

# Economic Freedom: The Path to Economic cum Political Renaissance of the Conflict-affected Region of Sri Lanka

## 1. Introduction

Sri Lanka is, slowly but surely, emerging out of a vicious civil war that has lasted over twenty-five years (July 1983 – May 2009); armed conflict since 1972; and the conflict per se ever since independence in 1948. The amount of human, material, environmental and psychological destruction caused by this long-drawn out civil war, especially in the conflict-affected Eastern and Northern Provinces, is immeasurable and would last for generations; though some quantitative and qualitative estimations exist (Arunatilake, et al., 2000; Gunatilleke, 2001; Sarvananthan, 2008; Somasundaram, 1998).

The purpose of this policy brief is to set out the contours of a broad political and economic policy framework for rebuilding the conflict region (Eastern and Northern Provinces) from the ashes. It is not intended to get into specific sectoral or sub-sectoral strategies, policies, programmes or projects. On the contrary, it charts out a political cum economic path that should be followed by the conflict region, and an enabling environment that the national government should create and foster for speedy recovery from the ruins. Economic resurrection of the conflict region, undoubtedly, would have a spill over effect on the national economy as well.

Japan and Germany are two prime examples of successful resurrection of battered minds and

economies after ruinous adventure of war. Imperial Japan and Nazi Germany pursued a militaristic path for dominance of their respective geographical regions of the world. In the same way, the Liberation Tigers of Tamil Eelam (LTTE or 'Tamil Tigers' for foreigners) waged a relentless and ruthless war for separation of the Eastern and Northern Provinces from Sri Lanka. The consequences have been disastrous for the Tamil community in particular, and for Sri Lanka as a whole. Though the Japanese and German military pursuits of dominance were transnational wars, LTTE's separatist war was internal. However, it could be argued that, though in pretence, LTTE's war against the Sri Lankan State was internal, its ultimate intent was to create a pan-Tamil national State based in Eastern and Northern Provinces of Sri Lanka (Bandarage, 2009; Sarvananthan, forthcoming).

However, we frame the LTTE's war of separation (whether national or transnational), resembled militaristic adventurism of the regimes of Imperial Japan and Nazi Germany in the run up to and during the Second World War. The *modus operandi* of the LTTE also has close resemblance of the Pol Pot's regime of Kampuchea (now known as Cambodia) in the late-1970s (Sarvananthan, forthcoming).

As Sri Lanka enters an era after a nasty war of attrition and consequent comprehensive defeat of the LTTE and elimination of its military cum political leadership, it is time for introspection, self-

**Dr. Muttukrishna Sarvananthan**  
Principal Researcher,  
Point Pedro Institute of  
Development.

criticism and remorse by the Tamil community and making a way out of the current morass. There are two potential pathways ahead for the Tamil community in particular, and Sri Lanka as a whole. One is that pursued by Japan and Germany in the aftermath of the Second World War, and the other followed by post-Khmer Rouge Cambodia.

Post-Second World War Japan and Germany rebounded from ashes following pacifism, resolute adherence to democracy cum rule of law, and industriousness; as a consequence, became economic powerhouses in the world within a short span. On the other hand, Cambodia was dogged by democratic deficit, corruption, nepotism and low-intensity authoritarianism even after the ouster of Khmer Rouge regime in 1979 and end of Vietnamese occupation in 1989; thereby continued to be one of the poorest countries in the world. Thus, whilst post-war Japan and Germany reflect prosperity, post-war Cambodia reflects pauperism.

It is imperative for the people of Eastern and Northern Provinces in particular, and Sri Lanka as a whole, to draw lessons from historical experiences of these two sets of contrasting post-war countries. Naturally, I would argue

in favour of the path pursued by both Japan and Germany in the aftermath of the Second World War for the Eastern and Northern Provinces in particular and Sri Lanka as a whole to pursue in this post-war (not yet post-conflict) era.

## 2. Tamil Polity

Historically, politics among the Tamil community has been narrowly focused on linguistic and religious nationalism cum freedom, and barely touched on economic emancipation cum freedom. Since the beginning of the twentieth century to date, politics among the Tamil community has been dominated by three strands of class cum caste politics at different time periods. I am clubbing class and caste together because the latter is originally and primarily (though not exclusively) based on occupation, and thereby class.

In the early part of the twentieth century, there was no distinct Tamil politics as such. Tamil politicians at that time were part and parcel of the Ceylon National Congress (ala Indian National Congress), which advanced the cause of independence from British colonial rule. Three leading Tamil politicians of that time (in alphabetical order) were Sir Ponnambalam Arunachalam, Sir Vaitilingam Duraiswamy and Sir Ponnambalam Ramanathan. All three were well educated and upper-class elitist proponents of Hindu renaissance/nationalism, who along with leading Buddhist revivalists like Sir Baron Jayatilake, felt that under colonial rule both Buddhism and Hinduism were marginalised and Christianity promoted. Besides, the aforesaid Tamil political leaders were largely based in Colombo though hailing from Jaffna (Northern Province).

Disgruntled with the upper-class elitism and Hindu nationalism of

Arunachalam, Duraiswamy and Ramanathan trio and their alliance with Buddhist nationalism, G.G. Ponnambalam established the All Ceylon Tamil Congress (ACTC) in competition to the Ceylon National Congress in the early 1940s. Subsequently, Stanley James Velupillai Chelvanayagam established the Federal Party in the late 1940s, advocating federal political set up for the Tamil dominated Eastern and Northern Provinces in the event of the end of British colonial rule in Ceylon. Thus, Tamil political leadership shifted from upper-class elitist Hindu nationalists likes of Arunachalam, Duraiswamy and Ramanathan to middle-class Chelvanayagam and Ponnambalam duo (though the latter could be classified as upper-class). The Federal Party formed an alliance with the Tamil Congress and the Ceylon Workers Congress (hill-country Tamil trade union cum political party) and formed the Tamil United Liberation front (TULF) in 1974 in order to advance the cause of the Tamils (both North East and hill-country), after Ceylon becoming a republic and renaming to Sri Lanka in 1972.

Disillusioned with the continued non-fulfilment of political aspirations of the Tamils, some Tamil youths took up arms against the Sri Lankan State in 1972, which resulted in the formation of several armed militant groups among the Tamils. These Tamil youths, not only revolted against the Sri Lankan State, but also challenged the middle-class Tamil political leadership as embodied by the TULF and individual Tamils who were members of the national political parties, such as, the Sri Lanka Freedom Party (SLFP) and the United National Party (UNP). Moreover, most of the original leaders of the first wave of armed

Tamil militant groups were youths from dispossessed castes (but not necessarily dispossessed class because, for example, the leader of the LTTE was from a middle-class family). Thus, the class base of Tamil political leadership evolved overtime from upper-class elitist, to middle-class, and finally to dispossessed caste/class.

History has proven that none of these three distinct class-based political leaderships has been able to fulfil the political aspirations of the Tamil community entirely. However, though the upper-class and middle-class Tamil democratic political leaderships had failed to fulfil the Tamil aspirations, their efforts did not bring about destruction of their community. On the other hand, the dispossessed caste/class-based violent armed struggle to win the (real or perceived) aspirations of the Tamils in the post-1972 period has brought about immeasurable destruction to the community, both physically and psychologically, which was pure militarism sans politics (Sarvanathan, forthcoming).

Tamil democratic politics requires profound reform. All the present Tamil political parties (formerly armed groups) having 'Eelam', 'Tamil Eelam' or 'Tiger' in their name, should rename their parties (Eelam People's Democratic Party - EPDP, People's Liberation Organisation of Tamil Eelam - PLOTE, Eelam People's Revolutionary Liberation Front - EPRLF, Tamil Eelam Liberation Organisation - TELO, Eelam Revolutionary Organisation of Students - EROS, Thamil Makkal Viduthalai Pulikal - TMVP - Tamil People's Liberation Tigers, Popular Front of the Liberation Tigers - PFLT). 'Eelam' or 'Tamil Eelam' has been a disaster to the Tamil community. Even the TULF should

take off 'Tamil' and 'Liberation' from its name.

All the aforementioned Tamil political leaderships have been largely preoccupied with language, land, religious, and political rights with only a marginal interest in economic rights and freedom. Thus, Tamil politics throughout the twentieth century was heavily concentrated on ethnic cum linguistic politics. It is time for the Tamil community to take a deep breath and ponder, what went wrong? Narrowly focused ethnic cum linguistic politics should be replaced with regional politics by fostering Eastern and Northern regional identity, which is multi-ethnic, multi-lingual, multi-religious, multi-caste and multi-class.

A rainbow coalition of different people of the Eastern and Northern Provinces is the need of Tamil politics in the twenty-first century. It is the TULF that is best suited to spearhead this reform and transformation of the Tamil polity, albeit under a reformed name (e.g., North East People's Party - NEPP), because of its steadfast commitment to democracy, rule of law and independence from Tigerism. As one of the oldest and most popular democratic party among the Tamils of North East, TULF has an historical duty to build a broad-based democratic coalition and lift the Tamil community from the present hopelessness. Such a broad democratic coalition should be multi-ethnic, multi-lingual, multi-religious, multi-caste and multi-class with regional identity (as opposed to racial or ethnic identity) as its political motto.

Historically, leaderships of the Tamil political parties in the North East have been Jaffna-centric that has alienated the non-Jaffna Tamils, particularly those of

Batticaloa district. Economic emancipation and freedom of the people of Eastern and Northern Provinces should take precedence over parochial linguistic nationalism of the days gone by. It is not that language is unimportant, but it should not take precedence over economic well-being. Thus, a fundamental re-orientation of Tamil politics is long overdue. I hope that the present TULF leadership will seize this historic opportunity to transform the Tamil political landscape and discourse by reaching out to other ethnic, linguistic, religious, caste, and class groups. My humble suggestion to all former Tamil militant armed groups is to disarm, dissolve and integrate with the erstwhile Tamil democratic political parties such as the TULF and ACTC.

### 3. Economic Freedom

A laypersons definition of economic freedom is the freedom to do business locally, nationally and internationally with minimal cost and minimal interference of the local, national and international governments. Economic freedom is an essential ingredient of democracy, like political freedom. Yet, economic freedom is less understood, and even less underscored, compared to political freedom.

According to Gwartney and Lawson (2008) "the key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and protection of person and property." A country's adherence to economic freedom is measured by the Economic Freedom of the World (EFW) index developed by the Fraser Institute based in Vancouver, Canada. The EFW index is based on 42 variables (including 22 survey-based variables derived from the International Country Risk Guide, Global

Competitiveness Report and Doing Business Report of the World Bank). The EFW index has a scale of 0 to 10: zero depicting no economic freedom at all, and 10 depicting highest economic freedom.

The EFW index is subdivided into 5 major components: (i) Size of Government: public expenditures, taxes and public enterprises; (ii) Legal Structure and Security of Property Rights; (iii) Access to Sound Money; (iv) Freedom to Exchange with Foreigners; and (v) Regulation of Credit, Labour and Business. Further, the 'Size of Government' is subdivided into 5 components<sup>1</sup> 'Legal Structure and Security of Property Rights' is subdivided into 7 components<sup>2</sup> 'Access to Sound Money' is subdivided into 4 components<sup>3</sup>; 'Freedom to Exchange with Foreigners' is subdivided into 9 components<sup>4</sup> and 'Regulation of Credit, Labour and Business' is subdivided into 17 components<sup>5</sup> (Gwartney and Lawson, 2008). Hence, altogether 42 variables compose the EFW index.

There is a positive correlation between economic freedom and economic growth, per capita income, life expectancy, poverty, income inequality, literacy rate, access to safe sanitation facilities and safe water (Gwartney and Lawson, 2008). Moreover, Eriksen and Soysa (2009) have proved that there is a positive relationship between economic freedom and human rights, i.e., higher the economic freedom index, better the condition of human rights.

Based on the conceptual framework of economic freedom as noted above, we would argue that the guiding principle of economic renaissance in the conflict-affected region of Eastern and Northern Provinces should be economic freedom, whereby the national and

provincial governments should create an enabling environment for private sector-led economic emancipation of the people, with private cum public partnerships where absolutely necessary.

#### **4. Accountability, Integrity and Transparency**

Accountability, integrity, and transparency should be the cornerstone of provincial and local governments and provincial and local public administrations in the conflict region, as well as rest of the country. A vibrant market economy could function effectively only when rule-of-law is supreme; merit and productivity are *sine qua non*; accountability, integrity and transparency are paramount.

In order to attain such an ethical system of governance, independent, efficient and credible Department of Auditor General, Bribery Commission, Public Services Commission, Police Commission, Human Rights Commission, and Media are indispensable. The existing similar national-level institutions are limited in scope and heavily politicised. The government has undermined the functions of the Public Service Commission, Police Commission, and Human Rights Commission set up under the seventeenth amendment to the Constitution by deferring the appointment of members to these commissions indefinitely. While an independent and proactive media is *sine qua non* for a vibrant, modern market economy (World Bank, 2002), the media in Sri Lanka is bruised and battered by extra judicial killings and public beatings under the present low-intensity authoritarian regime.

The functioning of the Auditor General's Department and the Human Rights Commission are

subverted by apportioning inadequate financial and human resources. The latter is also politically interfered at times. Further, the Bribery Commission has severe limitation on three counts: firstly, the legislative act setting up the Bribery Commission is fundamentally flawed, because, it restricts its functions to bribery and corruption in the public sector only. Secondly, Bribery Commission has authority to make investigations only when complaints are made orally or in writing. It has no power to proactively investigate suspected bribery and corruption on its own initiative. Thirdly, the abrupt transfer of the Director General of the Bribery Commission last year is just one of many examples of blatant political interference in its functioning. Hence, the legislative act should be amended to incorporate the private and non-governmental (NGOs) sectors as well under the Bribery Commission's purview, and allow it to proactively pursue cases against suspected bribery and corruption anywhere and in any sector.

The national integrity system encompassing the foregoing intended independent institutions should have been the watchdogs of democracy, justice, and rule-of-law. However, in reality, they have become just lapdogs of the powers that be. His Excellency the President has said, on May 19, 2009, that we have to find "home-grown solutions" to our political problems and that he does not require "lectures" from foreigners, with which I concur. But, the foregoing national institutions and the seventeenth amendment to the Constitution were entirely home grown and duly enacted by the national legislature. The home-grown solution to the North - East terrorism proposed (the majority

report) by the All Party Representatives Committee (APRC), members of which were appointed by none other than his Excellency the President, was also scuttled by himself.

Due to the aforementioned shortcomings in the national institutions, each province should set up regional institutions to foster good governance within its province. The corresponding national institutions could undertake the oversight of the provincial institutions. When we have truly independent, impartial and non-partisan governance institutions such as the foregoing, external interference or interventions on governance in the country would become irrelevant.

Moreover, equal opportunities should be ensured by law to stamp out discrimination based on ethnicity, religion, gender, caste, regional origin, physical disability, political party affiliation, etc, and to promote merit-based system of economic, social, and political governance. On this score, the conflict-affected provinces should become exemplary to rest of the provinces and the national government.

#### **5. Education and Knowledge Economy**

Historically, the bedrock of regional pre-eminence of the North, particularly the Jaffna peninsula, has been education and knowledge. It is time to spread that to the East as well. Relatively, the North is endowed with marginal natural resources in comparison to other provinces. Therefore, education was the pathway to prosperity by way of entering professions and public sector employment. Thus, the competitive advantage of the people of North has been education and knowledge (human capital).

Although the Eastern and Northern Provinces are touted as primarily agriculture cum fisheries economy, it is no more the case due to the protracted civil war resulting in mass displacement, mining of agricultural lands and coastal areas, and exodus of kith-and-kin overseas causing a 'demonstration effect' to migrate domestically or overseas (Sarvanathan, 2006 and 2008). During the conflict time, services sector was the largest contributor to the provincial economies (over 65%), which was larger than the services sector's share in the national economy (just over 50%). However, presently (and in the past), the services sector in the two conflict-affected provinces is dominated by defence and public administration sub-sectors that have minimal productivity (Sarvanathan, 2008).

These minimal productive services sub-sectors could and should be transformed into highly productive modern knowledge economy in order to compete in a globalised market place. The emerging economies in the conflict-affected provinces should seize this opportunity to foster and promote a knowledge-based economy. Information technology and English language are two indispensable ingredients of a knowledge economy. Besides, totally independent, private schools and tertiary educational institutions (such as universities and technical/vocational higher education colleges) are also indispensable to build a knowledge economy. State-owned and run schools, universities, and further/higher education institutions should be made to compete for students with corresponding private institutions. The State should provide financial resources directly to needy students so that they could buy the educational services

from either the public or private institutions according to their own choice.

Sri Lanka is one of the very few countries in the world where Vice Chancellors of Universities are appointed by the highest political authority of the country, which is ridiculous to say the least. Appointments to the independent governance bodies such as the ones noted in the foregoing section, judiciary, educational institutions, and the Central Bank should be made by groups of independent, non-partisan eminent persons in respective fields.

## **6. Fiscal Autonomy**

In the post-war Sri Lanka, the national government should abdicate most of its functions and responsibilities to all nine provinces, except monetary currency, defence, and foreign affairs. The national government's primary function should be regulation of the provincial governments under a unified country, such as imposing a cap on provincial budget deficit. In order to fulfil its functions and responsibilities, provincial governments should be given fiscal autonomy. That is, the power to raise and earn income and spend on public services within the respective provinces. Each province should impose and collect taxes, except import duty, excise duty, and value added tax on imports. Hence, the national government's revenue should primarily accrue from duties and taxes on international trade. Businesses within each province should register with their respective provincial government and pay taxes (both direct and indirect) to their respective provincial government. Both the public and private sector employees should pay income tax to their respective provincial government.

At the same time, national government employees (such as the Central Bank staff, employees of the three armed forces, Ministry of Finance employees, et al) should pay income tax to the national government.

By providing fiscal autonomy to provinces, the national government could promote competition among provinces to attract businesses and investments (both domestic and foreign). The fiscal space envisaged by the aforementioned method to the provinces would create an environment for productive competition among provinces. The national government should do away with the nanny state it currently operates, vis-à-vis the provinces, by providing annual grants to the provinces based on certain criteria. Present transfers from the centre to the provinces are barely adequate to pay for salaries, pensions, and recurrent expenditures of the provinces. On the contrary, provinces should be encouraged to earn and spend their own money.

The total revenue of the national government is insufficient to meet even the recurrent expenditures of the government for the past twenty years (since 1989). Therefore, part of the recurrent expenditure and entire capital expenditure of the government is financed through domestic and external borrowings. Furthermore, bulk of the annual government revenue goes for repayment of public debt (both domestic and external). Therefore, it is high time that the national government thinks out of the box to fix its fiscal hole by transforming the nature, content and extent of the fiscal architecture of the national government vis-à-vis provincial governments.

Government's avowed strategy of economic revival of the conflict

region is focused on physical (dwellings, roads, bridges, etc.), economic (electricity, water, telecommunications, railways, etc.), and social (schools, hospitals, etc.) infrastructure development, which is indispensable. However, I have serious reservations about the financing of such infrastructure projects. Given the very tight fiscal space of the government as noted above, I do not think that the government has adequate resources to finance such infrastructure development, because they are costly. Moreover, in the context of global financial crisis coupled with precarious external political relations of the government, it is unlikely that the government will be able to mobilise adequate concessionary finance from external donors (both bilateral and multilateral).

In this scenario, the only option left for the government is to attract private capital (both domestic and overseas) for investment in infrastructure in the conflict region and beyond, under BOO (Build, Operate, and Own) or BOT (Build, Operate, and Transfer) mechanisms. The government's attempt to re-build the rail line beyond Vavuniya up to Kankesanthurai (in the Jaffna peninsula) is laudable, because the northern rail line (legendary 'Yarl Devi') used to be the highest revenue earner for the Ceylon Government Railways (CGR) prior to its termination in the mid-1980s as a result of the civil war. Besides, rail transport is cheaper than road, ocean or air transport due to lower fuel cost per passenger, and absence of traffic congestion and security checkpoints.

However, I do not think that the government has sufficient financial resources to spend on this

ambitious and worthwhile project. Government is explicitly appealing to the people for contribution, and Sri Lanka's diplomatic missions abroad are organising 'benefit show' to mobilise finance from the diaspora, which are highly unlikely to yield desired results. According to the Central Bank (2008), the Department of Railways incurred operating loss of Rs.12.5 million every single day during 2008 (annual loss was LKR 4,553 billion or approximately USD 43 million). Our suggestion is that, whilst the government could invest its own money as well as borrow from a foreign donor/s to re-build the rail tracks and stations (infrastructure), it should open up the passenger transport to the private sector (both domestic and foreign). That is, locomotives and rail cars/carriages could be invested, managed, and operated by the private sector. This kind of public-private partnerships could be the best way to beat the fiscal crunch faced by the government. Although the national government should re-build the rail tracks and stations initially, the maintenance of the same should be handed-over to the respective provincial government.

## 7. Conclusion

Comprehensive and decisive defeat of the LTTE provides challenges and opportunities. Tamil political leaderships and the national political leaderships should transform themselves to meet the challenges of the post-war Sri Lanka and seize the historical opportunities it has bestowed. The broad policy framework we would suggest for the post-war Sri Lanka in general, and the conflict region in particular, could be summed up as follows:

1. *Economic strategy* – Economic freedom as the guiding principle in the conflict region as well as rest

of the country, both provincially and nationally.

2. *Cluster strategy* – Knowledge economy is the key to economic renaissance and leapfrogging of the conflict region to catch up with rest of the country.

3. *State reform* – Transformation from a nanny State to an empowering State.

4. *Political reform of the Tamils* – Transformation from a parochial linguistic cum ethnic identity towards a regional identity.

5. *Governance reforms* – Truly independent governance bodies that would safeguard and promote democracy and ensure justice and rule-of-law.

6. *Financing the foregoing reforms* – Fiscal autonomy is key to the realisation of the foregoing economic cum political reforms.

Need of the hour for Sri Lanka is statespersons likes of Nelson Mandela and F.W. de Klerk from both sides of the ethnic divide. Unfortunately, I am yet to discover such statespersons from either side of the ethnic divide in Sri Lanka. Wish I were proved wrong. The spirit of the people of Sri Lanka, particularly of those in the conflict region, should be the likes of the Japanese and the Germans in the aftermath of the Second World War. Together we rise from the ashes, or bury ourselves. It is a make or break situation. Would those who dare to hope stand up please?

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**Footnotes:**

<sup>1</sup> Government consumption, transfers & subsidies, government enterprises & investment, top marginal income tax rate and top marginal income & payroll tax rate.

<sup>2</sup> Judicial independence, impartial courts, protection of intellectual property, military interference in rule of law & political process, integrity of

legal system, legal enforcement of contracts, and regulatory restrictions on the sale of real property.

<sup>3</sup> Growth of money supply, standard deviation of inflation, recent annual inflation and freedom to own foreign currency.

<sup>4</sup> From trade taxes (as a share of trade sector), mean tariff rate, standard deviation of tariff rates, non-tariff trade barriers, compliance cost of importing & exporting, size of trade sector relative to expected, black market exchange rates, foreign ownership / investment restrictions, and capital controls.

<sup>5</sup> Ownership of banks, foreign bank competition, private sector credit, interest rate controls / negative real interest rates, minimum wage, hiring & firing regulations, centralised collective bargaining, mandated cost of hiring, mandated cost of worker dismissal, conscription, price controls, administrative requirements, bureaucracy costs, starting a business, extra payments / bribes, licensing restrictions, and cost of tax compliance.

