquisitions in more economically distant (i.e., increasingly economically developed) country locations (Luo & Tung, 2007). Commensurate with their more aggressive profile, we hypothesize EMNEs will seek increased degrees of internationalization via higher ownership equity shares in these acquisitions (from countries with increased relative economic class and caliber characteristics) to increase control and facilitate the transfer of tacit assets. (Figure 1)

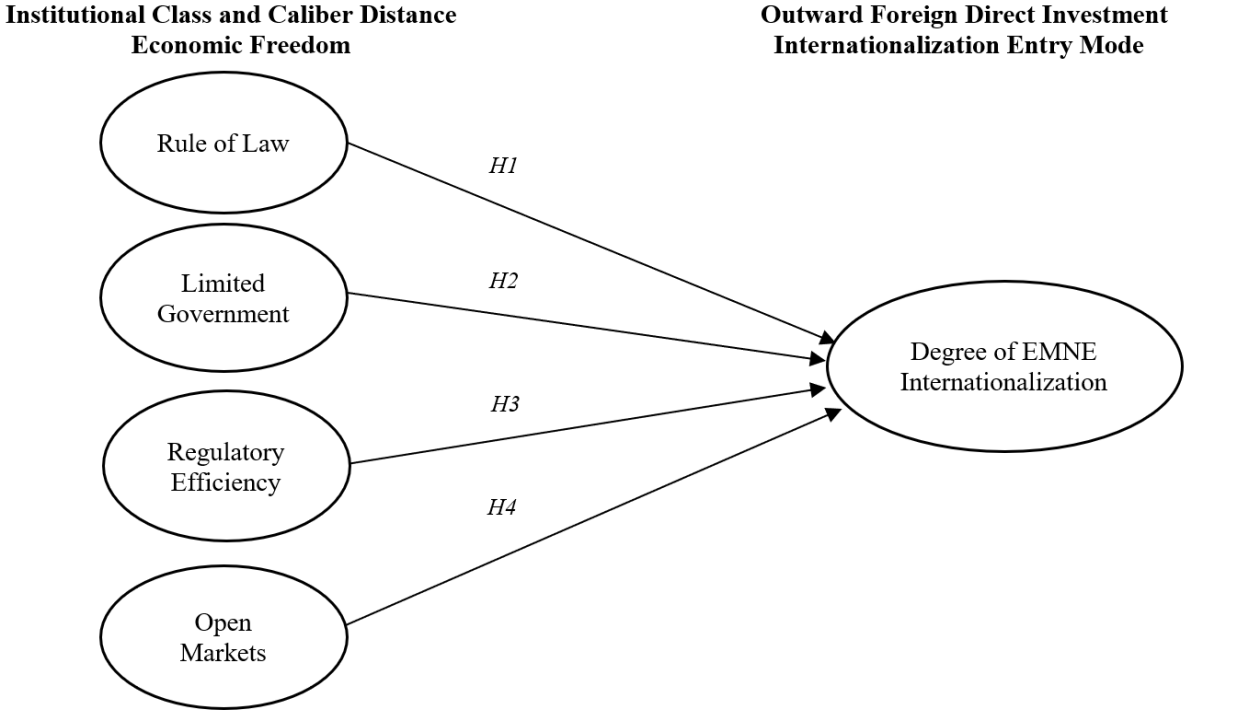
Hypothesis 1: *Increased 'Rule of Law' class and caliber economic distance between the home and host countries will be positively associated with an increased degree of internationalization pursued by Emerging Market Multinationals.*

Hypothesis 2: *Increased 'Limited Government' class and caliber economic distance between the home and host countries will be positively associated with an increased degree of internationalization pursued by Emerging Market Multinationals.*

Hypothesis 3: *Increased 'Regulatory Efficiency' class and caliber economic distance between the home and host countries will be positively associated with an increased degree of internationalization pursued by Emerging Market Multinationals.*

Hypothesis 4: *Increased 'Open Markets' class and caliber economic distance between the home and host countries will be positively associated with an increased degree of internationalization pursued by Emerging Market Multinationals.*

FIGURE 1
STRUCTURAL MODEL: INSTITUTIONAL CLASS & CALIBER DISTANCE AND EMNE INTERNATIONALIZATION



Four predictor latent constructs of institutional class and caliber (Rule of Law, Limited Government, Regulatory Efficiency, & Open Markets) reflected by indicators from The Economic Freedom Index on criterion latent construct Degree of Internationalization reflected by Cross-border Acquisition Equity Ownership Participation

METHODS

Our study is based on analysis of a sample of all completed cross-border acquisitions taken by an EMNE valued more than $5 million ($US) between 2007 to 2011, as reported in the Thomson Financial SDC Platinum Database for Worldwide M&As. SDC Platinum is the premier source of up to date information on global firm transactions. It is most often used by investment banks to quote prices on companies that are being investigated for acquisition. It has also been used as the source of deal information by numerous top-tier academic journal publications focused on cross-border acquisitions (e.g., Aybar & Ficici, 2009; Chakrabarti, Gupta-Mukherjee, & Narayanan, 2009; Dikova et al., 2010; Gubbi et al., 2010; Hope et al., 2011).

The study sample comprises all completed cross-border acquisitions from 2007 to 2011 by MNEs based in Brazil, Russia, India, and China, with values greater than $5 million ($US). This EMNE specific sample will test all hypotheses (Figure 1). For each completed deal, we matched by year and country pair for each acquisition, the deal characteristics provided in the SDC with institutional class and caliber distance measures between the home and host country. Distance measures were derived using country level economic class and caliber indicators from The Index of Economic Freedom, published by The Heritage

Foundation and The Wall Street Journal. Brazil, Russia, India, and China are the largest and most influential of the emerging markets, as defined by the United Nations Conference on Trade and Development (UNCTAD), and thus, are a representative sample of the classification of Emerging Market Multinationals (EMNEs). After removing acquisitions with critical missing data (i.e. predictor and/or criterion data), our remaining sample contained 973 unique acquisitions over the 5-year period.

Measures

The endogenous latent construct of interest is degree of internationalization, or the level of ownership equity in the target firm that the acquirer secures through international acquisition. It is reflected by two indicators, equity acquired and equity total owned, measured with continuous scales provided in the SDC Platinum for each completed acquisition ranging from 0.1% to 100%. Rather than using a dichotomous variable of partial or full acquisition, as has been done in much previous research, we join scholars Chari and Chang, 2009; Chen and Hennart, 2004; as well as Malhotra and associates, 2011, in examining the full range of equity ownership sought as a proxy for degree of internationalization. This provides a more nuanced incremental examination of the degree of internationalization when compared to forcing polar extremes via a dichotomous variable, which may artificially intensify findings. Further, we use a latent construct reflected by two indicators of degree of internationalization (equity acquired in transaction and equity total owned) to obtain a more robust representation of internationalization via acquisition, and, by extension, examine relationships between constructs.

The four exogenous latent constructs (Rule of Law, Limited Government, Regulatory Efficiency, and Open Markets) represent institutional class and caliber as proxy herein and are reflected by ten indictors of separate component aspects of economic characteristics, operationalized as dyadic measures of difference (distance) between acquirer nation (home) and target nation (host) on a matched pair basis. All indicators are measured on a continuous scale 0.1% to 100%, signifying increasing levels of indicator-specific economic class and caliber, and operationalized from The Index of Economic Freedom, published by The Heritage Foundation and The Wall Street Journal. The Index of Economic Freedom has been published yearly since 1995 and includes ten benchmark indicators that measure economic class and caliber, as well as the economic success of 185 countries globally. Economic class and caliber variance (distance) is broadly defined as differences in economic development and macroeconomic characteristics as determined by variation in Income, Inflation, Exports, and Imports (Campa & Guillen, 1999; Caves, 1996; Iyer, 1997; Whitley, 1992; Yeung, 1997; Zaheer & Zaheer, 1997). Measurement definitions and parameters of the ten specific indicators of economic quality used in this study are delineated in Appendix 1.

Structural Equation Modeling (SEM) is a statistical technique used to analyze complex relationships between variables, including directly observed and latent (unobserved) variables, by simultaneously modeling multiple regression equations and incorporating concepts from factor analysis to test hypothesized causal pathways between constructs in a system. Iacobucci (2009) substantiated, “SEM is a statistical tool, orthogonal to the substantive domain of data on which it is implemented. Thus, SEM may be applied to secondary databases”. As such, we utilized SEM to model and analyze our secondary data. Further, all indicator scale items have been consistently used in the literature, and their associated properties are well established. As a result, scale items measuring all the constructs were subjected to confirmatory factor analysis (CFA) using structural equation modeling (SEM) procedure (Anderson & Gerbing, 1988; Bagozzi & Yi, 1988; Bollen, 1989; Jöreskog & Sörbom, 1996). The CFA standardized regression weights (factor loadings), critical ratios, and test significance levels are presented under the *Measurement Relations* section of Table 1. All factor loadings were above 0.72, indicating acceptable levels of internal consistency (Nunnally, 1978). Further, all constructs were subjected to single-factor analysis and the individual fit indices were also above the acceptable levels for all factors (Bagozzi & Yi, 1988). Average variance extracted (AVE) and construct reliability (CR) were computed to assess construct validity and are depicted in Table 2 (Hair, Black, Babin, Anderson, & Tatham, 2006). All AVE estimates are above 0.6 and are greater than the square of correlations between constructs. Further, all CR estimates are better than 0.78. In aggregate, this suggests acceptable convergent and discriminant validity (Hair et al., 2006). The scale items for each factor were next deployed in testing the hypotheses using SEM procedure.

Hypotheses Testing

The hypothesized relationships were tested using the SEM procedure (Anderson & Gerbing, 1988; Bagozzi & Yi, 1988; Bentler & Chou, 1987; Bollen, 1989; Jöreskog & Sörbom, 1996), and results are presented under *Structural Relations* in Table 1. All four hypothesized relationships, revisited below, were found to be supported. Likewise, all four direct effect structural relationships were directionally positive, as hypothesized, with latent construct path coefficients of tested significance and practical importance.

H1: +Rule of Law Distance => +Internationalization Degree (**Supported**; Significant)

H2: +Limited Government Distance => +Internationalization Degree (**Supported**; Significant)

H3: +Regulatory Efficiency Distance => +Internationalization Degree (**Supported**; Significant)

H4: +Open Markets Distance => +Internationalization Degree (**Supported**; Significant)

TABLE 1
SEM ANALYSES: MEASUREMENT AND STRUCTURAL RELATIONS

Measurement Relations	Standardized Regression Weight	CR/p
~*Rule of Law* CR .830; alpha .821		
Property Rights	.86	Set to 1
Freedom from Corruption	.82	27.913/***
~*Limited Government* CR .786; alpha .769		
Government Spending	.79	23.177/***
Fiscal Freedom	.82	Set to 1
~*Regulatory Efficiency* CR .815; alpha .804		
Business Freedom	.72	17.676/***
Labor Freedom	.78	21.318/***
Monetary Freedom	.81	Set to 1
~*Open Markets* CR .845; alpha .836		
Trade Freedom	.77	20.115/***
Investment Freedom	.82	27.312/***
Financial Freedom	.85	Set to 1
~*Equity Participation* CR .938; alpha .939		
Equity Acquired	.93	33.069/***
Equity Total Owned	.95	Set to 1
Structural Relations	Coefficients	CR/p
Rule of Law => Internationalization Degree	.33	5.161/***
Limited Government => Internationalization Degree	.27	3.982/***
Regulatory Efficiency=>Internationalization Degree	.18	2.647/***
Open Markets => Internationalization Degree	.62	10.97/***

*** p<001; Indicator measurement definitions (Appendix 1);
$\chi 2$ = 155.16: df 48: p-value .000: RMSEA 0.059: RMR 0.65: NFI 0.91: NNFI 0.95:
CFI 0.96: IFI 0.96: RFI 0.91: GFI: 0.89 AGFI: 0.85

TABLE 2
CONVERGENT AND DISCRIMINANT VALIDITY

	1 RoLw	2 LmGov	3 RegEff	4 OpMkt	5 EqPart	CR	Chronbach's Alpha
1. Rule of Law	**(0.706)**	0.171	0.106	0.263	0.061	.830	.821
2. Limited Government	0.413	**(0.648)**	0.056	0.054	0.037	.786	.769
3. Regulatory Efficiency	0.325	0.237	**(0.618)**	0.133	0.068	.815	.804
4. Open Markets	0.513	0.233	0.364	**(0.638)**	0.057	.845	.836
5. Internationalization	0.247	0.192	0.261	0.239	**(0.884)**	.938	.939

Lower diagonal elements are correlation estimates between latent constructs; the upper diagonal elements are correlations squared; the (bold) diagonal elements are the average variance extracted (AVE); Construct reliability (CR) is calculated using standardized estimates of confirmatory factor analysis using SEM.

DISCUSSION

This paper contributes to the literature by examining how institutional variance or distance based on class (economic characteristics) and caliber (economic development levels) between the home and host countries influences degree of internationalization (equity ownership) taken by EMNEs in cross-border acquisitions. While institutional distance has been shown to diminish DMNE aggressiveness and decrease degree of internationalization with reduced equity levels taken during cross-border acquisitions (Pan & Tse, 2000), our findings suggest that the effect of distance may be different - and even positive (reversed) - for EMNEs. Reviewing this study's reliability, measurement fit, and positive structural relationships significance, it may begin to substantiate that the effect of institutional distance, in this case economic class and caliber, may be positive for EMNEs in certain contexts. As hypothesized, all latent constructs proved to have significant positive relationships with degree of internationalization of EMNEs in ownership levels taken via cross-border acquisitions. This supports the broader assertion of the EMNE internationalization literature that EMNEs are looking to acquire strategic assets through the internationalization process, in accordance with their strategic global mindset, and may do so relatively via more aggressive behavioral means. By taking a larger equity share, EMNEs increase control over the tangible and intangible assets of the target firm, and by extension, facilitate transfer of organizational knowledge and capabilities. This more quickly satisfies identified EMNE strategic capability/resource gaps/needs, as opposed to growing capabilities internally and organically, for example.

LIMITATIONS AND FUTURE RESEARCH

This study has similar limitations which accompany most cross-sectional empirical investigations. Further, the hypothesized, confirmed, and statistically significant structural findings are associative relationships and should not be construed as causal in nature. In comparing our findings with recent EMNE empirical studies, ours lends to convergence regarding influences of cross-national institutional differences between countries. At the strategic country level of analysis, a great deal of 'noise' exists elicited by a multitude of antecedents, moderators, mediators, and contextual factors. With this understanding, our findings support country-level cross-national institutional class and caliber differences or 'distance' as a theoretically underpinned foundation from which we can move associated research forward. To this end, future research may be well served in examining these interactive constructs in larger and smaller contexts, such as in supranational and subnational regions. Relationships substantiated in our study may be further influenced by the host firm's relative location within specific regions of the world (Arregle, Miller, Hitt, & Beamish, 2013). Likewise, the cultural tightness-looseness literature may help further explain variance between countries, and future research could look to this stream for possible additional explanation of when, how, and why EMNEs may behave differently from traditional DMNEs. The interaction effects of cross-cultural distance specific to the degree of strength in social norms and tolerance for deviant behavior

(Gelfand et al. 2011) may further influence outcomes such as those examined in this study. Specific indicators of institutional distance may be more significantly influenced by cultural tightness-looseness distance than others. This study has improved the generalizability of findings due to the incorporation of all associated industries, all completed deals over US $5 million, and inclusion of the four leading countries in EMNE cross-border acquisitions (i.e., BRIC). However, it may be worthwhile to test the relationships found in this study with EMNEs based in other emerging and transition market countries beyond the BRIC countries to discover possible behavioral variations. We hope this study has reinforced the theoretical and empirical foundation of institutional distance in the literature, from which further investigation can extend.

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APPENDIX: THE INDEX OF ECONOMIC FREEDOM: INDICATOR DEFINITIONS AND PARAMETERS

Rule of Law

Property Rights – Assessment of the ability of individuals and businesses to accumulate private property, secured by clear laws that are fully enforced by the state. It measures the degree to which a country's laws protect private property rights and the degree to which its government enforces those laws. The more certain the legal protection of property, the higher a country's score; similarly, the greater the chances of government expropriation of property, the lower a country's score.

Freedom from Corruption –Corruption erodes economic freedom by introducing insecurity and uncertainty into economic relationships. The score for this component is derived primarily from Transparency International's Corruption Perceptions Index (CPI) for 2011, which measures the level of corruption. The higher the level of corruption, the lower the level of overall economic freedom and the lower a country's score.

Limited Government

Government Spending – The level of government expenditures as a percentage of GDP. Government expenditures, including consumption and transfers, account for the entire score. Excessive government spending that causes chronic budget deficits and the accumulation of sovereign debt is one of the most serious drags on economic dynamism. The higher the level of government spending, the higher the score. Non-linear.

Fiscal Freedom – A measure of the tax burden imposed by government. It includes direct taxes, in terms of the top marginal tax rates on individual and corporate incomes, and overall taxes, including all forms of direct and indirect taxation at all levels of government, as a percentage of GDP.

Regulatory Efficiency

Business Freedom -Indicator of the efficiency of government regulation of business. The quantitative score is derived from an array of measurements of the difficulty of starting, operating, and closing a business. The business freedom score for each country is a number between 0 and 100, with 100 equaling

the freest business environment. The score is based on 10 factors, all weighted equally, using data from the World Bank's Doing Business study

Labor Freedom -A measure that considers various aspects of the legal and regulatory framework of a country's labor market, including regulations concerning minimum wages, laws inhibiting layoffs, severance requirements, and measurable regulatory restraints on hiring and hours worked. Based on data collected in connection with the World Bank's Doing Business study, these factors specifically examine labor regulations that affect "the hiring and redundancy of workers and the rigidity of working hours."

Monetary Freedom – Combines a measure of price stability with an assessment of price controls; the weighted average inflation rate for the most recent three years and price controls. Both inflation and price controls distort market activity. Price stability without microeconomic intervention is the ideal state for the free market.

Open Markets

Trade Freedom - A composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services. The trade freedom score is based on two inputs The trade-weighted average tariff rate and non-tariff barriers (NTBs).

Investment Freedom - In an economically free country, there would be no constraints on the flow of investment capital. Individuals and firms would be allowed to move their resources into and out of specific activities, both internally and across the country's borders, without restriction. Such an ideal country would receive a score of 100.

Financial Freedom - A measure of banking efficiency as well as a measure of independence from government control and interference in the financial sector. State ownership of banks and other financial institutions such as insurers and capital markets reduces competition and generally lowers the level of available services.

Index of Economic Freedom (2013) – The Heritage Foundation and Dow Jones & Company, Inc. http://www.heritage.org/index.