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The Economist

Globalisation stalled

How global economic upheaval will hit the business environment

Special Report

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The Economist Intelligence Unit

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Symbols for tables

"n/a" means not available; "–" means not applicable

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Executive Summary

This report provides an assessment of how the current global financial and economic crisis will affect the global business environment in the medium term, as seen through the prism of the Economist Intelligence Unit's Business Environment Rankings (BER) model. Until recently, it was expected that business environments around the world would continue to improve, reflecting the apparently relentless "forward march of globalisation". Now, however, for the first time since the BER were introduced in 1996, the average business environment score for the 82 countries covered by the model is lower for the five-year forecast period (now 2009-13) than for the historical period (2004-08). More than half the countries (44 in all) are expected to have a worse overall business environment in 2009-13 than they had in 2004-08. The long-standing trend of continually improving global business environments—as a result of robust growth, liberalisation and infrastructure improvements—will be halted and even partially reversed in some areas.

The BER model measures the attractiveness of the business environment and its key components. The model uses quantitative data, business surveys and expert assessments to measure the attractiveness of countries' business environments for forecast as well as historical five-year periods. The framework reflects the main criteria used by companies to formulate their global business strategies and investment location decisions. The overall scores (on a 1-10 scale) and rankings are based on scores for 91 indicators, grouped into ten categories of the business environment.

The new global business landscape

The current crisis will have a significant impact on business environments in the medium term. The global business landscape will be characterised by greater caution, less liquidity, lower cross-border capital flows, tighter regulation and less risk-taking. Confidence in many countries has been battered, and may take a long time to recover. As measured by the BER, the deterioration in the global business environment reflects worsening market opportunities, increased macroeconomic and political risk, and problems in financial systems.

The economic downturn is the main reason for the deterioration in the global business environment. Annual average global growth in 2009-13, measured at purchasing power parity (PPP) exchange rates, is forecast to be only half the rate achieved in the previous five years—2.3% compared with 4.6% respectively. Much of the slowdown is, of course, a result of the deep and synchronised global recession in 2009, the worst since the end of the second world war, and the very tepid recovery expected in 2010. But performance in 2011-13 is also expected to be well below trend.

The macroeconomic environment will be affected by increased budget deficits and public debt levels (the result of weak growth and fiscal stimulus measures), expected currency volatility and ongoing appreciable risks to asset prices. Poor ratings for the soundness of banking systems, financial sector distortions and impeded access to finance, in particular, will have a significant effect on the outlook for financial systems.

There is an increasing risk of political unrest caused by the severe economic downturn, which has led to rising unemployment and increased economic hardship. Deteriorating relations between governments and oppositions and increased international tensions—both of which are also in part related to economic distress— also mar the outlook for political stability.

Anglo-Saxon woes

Given that the financial system is at the epicentre of the global crisis, it is unsurprising that the US and UK are among the countries that suffer the most significant deterioration in their business environments. The US's global ranking declines to 12th in the forecast period (2009-13) from 7th in the historical period (2004-08), owing to a severe deterioration in the categories of market opportunities, the macroeconomic environment and financing. For similar reasons, the UK's relative position deteriorates even more sharply—its ranking slides to 25th globally in 2009-13 from 13th in 2004-08.

Although other categories of the business environment are expected to be less affected, on average, improvements will be far more modest than would have been previously forecast. Any further progress on liberalisation and deregulation will be slower than in earlier years. This is a time of great intellectual confusion and uncertainty. The current crisis is raising scepticism about free markets in general. This will have an impact on the regulatory environment in many countries, beyond the financial sector.

A mixed impact on policies

Nevertheless, the extent to which the shift in attitudes will translate into sustained anti-market and statist policies remains an open question. Our BER results do not embody the expectation of a significant, generalised global retreat from markets and openness (globalisation is stalled rather than reversed). Much of the backlash against deregulation and liberalisation has been concentrated in developed countries, which have been hit more intensively and directly by the banking crisis. Even in these, we do not expect a wholesale move to across-the-board increased regulation and government interference in the economy. In the emerging-market world, the picture is more mixed. Some countries will follow developed countries in the direction of greater statism and regulation. In others, including many that start from a low level and have only relatively recently embarked on liberalisation, reforms are likely to continue, even if often at a slower pace than would previously have been expected.

The threat of protectionism

The weakening of the global economy has led to a rise in protectionist sentiment and some protectionist policies are being implemented. A number of factors are expected to mute protectionist pressures. Countries today are far more interdependent than in the past, export lobbies now wield more power. and successive GATT/WTO agreements provide greater legal stability for trading relations. The business environment rankings embody the baseline assumption that globalisation will stall over the next five years. However, there is also a significant risk of even worse outcomes—that globalisation could suffer more severe setbacks. Even before the current crisis, globalisation was under threat from a variety of sources. The danger to globalisation has now increased many times over. In particular, the potential damage to the global business environment and to longer-term economic growth prospects cannot be underestimated, were there to be a descent into significant and sustained protectionism around the world.

Trends in business environments across the world: globalisation stalled

Introduction

The results from the latest issue of the Economist Intelligence Unit's Business Environment Rankings (BER) model reflect the likelihood that the current global crisis will have an adverse impact on business conditions in the medium term. Recent years have brought considerable improvement in the global investment climate as growth has been strong and investor-friendly policies have been adopted in many countries around the world. The BER model provided a quantitative representation of these trends. Until recently, it was expected that business environments would continue to improve, reflecting the apparently relentless "forward march of globalisation".

Now, however, for the first time since our BER model was introduced in 1996, the average business environment score for the 82 countries covered by the model is lower for the five-year forecast period (now 2009-13) than for the historical period (2004-08). More than half the countries (44 in all) are expected to have a worse overall business environment in 2009-13 than they had in 2004-08. The long-standing trend of continually improving global business environments—as a result of robust growth, liberalisation and infrastructure improvements—will be halted and even partially reversed in some areas.

Business environment regional scores

	2004-08 Total score	2009-13 Total score
North America	8.44	8.04
Western Europe	7.67	7.39
Eastern Europe	6.16	6.14
Asia-Pacific	6.60	6.58
Latin America	5.89	5.80
Middle East & North Africa	5.81	6.03
Sub-Saharan Africa	4.66	4.69
World average	**6.72**	**6.61**

Source: Economist Intelligence Unit.

The current global financial and economic crisis will have a significant impact on business environments worldwide in the medium term, with all but the Middle East and Africa regions experiencing falls in their average business environment scores (traditionally these are our lowest-ranked regions, which also start from a significantly lower base). The biggest losers are the developed-country regions—North America and Western Europe—that have started from the strongest historical base and are also among those regions that have been hit the hardest by the current global downturn.

The deterioration in the global business environment reflects in particular worsening market opportunities, increased macroeconomic and political risk, and problems in financial systems. The crisis has affected four business environment categories the most, all of which register declines in their average scores between 2004-08 and 2009-13. These categories are market opportunities (a drop by 1.2 points), the macroeconomic environment (0.7), financing (0.3) and the political environment (0.1).

Deterioration in business environments

The economic downturn is the main reason that the global business environment, in particular market opportunities, is expected to deteriorate in 2009-13 compared with 2004-08. According to our baseline forecast, in 2009-13 annual average global growth, measured at purchasing power parity (PPP) exchange rates, will be only half the rate achieved in the previous five years—2.3% compared with 4.6% respectively. At market exchange-rate weights, annual average growth in 2009-13 is forecast to be only 1.3%, compared with 3.4% in 2004-08. Much of the slowdown is, of course, a result of the deep and synchronised global recession in 2009, the worst since the end of the second world war, and the very tepid recovery expected in 2010. But performance in 2011-13 is also expected to be well below trend (see the article in this volume, *The medium-term economic outlook*).

The average macroeconomic environment score for 2009-13 is affected by increased budget deficits and public debt levels (the result of weak growth and fiscal stimulus measures early in the period), expected currency volatility and ongoing appreciable risks to asset prices. Poor ratings for the soundness of banking systems, financial sector distortions and impeded access to finance have a significant effect on the financing category scores for many countries in the world. The shrinkage of the financial services industry will curtail crossborder capital flows. Banks that have received public funding will be under pressure to prioritise domestic lending. More generally, the availability of crossborder capital will be constrained in a climate of risk aversion.

Business environment scores by category

	2004-08	2009-13
Political environment	6.2	6.1
Political stability	6.8	6.6
Political effectiveness	5.7	5.7
Macroeconomic environment	7.5	6.8
Market opportunities	6.2	5.0
Policy towards private enterprise	6.0	6.2
Foreign trade and exchange regimes	7.2	7.7
Policy towards foreign direct investment	6.9	7.0
Tax regime	6.1	6.4
Financing	6.2	5.9
Labour market	6.1	6.2
Infrastructure	6.2	6.8

Source: Economist Intelligence Unit.

A rising risk of social unrest

For the political environment, the deterioration reflects an increasing risk of political unrest, in particular, caused by the severe economic downturn, which has led to rising unemployment and increased economic hardship. Of the 82 countries covered by the BER, 33 are expected to have increased risk of social unrest in 2009-13, while the risk was already high for many others even in the historical period. On average, deteriorating relations between governments and oppositions and increased international tensions—both of which are also in part related to economic distress—also worsen political stability scores.

Although other categories in the BER do not suffer declines in their average scores, the increases are very modest and in most cases far lower than would previously have been forecast for the medium term. Any further progress on liberalisation and deregulation of domestic markets will be slower than in earlier years. The current crisis is raising scepticism about free markets in general. This will have an impact on the regulatory environment in many countries, beyond the financial sector. The idea that retrenchment from liberalisation and increased regulation will only affect the financial sector and bypass other areas is likely to prove an illusion (as may be demonstrated already by the involvement of many governments in propping up their automotive industries). The financial sector can hardly be insulated, or ring-fenced, from the rest of the economy; it is, of course, the lifeblood of the market economy, leaving aside the fact that financial institutions also own companies in many other industries.

A mixed impact

Nevertheless, the extent to which the shift in attitudes will translate into sustained anti-market and statist policies remains an open question. Our baseline BER do not embody the expectation of a significant, generalised global retreat from markets and openness (globalisation is stalled rather than reversed). Much of the backlash against deregulation and liberalisation has been concentrated in the developed world, which was hit more intensively and directly by the banking crisis. Even there, we do not expect a wholesale move to across-the-board increased regulation and government interference in the economy. In the emerging-market world, the picture is more mixed. Some countries will follow developed countries in the direction of greater statism and regulation. In others, including many that start from a low level and have only relatively recently embarked on liberalisation, reforms are likely to continue, even if often at a slower pace than would previously have been expected.

It remains the case, however, that the consequences of the banking collapse and fallout into the real economy could have a profound effect on behaviour for years to come. The business landscape will be characterised by greater caution, less liquidity, tighter regulation and less risk-taking. Risk appetites will diminish and confidence in many countries among consumers, managers and shareholders has been battered, and may take a long time to recover.

De-globalisation

The weakening of the global economy has led to a rise in protectionist sentiment and some protectionist policies are being implemented. In a world where competition for new investment is intense, governments will be tempted to impose restrictions on companies planning overseas investments. High unemployment and social unrest will make labour immigration an even more contentious political issue than is already the case.

The business environment rankings embody the baseline assumption that globalisation will stall over the next five years. However, there is also a significant risk of even worse outcomes—that globalisation could suffer more severe setbacks and go into reverse. Were the global economy to slip into a depression, the likelihood of de-globalisation or a rollback of globalisation would be very high. In such circumstances, the developed world, as well as much of the developing world, would enter a lengthy vicious cycle of deflation, renewed financial turmoil and serious protectionism. This would greatly exacerbate negative trends in world trade and investment.

It is interesting that business people appear to expect a significant policy shift among most governments over the medium term as a result of the current crisis. A recent Economist Intelligence Unit survey of more than 400 global executives (see *Risk and regulation: A new era for capitalism*) showed that business believes that the liberal consensus that has governed relations between the state and the private sector for some three decades is at an end. Almost 60% of respondents agreed with the view that the current crisis has "fundamentally changed" capitalism. An overwhelming majority believed that protectionism would increase. The majority seemed to be resigned to greater government control over commerce in general. Strikingly, almost one-half of respondents favoured more regulation in non-banking industries and a similar percentage favoured new regulations that limit risk-taking across the entire private sector.

Key business environment forecasts

- The US's global ranking declines to 12th in the forecast period (2009-13) from 7th in the historical period (2004-08), owing to a severe deterioration in market opportunities, the macroeconomic environment and financing. Concerns about security risks and long-standing problems with political lobbying also weigh on the US business environment. As the world's largest economy, the US will remain an indispensable business destination. It has a long tradition of establishing a favourable business climate that will, in part, remain intact during the forecast period. In addition to the attractions of a large market, the US is still a technology leader, has flexible labour markets and a good infrastructure. Nevertheless, the US will experience a period of painful adjustment as major imbalances that have built up over the past years are unwound, and this will weigh on the country's macroeconomic stability and dampen market opportunities. There has been a rise in protectionist sentiment and some increase in protectionism is expected.

- For similar reasons, the UK's relative position deteriorates even more sharply. Countries that have seen the largest declines in scores are those that experienced asset bubbles, those whose governments are dependent on foreign financing and those with large financial services industries. As the UK economy has all three of these attributes, its score in the forecast period falls most, resulting in a sharp slide in its ranking to 25th globally in 2009-13 from 13th in 2004-08.

- Despite the sharp contraction expected in 2009, Finland has the best business environment in the next five years. It overtakes Singapore, which held the top position in 2004-08.

- All west European countries, with the exception of Turkey, experience a decline in their business environment scores between 2004-08 and 2009-13. Despite the deterioration, western Europe remains well represented among the countries with the best business environments. It has five of the top ten countries and ten among the top 20. In part, this reflects the expectation that the anti-market backlash in policy choices will be relatively limited.

- The gap between the best (North America) and the worst (Middle East and Africa) overall performers has narrowed. However, within some regions, particularly Latin America, the gap between the stronger and poorer performers has actually widened.

- The largest emerging markets—Brazil, Russia, India and China (the BRICs)—score relatively poorly. Brazil is the best performer of the four, ranking 39th in the forecast period. China, however, records one of the biggest improvements—a jump in rank by 11 places from 56th in 2004-08 to 45th in 2009-13. This primarily reflects the fact that its economic performance will be so much better than any other country; China moves to first place in the market opportunities category in 2009-13.

- Most Asian countries remain attractive destinations for investment, although the overall business environment score falls between the historical and forecast periods in the three top-rated countries (Singapore, Hong Kong and Australia). More than one-half of the countries in the region see an improvement in the quality of their business environment in 2009-13. Low labour costs remain an important attraction for many countries.

- Asia's overall average business environment score between the forecast and historical periods deteriorates only marginally from 6.60 to 6.58. This reflects improvement in certain categories, as governments across Asia look to attract increased flows of foreign direct investment (FDI) and support their economies.

- The average business environment score for Latin America deteriorates slightly in the forecast period. One-half of the countries in the region suffers a decline in their overall score between 2004-08 and 2009-13. The current global recession will, in particular, have an adverse effect on those countries in the region that have failed to make progress in recent years on structural reforms.

- The decline in Venezuela's ranking is most significant; it drops from 70th place in the historical period to virtually the worst place in which to conduct business operations in the forecast period. Ecuador's decline in rank (from 68th to 78th) is also dramatic, while Argentina's ranking falls from 59th to 65th. These countries share a particularly high risk of a major financial crisis.

- The global crisis has hit eastern Europe very hard, and in the emerging world eastern Europe is the region most exposed to the global turmoil. Policy deficiencies in some countries have exacerbated this vulnerability. Real GDP in the region is forecast to contract in 2009 for the first time since 1998 and by more than at any time since the height of the transition recession in 1994, and more than in any other emerging-market region. A high degree of trade integration, large current-account deficits, heavy dependence on foreign private capital flows, the existence of credit/asset bubbles, significant volumes of foreign-currency loans and, in some cases, high dependence on commodity exports render many countries in the region vulnerable to macroeconomic crisis.

- The quality of business environments in eastern Europe either deteriorate in 2009-13 compared with 2004-08 (for seven out of the 16 countries in the region that are covered by our model), stagnate or improve only modestly—

certainly at a much slower rate of improvement in business environments than seemed likely at one stage.

Political stability is under threat

- Political stability in the region is at risk. Incomes are falling and unemployment is rising. Many countries in eastern Europe have characteristics that are associated with vulnerability to political upheaval: new and inexperienced states and bureaucracies; a history of unrest; intermediate regimes—that is, neither full democracies nor autocracies—that are the most prone to unrest; very high levels of popular dissatisfaction; and low levels of trust in political institutions. A total of 12 out of the 16 countries covered have an increased risk of social unrest in 2009-13 compared with 2004-08.

- The Middle East and North Africa (MENA) remains among the lowest-ranked regions. However, the gap with other regions is narrowing as other areas of the world feel the adverse effects of the global economic crisis more deeply. Only a few MENA countries are expected to experience an outright recession. Although the slowdown in growth across the region has had a dampening effect on scores for the categories of market opportunities and the macroeconomic environment, the scores have fallen by less than in other regions. Middle Eastern governments also remain broadly committed to reforms aimed at enhancing the role of the private sector as part of a strategy of economic diversification. However, progress in implementing these reforms is likely to continue to be slow.

- The average business environment score for Sub-Saharan Africa in 2009-13 is virtually unchanged compared with 2004-08. Expected improvements in Angola and Kenya offset a deterioration in the region's two largest economies, Nigeria and South Africa. The average quality of the region's investment environment will continue to be poor. However, for those companies that can master the complicated political environment and the difficult regulatory climate, rates of return are potentially high. This is especially the case in the oil producers, Angola and Nigeria.

Business environment rankings

	2009-13 Total score	Rank	2004-08 Total score	Rank	Change in total score	Change in rank
Finland	8.31	1	8.53	3	-0.22	2
Singapore	8.27	2	8.87	1	-0.61	-1
Canada	8.24	3	8.52	4	-0.28	1
Hong Kong	8.24	4	8.59	2	-0.36	-2
Switzerland	8.20	5	8.52	5	-0.31	0
Denmark	8.19	6	8.51	6	-0.32	0
Australia	8.08	7	8.20	11	-0.12	4
Sweden	8.00	8	8.21	10	-0.21	2
Norway	7.96	9	8.06	14	-0.10	5
Netherlands	7.91	10	8.33	8	-0.42	-2
New Zealand	7.88	11	8.19	12	-0.30	1
US	7.83	12	8.36	7	-0.53	-5
Germany	7.80	13	8.04	15	-0.24	2
Ireland	7.70	14	8.28	9	-0.58	-5
Chile	7.69	15	7.83	18	-0.14	3
Taiwan	7.66	16	7.65	20	0.01	4

Business environment rankings

	2009-13 Total score	Rank	2004-08 Total score	Rank	Change in total score	Change in rank
France	7.56	17	7.81	19	-0.25	2
Belgium	7.52	18	7.99	16	-0.47	-2
Qatar	7.50	19	7.17	27	0.33	8
Austria	7.47	20	7.95	17	-0.48	-3
Israel	7.29	21	7.36	23	-0.07	2
Czech Republic	7.24	22	7.29	24	-0.05	2
Spain	7.19	23	7.43	22	-0.24	-1
Estonia	7.19	24	7.50	21	-0.31	-3
UK	7.16	25	8.17	13	-1.01	-12
UAE	7.15	26	7.20	26	-0.04	0
South Korea	7.07	27	7.04	30	0.02	3
Japan	7.03	28	7.15	28	-0.12	0
Bahrain	7.02	29	7.09	29	-0.07	0
Slovenia	6.97	30	6.96	31	0.01	1
Slovakia	6.94	31	6.83	35	0.11	4
Poland	6.93	32	6.92	33	0.02	1
Malaysia	6.91	33	7.28	25	-0.37	-8
Cyprus	6.90	34	6.93	32	-0.03	-2
Mexico	6.79	35	6.78	36	0.02	1
Portugal	6.74	36	6.85	34	-0.11	-2
Hungary	6.65	37	6.73	37	-0.09	0
Thailand	6.51	38	6.62	38	-0.11	0
Brazil	6.49	39	6.47	40	0.02	1
Costa Rica	6.38	40	6.44	43	-0.06	3
Kuwait	6.37	41	6.36	44	0.01	3
Italy	6.36	42	6.47	41	-0.11	-1
Lithuania	6.33	43	6.53	39	-0.19	-4
Latvia	6.32	44	6.44	42	-0.12	-2
China	6.28	45	5.83	56	0.46	11
Peru	6.27	46	6.10	47	0.18	1
Saudi Arabia	6.25	47	5.95	53	0.30	6
Romania	6.19	48	6.03	49	0.16	1
Egypt	6.13	49	5.46	60	0.67	11
Bulgaria	6.09	50	6.06	48	0.02	-2
South Africa	6.05	51	6.34	45	-0.28	-6
Philippines	6.03	52	5.98	51	0.05	-1
Croatia	6.02	53	5.93	54	0.09	1
Colombia	6.01	54	5.95	52	0.06	-2
Greece	6.01	55	6.26	46	-0.24	-9
Turkey	5.99	56	5.80	57	0.19	1
Jordan	5.99	57	5.84	55	0.15	-2
El Salvador	5.96	58	6.01	50	-0.05	-8
India	5.75	59	5.42	62	0.33	3
Russia	5.74	60	5.73	58	0.01	-2
Tunisia	5.68	61	5.36	64	0.32	3
Indonesia	5.59	62	5.46	61	0.14	-1
Dominican Republic	5.56	63	5.20	66	0.37	3
Serbia	5.55	64	5.30	65	0.26	1
Argentina	5.54	65	5.62	59	-0.08	-6
Sri Lanka	5.51	66	5.39	63	0.12	-3

Business environment rankings

	2009-13 Total score	Rank	2004-08 Total score	Rank	Change in total score	Change in rank
Vietnam	5.33	67	4.92	71	0.41	4
Morocco	5.24	68	5.00	69	0.24	1
Bangladesh	4.96	69	4.74	73	0.22	4
Algeria	4.91	70	4.52	76	0.40	6
Pakistan	4.82	71	4.81	72	0.01	1
Kazakhstan	4.82	72	5.06	67	-0.25	-5
Azerbaijan	4.67	73	4.60	74	0.07	1
Libya	4.59	74	4.41	77	0.18	3
Ukraine	4.54	75	4.59	75	-0.05	0
Cuba	4.51	76	4.28	79	0.23	3
Kenya	4.50	77	4.23	80	0.27	3
Ecuador	4.34	78	5.03	68	-0.69	-10
Nigeria	4.30	79	4.41	78	-0.11	-1
Iran	4.29	80	3.77	81	0.52	1
Venezuela	4.05	81	4.99	70	-0.94	-11
Angola	3.89	82	3.65	82	0.24	0
Average	**6.41**	**–**	**6.47**	**–**	**-0.06**	**–**
Median	**6.37**	**–**	**6.45**	**–**	**-0.09**	**–**

The medium-term economic outlook

Global outlook

(%)	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Real GDP growth (PPP exchange rates)										
World	**4.8**	**4.4**	**5.0**	**5.0**	**3.0**	**-1.8**	**1.9**	**3.4**	**3.9**	**4.1**
OECD	3.2	2.6	3.1	2.7	0.9	-4.0	0.2	1.6	2.0	2.2
Non-OECD	7.7	7.4	8.1	8.7	6.2	1.3	4.2	5.8	6.3	6.4
Real GDP growth (market exchange rates)										
World	**4.0**	**3.5**	**4.0**	**3.8**	**1.9**	**-3.0**	**0.9**	**2.4**	**2.9**	**3.1**
North America	3.6	2.9	2.8	2.1	1.1	-3.2	0.6	1.5	1.9	2.1
Western Europe	2.5	2.1	3.1	2.7	0.7	-4.1	-0.5	1.2	1.7	1.9
Eastern Europe	6.7	5.7	7.4	7.3	4.6	-4.0	1.6	3.7	4.2	4.7
Asia & Australasia (incl Japan)	5.4	5.0	5.5	6.0	3.0	-2.3	2.5	3.9	4.4	4.5
Latin America	5.8	4.6	5.6	5.5	3.9	-2.5	1.3	3.4	4.0	4.0
Middle East & North Africa	6.6	5.7	5.7	5.9	5.8	1.5	2.8	4.8	5.5	5.5
Sub-Saharan Africa	5.7	6.5	6.5	6.3	4.7	-1.0	3.0	4.9	5.0	4.7
Inflation (av; %)										
World	**2.8**	**3.0**	**3.2**	**3.4**	**4.9**	**1.1**	**2.1**	**2.7**	**2.9**	**2.9**
Trade in goods										
World	**10.8**	**7.5**	**9.1**	**7.1**	**3.3**	**-8.2**	**1.3**	**4.6**	**5.2**	**5.7**

Source: Economist Intelligence Unit.

Introduction

The short- and medium-term economic outlook will be dominated by the current global economic and financial crisis and its repercussions. The economic downturn is the main reason that the global business environment is expected to deteriorate in 2009-13 compared with 2004-08. According to the Economist Intelligence Unit's baseline forecast, in 2009-13 annual average global growth, measured at purchasing power parity (PPP) exchange rates, will be only half the rate achieved in the previous five years—2.3% compared with 4.6% respectively. At market exchange-rate weights, annual average growth is forecast to be only 1.3% in 2009-13, compared with 3.4% in 2004-08.

Much of the slowdown is, of course, the result of the deep and synchronised global recession in 2009, the worst since the end of the second world war, and the very tepid recovery expected in 2010. But performance in 2011-13 is also expected to be well below trend. In no year during the forecast period will annual world growth be anywhere near even the lowest rate recorded during the 2004-07 boom (which was 4.4% in 2005 at PPP and 3.5% at market exchange rates; in 2013 we forecast growth of 4.1% at PPP and 3.1% at market exchange rates).

Global trade is set to contract dramatically this year

A dramatic contraction in the volume of world trade (by about 8% in 2009) is another telling sign of the global recession. Even if a descent into serious protectionism is averted (as we expect will be the case—see the article in this volume, *The global business environment and the risks of trade protectionism*), world trade will recover only slowly, to a forecast increase of only 1.3% in 2010. The annual average rate of growth in world trade was 7.5% in 2004-08. The enormous decline in 2009 means that annual average trade growth in 2009-13 is forecast to be only 1.6%. This also means that, for the first time in decades, growth in world trade will lag behind growth in world GDP. This implies, again for the first time in decades, that the share of trade in world GDP will decline—a poignant illustration of this report's main theme of stalled globalisation.

Similarly, foreign direct investment (FDI) flows—the "cutting edge" of globalisation—are set to decline sharply in 2009 on the back of a slump in global crossborder mergers and acquisitions (M&A)--by more than one-third in US dollar terms, to less than US$1trn. The recovery in FDI flows in 2010-13 is expected to be very slow, given weak output recovery, impeded access to finance, and prevalent caution and risk aversion. Even by the end of the period, FDI inflows will fall well short of the high of US$1.9trn recorded in 2007.

Recession rather than depression

The world is experiencing a "Great Recession" rather than a "Great Depression", thanks to policy action on an unprecedented scale. Interest rates have been cut dramatically in all major countries and unorthodox measures such as quantitative easing (increased central bank purchases of various types of assets to increase the money supply) are now a cornerstone of policy in the US, and other developed economies are following suit. The major economies will all implement significant fiscal stimulus packages. The developed world's budget deficits will, on average, reach almost 9% of GDP next year, six times higher than before the crisis. In February 2009 the US government approved a stimulus package of US$787bn, or 5.5% of GDP (to be disbursed mainly over the next two years). In December 2008 the EU reached an agreement to provide a fiscal stimulus package worth around €200bn (US$266bn), or around 1.5% of the region's GDP. In early April this year, the Japanese government announced new stimulus measures worth some 2% of GDP, in addition to already approved measures of 2.4% of GDP. A number of emerging markets, most notably China, have also taken aggressive fiscal policy action.

Expectations of a recovery are premature

Following months of almost unrelieved gloom and bad news, some recent indicators in many parts of the world suggest that the worst of the recession may be coming to an end, and some observers have even begun to talk of an imminent global recovery. In the US, recent data on home sales, housebuilding and consumer spending have been more encouraging. There has been at least a partial normalisation of financial markets in many countries. Confidence indicators are improving and China's growth has held up. Recent data at least do not replicate the near-catastrophic output and trade data reported in recent months in many parts of the world. The rate of decline appears to be decelerating, with some prospects of a bottoming out. However, any sort of recovery, let alone a sustained one, is still some way off. Global growth is unlikely to return to potential for years.

The baseline forecast

Our baseline forecast assumes that growth will gradually resume and then pick up in the latter part of the forecast period. The massive short-term stimulus packages alone cannot drive growth in the medium term, but are likely to spark at least some autonomous private-sector uptick. Entrepreneurs will gradually rediscover their "animal spirits" as confidence begins to return. The risk appetite of investors is expected to be at least in part restored. The recovery of global trade late in the forecast period will eventually boost growth prospects, especially of emerging markets.

Investors from the developed world will in time again seek to outsource production and services to lower-cost destinations in the developing world. Although growth in the developed world will remain below trend throughout the forecast period, growth in emerging markets is expected to recover more strongly, but will remain generally below the rates achieved before the crisis.

Emerging Asia will again be the world's fastest-growing region in 2010-13, but in 2009 it loses the top slot to the Middle East and North Africa (MENA) region as its openness to trade has left it highly exposed to the recession in the developed world. Eastern Europe has been hit hard by the recession in the euro area, low commodity prices and the vulnerability created by massive imbalances in many countries in the region. It will suffer the most severe income contraction among emerging-market regions in 2009. Latin America will also be hit by the downturn in its main export markets (with several countries highly exposed to the US), the sharp deterioration of global financial conditions and the collapse of commodity prices. Growth in Sub-Saharan Africa will soften more moderately, as it is less integrated in the global financial and commercial system, but will also contract in 2009.

Reasons for caution abound

There is, nevertheless, a host of reasons why our baseline forecast is for only a slow and subdued global recovery. High unemployment and low investment over the next few years, as well as the consequences of higher public debt burdens, will reduce economies' medium- and longer-term growth potential. There are other contributing factors:

- the specific nature of the current recession, which stems from a major financial crisis;
- the need to rebuild balance sheets and reduce inflated private-sector debt levels in many countries as well as the need to increase savings rates;
- the negative impact on medium-term public finances of current stimulus packages and financial sector support;
- adverse developments in regulatory trends and state involvement in the economy;
- the limited scope for countries to "export their way" out of the downturn;
- the impact of depressed property markets;
- the likelihood that access to credit will be restricted for some time; and
- depressed crossborder capital flows.

A specific recession

The current downturn is marked by the fact that it stems from a deep financial crisis. This does not augur well for the prospects of a quick and strong recovery. In a recent study, the IMF examined 122 recessions in the developed world since 1960. In recessions brought on by financial crises, private investment usually continues to fall even after the lowest point in the downturn; at the same time consumer spending grows more slowly than is the case in other recoveries. Historical experience shows that recovery from recession tends to be slower the more countries are simultaneously affected.

The financial crisis is not over

The financial crisis in the developed world is far from over. Banks have been saved and supported with public money, but their balance sheets have not been cleaned up. Banks will experience further problems and losses as the recession boosts bankruptcies. According to IMF estimates, losses for banks and other financial institutions in the US and western Europe could rise to some US$4trn. This means that financing conditions will continue to be tight at least for the next two years, with only a gradual easing in subsequent years.

The risk appetite of investors and entrepreneurs is expected to increase in the latter half of the forecast period, but is unlikely to return to the levels seen before the current crisis. This means that risky but potentially high-growth projects—whether in uncertain but promising cutting-edge technologies or in volatile but low-cost emerging-market production facilities—will continue to find financing difficult. This could hamper productivity growth well beyond the forecast period.

One of the consequences of the earlier availability of easy and cheap credit was a surge in house prices and construction in most developed and many emerging economies. While concerns about property markets have focused on residential real estate in the US and to a lesser extent the UK, house prices are excessive in a broader range of economies. The channels through which this will affect the real economy will differ between countries. In most of western Europe, for example, the impact of residential housing wealth on private consumption is much weaker than in the US or the UK, but the impact on residential investment and on the health of the banking system could still be significant.

Consumer spending and firms' investment will be constrained by the need to pay back debt and restore savings. The turmoil in financial markets has hit private consumption. Consumers, particularly in the US and the UK, are over-extended. Households need to increase the share of their income going to savings to make up for insufficient saving in the recent past and for losses incurred as a result of the crisis. The household savings rate has already risen substantially in the US to around 4-5%. This is the highest level since 1998, but a substantial further rise is probably necessary, which together with weak income growth will undermine consumption.

Public debt will soar because of weak growth, the stimulus spending and the costs of cleaning up the financial systems. The impact on public finances stemming from these factors will be exacerbated by the effects of some long-standing trends, such as the fiscal impact of the ageing of populations in most developed economies. The result will be increased tax burdens, which will hurt business and restrain entrepreneurship, and less scope for public spending on infrastructure.

Constraints on emerging markets

Given the nature of the current crisis and depressed demand in the developed world (which will not revive significantly any time soon), emerging markets will not be able to export their way out of their recessions or slowdowns. The groundwork for the recovery will have to be laid at home, at least in the big economies. This normally takes much longer than export-driven recoveries. The ability of emerging-market governments to support their economies through fiscal stimulus is limited and sustainable debt limits for these countries tend to be much lower than in the developed world.

Emerging markets strongly dependent on external financing will suffer from the deleveraging of global finance. According to IMF data, emerging-market borrowers need to roll over some US$1.8trn worth of debt falling due this year (much of that is in eastern Europe). Bank rescue packages in the developed world also threaten to curtail further crossborder capital flows because many Western banks are under pressure to engage in financial protectionism—to give priority to domestic lending at the expense of foreign operations. Although IMF support funds will help to stabilise countries, there is still a significant chance of financial crises in some countries. Even if emerging markets escape debt crises, investors' confidence is likely to remain dented for years.

Forecast risks

There are a number of downside risks to our baseline outlook. First, the various stimulus packages may not trigger an autonomous recovery. Importantly, fiscal easing cannot boost growth permanently if it does not kick-start, or is not accompanied by, a recovery in autonomous private demand. The stimulus would have to be renewed, and indeed increased further, for medium-term growth to be lifted. However, this would scarcely be possible in many countries given the sharp deterioration of public finances as a result of the economic crisis and the need to bolster financial systems (with a lot more than the amount spent likely to be needed over the next two years).

There is also a risk that efforts to stabilise financial markets will not yield expected results. This would cause even more drastic cuts in lending to households and companies and even greater disruptions to the real economy. Another risk is that the decline in global demand will trigger a deflationary spiral, with dire consequences for borrowers.

Thus the overriding risk is that the global economy descends into a depression rather than a short-term recession, followed by a slow recovery, as under our baseline forecast. In such circumstances, the developed world, as well as much of the developing world, would enter a lengthy vicious cycle of deflation, renewed financial turmoil and probably also serious protectionism, which would greatly exacerbate negative trends in world trade and investment.

The global business environment and the risks of trade protectionism

Protectionism appears to be on the rise, sounding alarm bells around the world for proponents of free trade. The Economist Intelligence Unit believes that a significant and sustained increase in global trade barriers is unlikely, but the recent spate of protectionist measures introduced by many governments to support their domestic industrial and financial sectors carries a definite risk that should not be ignored. Policymakers will continue to face pressures to protect domestic employment as the global economy contracts. If serious protectionism were to take hold, the consequences for the global economy would be dire.

Protectionism is on the rise

The world trade environment has worsened significantly over the past six months. According to the World Bank, since the G20 leaders signed a pledge in November 2008 to avoid protectionist measures, several countries, including 17 of the G20, have implemented a total of 47 measures that restrict trade (as of end-March 2009). Another 78 protectionist measures have been proposed, but have not been implemented—at least until now. The World Trade Organisation (WTO) has also noted a "significant slippage" globally towards trade protectionism. Since the start of 2009, increases in tariffs, the introduction of new non-tariff barriers and anti-dumping actions have increased considerably, as governments have reacted to the rapid descent into global recession. In addition, some of the financial rescue and fiscal stimulus packages adopted by governments contain elements such as state aids, subsidies and purchase requirements favouring domestic goods and services over imports. The WTO identifies 85 measures that can be considered to be protectionist, imposed by 23 countries between September 2008 and March 2009.

Business certainly seems to expect or be braced for more protectionist policies from governments. A recent Economist Intelligence Unit survey of 418 global executives (see *Risk and regulation: A new era for capitalism*) showed that an astonishing 87% of respondents believed that protectionism would increase, although fewer than 30% seemed completely convinced, and the question did not specify the expected severity of the retreat from globalisation. In the sample, 28% "agreed strongly" and 59% "agreed slightly" with the statement, "On balance, the current downturn will lead to more protectionism by government."

Recent examples of protectionism include Russia raising tariffs on used car imports and Ecuador raising tariffs on more than 600 items. Non-tariff measures include such policies as Argentina's imposition of new licensing requirements on automotive parts, textiles, TVs, toys, shoes and leather goods, or Indonesia's requirement that transport of five categories of goods (including garments, footwear, toys, electronics, food and beverages) be permitted in only five ports and airports.

Worldwide, increases in tariffs that directly contravene WTO rules remain rare. Governments today are much less likely to resort to increases in tariffs than in the 1970s, and certainly less so than during the Great Depression in the 1930s, when unilateral hikes in tariffs contributed to a two-thirds decline in world trade. Currently, almost three-quarters of all trade occurs within customs unions or free-trade areas, such as the North America Free Trade Agreement (NAFTA) or the EU, or between OECD countries. Within these areas, trade occurs either entirely without tariffs, or according to WTO rules. In other words, for almost 75% of all global trade, tariff increases could only take place in violation of rules and regulations, with a strong risk of incurring fines or punitive sanctions. Nevertheless, that still leaves 25% for which the risk of rising tariffs remains significantly real. However, even for non-tariff or low-tariff areas, the risk of non-tariff protection remains a potential threat.

Outside of these low- or non-tariff areas, the risk of seeing a renewed increase in tariffs is high. In recent years, many emerging markets have in fact unilaterally reduced their tariffs further than they were bound to under the GATT agreement (the Uruguay round). These countries can freely raise their tariffs to these bounds, and some countries, such as Turkey and India, have already done so. An estimate by the European Commission assesses that the total loss to global trade from such measures could reach €400bn (US$530bn). To date, most countries have not yet raised tariffs to bound levels or taken full advantage of headroom on agricultural subsidies. However, as the recession deepens, many countries may be tempted. This threat underscores the importance of pushing forward with a rapid conclusion of the Doha round.

The main threat to global trade is likely to arise from non-tariff barriers. Examples abound. This includes the massive subsidies earmarked for the automotive industry in developed countries. According to Deutsche Bank, subsidies worth US$43bn have already been allocated worldwide. The US administration has transferred more than US$17bn to US car manufacturers, and governments in Japan, France, the UK, Sweden and Brazil have spent US$20bn in direct aid to their automotive industries.

The recent controversy over the original "Buy American" provision included in the US's wide-ranging fiscal stimulus package—a requirement for US firms to use domestic steel and manufacturing products in projects funded by the stimulus bill—highlighted the political pressures now in play. The clause has since been substantially watered down following criticism from the EU, Japan and Canada (among others), and after some of the US's main trading partners made implicit threats of retaliatory action.

Trends in the EU

A commitment to free trade, certainly among its members, remains one of the main pillars of the EU. However, although it has not broken any WTO rules yet, the EU has resorted to some protectionist measures. It has reintroduced customs duties on imports of certain cereals (the duties had been suspended in January 2008, when commodity prices were soaring). It has also reintroduced export subsidies for butter, cheese, and whole and skimmed milk powder. This is particularly serious given the decision in principle by WTO members to eliminate export subsides for agricultural exports if and when the Doha round of trade liberalisation talks is concluded. Such subsidies drive down prices for producers in developing-country markets (which are usually able to produce at costs below those of the West), where governments do not have the means to subsidise their farmers.

The EU has initiated a number of new anti-dumping investigations since the middle of 2008 and imposed new duty orders (duties imposed on imports following an investigation that shows that dumping is taking place) stemming from earlier investigations. Anti-dumping duties are a means of protecting a market from unfair practices of foreign producers, such as below-cost selling. That said, given the inherent difficulty in determining whether an item produced in another jurisdiction is being sold at below cost, resorting to this mechanism with increasing frequency amounts to protectionism.

A significant threat is now also emerging to the EU's own internal market. Statements earlier this year by both the French president, Nicolas Sarkozy, and Peer Steinbrück, the German finance minister, suggested that their governments would extend state aid to their respective country's automotive sectors in a way that would discriminate against foreign producers. However, so far there have been no moves in the EU to undermine the customs union established in the 1960s nor to reimpose non-tariff barriers on goods, which were eliminated over the period 1986-92. But a genuine internal market requires a level playing field in which competition rules are upheld, and one of the key aspects of competition policy is to ensure that state aid does not significantly distort competition.

The baseline scenario

There is clearly much evidence of a disturbing trend towards protectionism in many parts of the world in response to the economic crisis. Nevertheless, the Economist Intelligence Unit's baseline scenario for the global business environment over the next five years—as reflected in the business environment rankings—does not predict a slide into serious protectionism. On average, the score for tariff and non-tariff protection within the foreign trade and exchange controls category rises marginally, from 3.5 to 3.6 (on a scale from 1 to 5, with higher scores indicating greater openness or less protection). However, it is also important to note that prior to the crisis the expectation would have been for a much more significant increase in the average score for this indicator. The BER model thus embodies the expectation that trade liberalisation will come to halt in the medium term, rather than be subject to outright reversal or regression. That said, there are some cases in which countries register an outright fall in the score for trade protectionism during the forecast period; these include the US, Canada, Argentina, Ecuador, Azerbaijan and Kazakhstan.

A number of factors are expected to mute protectionist pressures. Countries today are far more interdependent than in the past, being connected through supply chains. Export lobbies now wield more power. Producers for domestic markets are more reliant on imported inputs and production chains connect global markets through a web of trade in parts and components (this type of trade has more than doubled as a share of total trade since 1970). According to the World Bank, the simple average of trade/GDP ratios is 96% today compared with 55% in 1970.

In addition, successive GATT/WTO agreements have provided much greater legal stability for trading relations. This increases the likelihood that many proposed trade restrictions will be rejected or not enacted. In Brazil, for example, the bureaucracy attempted to impose widespread licensing arrangements and import controls reminiscent of the 1970s, only to provoke a response of outrage from the private sector that led to immediate reversal. In today's world, the benefits of freer trade for growth and development are generally better understood, and accepted globally, than ever before.

The risks are real

Nevertheless, despite the factors that underpin our baseline forecast, there is no cause for complacency. The risks of protectionism are significant. With unemployment rising, governments are coming under increasing political pressure to protect domestic jobs. This, in turn, is leading to measures to support those industries suffering in particular from the downturn. The clearest examples so far have been the automotive and financial services sectors. With public finances already under strain in many countries, it is hardly surprising that governments want to see their stimulus packages benefiting voters and companies in their own countries. Populist appeals to protectionist sentiment will be persistent. Politicians struggling to develop a coherent policy response to the crisis, and in many cases also wrestling with falling popularity ratings because of the worsening economic climate, can exploit the fact that foreign trading partners are an easy target.

Even before the current crisis, globalisation was under threat from a variety of sources. The bursting of the dotcom bubble, September 11th and corporate scandals dampened spirits and altered attitudes. The rise of China and India had already strengthened protectionist forces, and there have been growing signs of an emergent backlash against liberalising trends that in some cases has been directed towards foreign direct investment (FDI).

The danger to globalisation has now increased many times over. A global beggar-thy-neighbour rush to trade protectionism would lead to a much stronger contraction in world trade than we currently forecast and would contribute to a further overall deterioration in the global business environment. Amid the current general retreat from free markets and liberalisation, the potential damage to the global business environment and to longer-term economic growth prospects cannot be underestimated, were there to be a descent into significant and sustained protectionism around the world.

Regional business environment summaries

Western Europe

Business environment scores and rankings

	2004-08 Total score (out of 10)	Global rank (out of 82)	2009-13 Total score (out of 10)	Global rank (out of 82)	Change in total score	Change in rank
Austria	7.95	17	7.47	20	-0.48	-3
Belgium	7.99	16	7.52	18	-0.47	-2
Cyprus	6.93	32	6.90	34	-0.03	-2
Denmark	8.51	6	8.19	6	-0.32	0
Finland	8.53	3	8.31	1	-0.22	2
France	7.81	19	7.56	17	-0.25	2
Germany	8.04	15	7.80	13	-0.24	2
Greece	6.26	46	6.01	55	-0.24	-9
Ireland	8.28	9	7.70	14	-0.58	-5
Italy	6.47	41	6.36	42	-0.11	-1
Netherlands	8.33	8	7.91	10	-0.42	-2
Norway	8.06	14	7.96	9	-0.10	5
Portugal	6.85	34	6.74	36	-0.11	-2
Spain	7.43	22	7.19	23	-0.24	-1
Sweden	8.21	10	8.00	8	-0.21	2
Switzerland	8.52	5	8.20	5	-0.31	0
Turkey	5.80	57	5.99	56	0.19	1
UK	8.17	13	7.16	25	-1.01	-12
Regional average	**7.67**	**-**	**7.39**	**-**	**-0.28**	**-**

Source: Economist Intelligence Unit.

Long-term trend of improvement reverses

There is a significant decline in the average score for western Europe between the historical and forecast periods. In few other regions is it as evident that the long-term trend, whereby environments in which companies operated gradually improved, is being partly reversed under the impact of the global financial and economic crisis. The effects on business environments in the medium term will be both direct, by reducing market opportunities for example, and indirect, as government policy adjusts by, for instance, raising taxes to reduce public debt.

The profundity of the ongoing economic crisis has resulted in significant declines in scores for the forecast period (2009-13). All countries in the region, with the sole exception of Turkey, register a fall in 2009-13 compared with their score for the historical period (2004-08). Those countries that have seen the largest decline in scores are those that experienced asset bubbles, those whose governments are dependent on foreign financing and those with large financial services industries. As the UK economy has all three of these attributes, its score in the forecast period falls most, resulting in a sharp slide in its ranking to 25th globally in 2009-13 compared with 13th in 2004-08. Ireland registers the second-largest decline in its score, owing to the magnitude of its property market reversal and an explosion of public debt. Its global ranking in the forecast period falls to 14th from 9th in the historical period.

Countries that see an improvement in their rankings in the forecast period are those where credit growth has been more modest, current accounts have been balanced or in surplus and the financial sector is not large relative to GDP. Norway, which has all these characteristics as well as huge public savings from oil revenue, is ranked 5th regionally (up from 8th in the historical period). Finland, ranked first in the western Europe region for both the historical and forecast periods, overtakes Singapore and Hong Kong in the global rankings, to take top spot internationally. France, Germany and Sweden have also seen their global rankings for the forecast period rise by two places compared with the historical period.

Market opportunities, economic stability and financing deteriorate

The rapid deterioration in the average scores across the region for three categories of the rankings—market opportunities, the macroeconomic environment and financing—account for the decline in overall scores between the historical and forecast periods. The largest decline in average score is for market opportunities, from 6.5 in the historical period to 5.1 in the forecast period. This reflects the extreme nature of the contraction in demand across the region in the early part of the forecast period, as well as the drag on growth from longer-standing issues such demographic decline, that will limit market growth. Although Europe remains among the most economically stable parts of the world, its average macroeconomic environment score falls from 8.0 in the historical period to 7.0 in the forecast period. Much of the decline is the result of a widening of budget deficits and large expected increases in government debt. During the current crisis, fiscal stabilisers and stimulus plans will result in the opening up of substantial deficits. This means that a large additional amount will be added to the already large stock of public debt in the region. Falls in asset prices in most countries will add to instability.

The third major factor that accounts for the deterioration of the business environment is the prospect of more challenging financing conditions. The financial crisis in the developed world has demonstrated that levels of credit and leverage once considered sustainable are in fact anything but sustainable. As the financial system restructures, deleverages and adapts to stricter regulation, the flow of funds to businesses will be considerably tighter in the future than in the recent past.

A long-standing feature of the business environment in many west European countries has been the onerous tax burden (which is higher than in any other region in the world). Many of the EU's west European members have presided over modest reductions in their tax burdens in recent years, but the precariousness of their budgetary positions and the costs associated with recession and banking bail-outs will push the tax burden back up as a share of GDP over the forecast period. Large variations in both direct and indirect tax rates will persist across EU countries. With most member states trying to reduce non-wage labour costs (which have contributed to high levels of unemployment in many countries in the region), a continued trend across much of Europe will be to reduce the burden of social security contributions as well as income and corporation tax, and to pay for these with increases in indirect taxes (including environmental taxes). Despite periodic pressure from high-tax countries, a harmonised rate of corporation tax at EU level is not expected, although a common tax base may be agreed.

Another salient characteristic will continue to be the inflexibility of some countries' labour markets, which will be saddled with short working hours, high costs of dismissal (which discourage employers from hiring workers) and sometimes rigid wage-bargaining structures that compress wage differentials. Reforms are taking place in some countries and can be expected to continue over the next five years, but these will be incremental at best. Voters' attachment to social protection will hamper reform efforts. With governments reluctant to take the political risk of reducing the privileges of labour-market "insiders", a two-tiered labour market will continue to exist in some countries, consisting of old jobs with high levels of social protection and newer part-time or temporary jobs with less protection.

West European countries will still have solid environments

Despite the negatives, western Europe remains well represented in the global top 20, accounting for half of the highest-ranked countries. This reflects the high degree of political stability in the region and the expectation that there will not be a significant anti-market backlash in policy choices. More specifically, factors supporting business environments across the region will be the gradual EU-wide liberalisation of sectors previously dominated by state monopolies, notably in gas and electricity distribution. Domestic structural reforms of product and labour markets will come to a halt in many countries, at least during the early part of the forecast period, but the logic of reform should reassert itself later in the forecast period. Political interference, meanwhile, may impede crossborder corporate consolidation in certain sectors that are considered strategic. The risks of such interference are rising considerably as the European economy goes into recession, and some incidents have already been recorded.

Asia-Pacific

Business environment scores and rankings

	2004-08 Total score (out of 10)	Global rank (out of 82)	2009-13 Total score (out of 10)	Global rank (out of 82)	Change in total score	Change in rank
Australia	8.20	11	8.08	7	-0.12	4
Bangladesh	4.74	73	4.96	69	0.22	4
China	5.83	56	6.28	45	0.46	11
Hong Kong	8.59	2	8.24	4	-0.36	-2
India	5.42	62	5.75	59	0.33	3
Indonesia	5.46	61	5.59	62	0.14	-1
Japan	7.15	28	7.03	28	-0.12	0
Malaysia	7.28	25	6.91	33	-0.37	-8
New Zealand	8.19	12	7.88	11	-0.30	1
Pakistan	4.81	72	4.82	71	0.01	1
Philippines	5.98	51	6.03	52	0.05	-1
Singapore	8.87	1	8.27	2	-0.61	-1
South Korea	7.04	30	7.07	27	0.02	3
Sri Lanka	5.39	63	5.51	66	0.12	-3
Taiwan	7.65	20	7.66	16	0.01	4
Thailand	6.62	38	6.51	38	-0.11	0
Vietnam	4.92	71	5.33	67	0.41	4
Regional average	**6.60**	**-**	**6.58**	**-**	**-0.02**	**-**

Source: Economist Intelligence Unit.

The deterioration in the outlook for the global economy has had a big impact on the business environment in Asia. Seven of the 17 Asian countries covered by our model suffer a fall in their business environment scores between the historical and the forecast periods. The global rank declines for six Asian countries and rises in the case of nine countries in the region. Asia has the third-best average business environment—ahead of the Middle East and North Africa, Latin America, eastern Europe and Sub-Saharan Africa, but behind both North America and western Europe.

There are huge differences between the worst and best regions in Asia

For a region as large and diverse as Asia, unsurprisingly there are huge differences in countries' overall scores. Although the overall business environment score falls between the historical and forecast periods in the three top-rated countries (Singapore, Hong Kong and Australia), the gap between these and the worst-scoring countries in the region (Bangladesh and Pakistan) remains huge. The largest improvements in score between the two periods are in the region's three most dynamic and fastest-growing countries: China, India and Vietnam. China records one of the biggest improvements globally—a jump in rank by 11 places from 56th in 2004-08 to 45th in 2009-13.

Meanwhile, the trade-exposed economies of Hong Kong, Malaysia and Singapore have the biggest falls in their scores. Exports play a vital role in all three of these economies, and the sudden collapse in export demand is having a devastating impact on economic growth this year. Despite the fact that the global crisis is forecast to have an impact on every country in Asia, some economies will be less badly affected.

As in most other regions, market opportunities is the category that deteriorates the most in the forecast period. This category has a number of indicators, including the level and rate of growth of GDP, trade growth, the extent of regional integration as well as proximity to major trading partners. Asia's average score for this category falls from 6.4 in the historical period to just 5.0 in the forecast period, while its global ranking falls from 3rd to 4th position. The main cause of the steep fall is the much bleaker outlook for both real GDP growth and trade growth than in the recent past. Both GDP growth and trade growth are forecast to fall sharply in the early part of the forecast period, amid a sharp drop in global demand. Although the score in the market opportunities category falls for all countries in Asia, the most open economies—Hong Kong, Singapore, South Korea, Taiwan and Japan—record the sharpest declines. Asia, however, also has two of the world's highest-scoring countries in this category—China, which rises to 1st place for market opportunities in the forecast period, and India, which is ranked 4th in 2009-13.

Political risk increases, amid rising unemployment and increased hardship

Another category in which many Asian countries score poorly is political stability. Asia's global ranking for this category falls from 4th in the historical period to 5th in the forecast period, while its score falls from 6.5 to 6.1. The deterioration reflects an increasing risk of political unrest caused by the severe economic downturn, which has led to rising unemployment and increased economic hardship. It also reflects increasing risks in a number of countries, which might have occurred regardless of the economic crisis. The fall in Japan's rank, for example, reflects the electorate's growing disillusionment with the ruling Liberal Democratic Party, which has dominated Japanese politics for over half a century. In Malaysia, there are signs that the monopoly on power held by the ruling United Malays National Organisation (UMNO, the dominant party within the ruling Barisan Nasional, or BN, coalition) may be coming to an end.

Despite the big falls recorded in the scores for a number of categories, Asia's overall average business environment score between the forecast and historical periods deteriorates only marginally from 6.60 to 6.58. Many governments across Asia are looking to improve areas of their business environment in a bid to attract increased flows of foreign direct investment (FDI) and support their economies. Indeed, Asia's score rises in six of the ten different categories. The category where the score rises the most is in the area of infrastructure, 6.0 to 6.7, and the global ranking rises from 4th to 3rd. Part of the reason for the big improvement in this category is the economic stimulus plans that governments across the region have announced in order to support their economies through the current downturn, many of which have a heavy infrastructure bias.

Latin America

Business environment scores and rankings

	2004-08 Total score (out of 10)	Global rank (out of 82)	2009-13 Total score (out of 10)	Global rank (out of 82)	Change in total score	Change in rank
Argentina	5.62	59	5.54	65	-0.08	-6
Brazil	6.47	40	6.49	39	0.02	1
Chile	7.83	18	7.69	15	-0.14	3
Colombia	5.95	52	6.01	54	0.06	-2
Costa Rica	6.44	43	6.38	40	-0.06	3
Cuba	4.28	79	4.51	76	0.23	3
Dominican Republic	5.20	66	5.56	63	0.37	3
Ecuador	5.03	68	4.34	78	-0.69	-10
El Salvador	6.01	50	5.96	58	-0.05	-8
Mexico	6.78	36	6.79	35	0.02	1
Peru	6.10	47	6.27	46	0.18	1
Venezuela	4.99	70	4.05	81	-0.94	-11
Regional average	**5.89**	**-**	**5.80**	**-**	**-0.09**	**-**

Source: Economist Intelligence Unit.

As is the case elsewhere, the current global crisis will have a short- and medium-term impact on Latin America. The average business environment score for the region deteriorates slightly in the forecast period. Half the countries in the region are expected to suffer a decline in their overall score between 2004-08 and 2009-13. The current global recession will, in particular, have an adverse effect on those countries in the region that have failed to make progress in recent years on structural reforms.

Difference between best and worst performers will widen

The differential between Latin America's best and worst performers widens. Venezuela's decline is most significant; it drops from 70th place in the historical period (2004-08) to virtually the worst place in which to conduct business operations in the forecast period (2009-13). Ecuador's decline in rank (from 68th to 78th) is also dramatic, while Argentina's ranking weakens from 59th to 65th. These countries share a particularly high risk of a major financial crisis.

Venezuela's business environment will remain extremely poor, owing to a high level of uncertainty for investors—the president, Hugo Chávez, has nationalised many industries in the past two years. Likewise, in Ecuador, heightened uncertainty about the content of a new constitution and its impact on business will undermine the already weak investment climate. The global recession in the early part of the forecast period, heightened risk aversion and deteriorating terms of trade affect Argentina's business environment. Deteriorating fiscal and financing conditions and rising political uncertainty heighten the risk of a new sovereign default or devaluation.

In contrast, those countries that have managed to accumulate fiscal savings during recent years of booming commodity prices are in a much better position to shore up their domestic economies through countercyclical fiscal measures and monetary easing. At the top end, although it suffers some deterioration in its business environment score, Chile will continue to lead the regional league in terms of its attractiveness as a business destination, and also maintains its high global ranking (15th). Its long-running commitment to economic liberalisation and structural reform is unlikely to be brought into question.

Both Peru and Colombia will benefit from recent progress, with the former developing an investor-friendly policy environment and the latter gaining from success in improving the security environment. This will help to protect against weaker global conditions during the forecast period. Yet both retain significant deficiencies; for Peru, political effectiveness remains a problem, while deterioration in the fiscal accounts exposes the deficiencies of Colombia's complex and inefficient tax system.

Little change for Brazil and Mexico

The scores for the region's two largest markets, Brazil and Mexico, remain virtually unchanged between the historical and forecast periods. Their attractiveness as investment locations remains underpinned by the large size of their markets. For Brazil, its extensive network of free-trade agreements (FTAs) and a large internal market ensures that it remains an attractive investment location, even though domestic economic conditions will be extremely weak in the first half of the forecast period. Pro-business measures adopted under the administration of Felipe Calderón—although watered down—will begin to take effect later in the forecast period. This explains the relative strengthening of the business environment in comparison to Brazil, whose ranking deteriorates marginally. Brazil has attracted an increasingly diverse array of investors in recent years, but low institutional effectiveness, a complex and burdensome tax system, and labour market and infrastructure deficiencies prevent it from moving up the global rankings.

Although Cuba remains the country least affected by the global economic slowdown in the region, it retains one of the world's least attractive business environments. Its low ranking is largely a result of the high degree of state control and tight restrictions on the private sector owing to the government's ideological hostility to the development of private businesses. In spite of some easing, foreign investment will remain closely controlled.

Eastern Europe

Business environment scores and rankings

	2004-08 Total score (out of 10)	Global rank (out of 82)	2009-13 Total score (out of 10)	Global rank (out of 82)	Change in total score	Change in rank
Azerbaijan	4.60	74	4.67	73	0.07	1
Bulgaria	6.06	48	6.09	50	0.02	-2
Croatia	5.93	54	6.02	53	0.09	1
Czech Republic	7.29	24	7.24	22	-0.05	2
Estonia	7.50	21	7.19	24	-0.31	-3
Hungary	6.73	37	6.65	37	-0.09	0
Kazakhstan	5.06	67	4.82	72	-0.25	-5
Latvia	6.44	42	6.32	44	-0.12	-2
Lithuania	6.53	39	6.33	43	-0.19	-4
Poland	6.92	33	6.93	32	0.02	1
Romania	6.03	49	6.19	48	0.16	1
Russia	5.73	58	5.74	60	0.01	-2
Serbia	5.30	65	5.55	64	0.26	1
Slovakia	6.83	35	6.94	31	0.11	4
Slovenia	6.96	31	6.97	30	0.01	1
Ukraine	4.59	75	4.54	75	-0.05	0
Regional average	**6.16**	**–**	**6.14**	**–**	**-0.02**	**–**

Source: Economist Intelligence Unit.

Recent years have brought considerable improvement in the east European investment climate. The early reformers among the countries of central Europe led the way in the early 1990s in adopting far-reaching stabilisation, liberalisation and privatisation programmes. Reform in the Commonwealth of Independent States (CIS), as well as in most of the Balkans, has been much more uneven and subject to periodic reversals, but even in these subregions significant progress has been made in recent years. Factors such as a low-cost but qualified labour force, proximity to developed markets and, in some cases, ample natural resource endowments attracted considerable foreign direct investment (FDI) to the region in the past decade.

The global crisis has, however, hit eastern Europe very hard. All the main growth drivers have taken a sharp turn for the worse. The euro area is in recession. The crisis has severely limited the region's access to external finance, including to FDI. International oil and other commodity prices have plummeted from their highs in mid-2008 and this has hit a number of CIS economies. The financial and economic characteristics of many countries in the region make them vulnerable to macroeconomic crises.

The current crisis is also likely to leave a longer-lasting negative impact in some areas. The quality of business environments will either deteriorate in 2009-13 compared with 2004-08 (for seven out of the 16 countries in the region that are covered by our model), stagnate or improve only modestly—certainly at a much slower rate of improvement than seemed likely in the past. The global ranking slips for six countries in the region in 2009-13, most significantly for Kazakhstan, Lithuania and Estonia.

The areas that are most adversely affected by the crisis include market opportunities, macroeconomic and political stability, access to financing, and certain areas in infrastructure, owing to funding constraints. The global crisis has affected four categories in particular, all of which have seen declines in their average scores between 2004-08 and 2009-13—market opportunities (a drop by 1.2 points), the macroeconomic environment (0.7), financing (0.3) and the political environment (0.1).

In the category of market opportunities, which deteriorates in every country in the region, the regional average score drops by 1.5 points between 2004-08 and 2009-13. The three Baltic countries in particular record some of the sharpest declines for this category in the world. Real GDP in the region is forecast to contract in 2009 for the first time since 1998 and by more than at any time since the height of the transition recession in 1994. No country in the region has remained unaffected. Trends in recent months confirm that the more solid central European economies are not escaping the global crisis. The central Europeans' dependence on the automotive sector—currently one of the most struggling industries in the world—is an important determinant of performance.

The crisis will also have a longer-lasting impact on regional growth prospects, in the context of existing negative factors constraining long-term growth—such as continuing institutional problems, deteriorating demographic outlooks and weak innovation performance.

The crisis and the discrediting of market solutions have come at a time when many countries were meant to push ahead with tough reforms of public finances, labour markets and institutions to fight bureaucracy and corruption. The standard policy prescriptions must now in part appear discredited, as developed countries have turned to heavy government intervention and away from deregulation.

Macroeconomic vulnerability

In the emerging world, eastern Europe is the region most exposed to the global turmoil. Policy deficiencies in some countries have exacerbated this vulnerability. A number of characteristics make many economies in the region highly vulnerable: a high degree of trade integration; large current-account deficits; heavy dependence on foreign private capital flows; the existence of credit/asset bubbles; significant volumes of foreign-currency loans; and, in some cases, high dependence on commodity exports. The size of external financing needs in the region is a key vulnerability.

The east European subsidiaries are heavily dependent on parent funding and exposed to the risk of a withdrawal of funding by the parent banks. Capital injections and funding guarantees to some parent banks by their home authorities have led to concern as to whether the parent banks will have to divert credit to their home market. While the reputational risk to the parent and the damage to its long-term business plans make a withdrawal unlikely, Western banks have been facing increasing balance sheet pressure to slow lending and liquidity provision abroad as funding conditions in home countries become more difficult.

Given the highly restricted access to commercial funding, many countries in the region have turned to the IMF for funding. This should help to stave off crises, but is no guarantee. By the end of 2009, well over one-half, and perhaps two-thirds, of the countries in the region will be under an IMF programme.

Although the financial crisis is making policymakers in the region keener to join the euro zone, the crisis will make it more difficult to meet the Maastricht criteria for euro entry. Falls in GDP will help to reduce domestic inflationary pressures. However, it is likely to have only a limited impact on their ability to meet the Maastricht inflation criterion, as inflation in the rest of the EU (and hence the highest level of inflation consistent with the inflation criterion) is also set to fall sharply as the euro zone falls into recession. The weakness of economic growth in the next few years will have an adverse impact on public finances, making it much more difficult to meet the Maastricht criterion that budget deficits should be below 3% of GDP.

Political stability is under threat

Political stability in the region is at risk. Incomes are falling and unemployment is rising. So far, only one government in the region—in Latvia—has fallen as a result of the crisis and the associated unrest. It is unlikely that this will remain an isolated case. Many countries in eastern Europe have characteristics that are associated with vulnerability to political upheaval: new and inexperienced states and bureaucracies; a history of unrest; intermediate regimes—that is, neither full democracies nor autocracies—that are the most prone to unrest; very high levels of popular dissatisfaction; and low levels of trust in political institutions.

The deterioration in the political environment reflects, in particular, an increasing risk of political unrest caused by the severe economic downturn, which has led to rising unemployment and increased economic hardship. A total of 12 out of the 16 countries have an increased risk of social unrest in 2009-13 compared with 2004-08. The decline in the average score for the risk of social unrest by 0.8 points is double the average global decline for this indicator.

Middle East and North Africa

Business environment scores and rankings

	2004-08		2009-13			
	Total score (out of 10)	Global rank (out of 82)	Total score (out of 10)	Global rank (out of 82)	Change in total score	Change in rank
Algeria	4.52	76	4.91	70	0.40	6
Bahrain	7.09	29	7.02	29	-0.07	0
Egypt	5.46	60	6.13	49	0.67	11
Iran	3.77	81	4.29	80	0.52	1
Israel	7.36	23	7.29	21	-0.07	2
Jordan	5.84	55	5.99	57	0.15	-2
Kuwait	6.36	44	6.37	41	0.01	3
Libya	4.41	77	4.59	74	0.18	3
Morocco	5.00	69	5.24	68	0.24	1
Qatar	7.17	27	7.50	19	0.33	8
Saudi Arabia	5.95	53	6.25	47	0.30	6
Tunisia	5.36	64	5.68	61	0.32	3
United Arab Emirates	7.20	26	7.15	26	-0.04	0
Regional average	**5.81**	**-**	**6.03**	**-**	**0.22**	**-**

Source: Economist Intelligence Unit.

Middle East business environments are set to improve, albeit from a low base

The Middle East and North Africa (MENA) remains among the lowest-ranked regions. However, the gap with other regions is narrowing as other areas of the world feel the adverse effects of the global economic crisis more deeply. Only a few MENA countries are expected to experience an outright recession. In most of these, this will stem purely from lower oil production, as growth is sustained in the non-oil sector of the economy on the back of strong public investment growth. Although the slowdown in GDP growth across the region has had a dampening effect on scores for the categories of economic stability and market opportunities, the scores have fallen by less than in other regions. This means that in these categories the gap between the stronger performers and MENA narrows markedly in the forecast period (2009-13).

Average scores for financing have fallen, as development projects, even in those countries that have had huge fiscal and current-account surpluses in recent years, have been affected by the seizure in international credit markets. However, again this fall has been modest compared with other regions. Middle Eastern governments also remain broadly committed to reforms aimed at enhancing the role of the private sector as part of a strategy of economic diversification. However, progress in implementing these reforms is likely to continue to be slow.

The best overall rankings among the 13 Middle East countries included in the model are for the member states of the Gulf Co-operation Council (GCC) and for Israel. The GCC countries saw their rankings climb during the historical period, owing to the rise in oil prices and the increased absorptive capacities of these economies for new investment, by comparison with previous oil booms. Economic stability scores in the GCC have fallen for the forecast period in line with the lower oil price outlook—with the exception of Qatar, where high rates of growth will continue as a result of increased production of liquefied natural gas—but these scores still remain relatively high by regional and international standards. Opportunities for the private sector in the GCC will be adversely affected by the constraints on financing, which is likely to result in an increase in the role of the state in development projects, after a period in which the private sector's role has expanded considerably.

The tax regime in the GCC will remain positive for business, but elsewhere in the region pressures on budgets may mean that governments will be obliged to increase taxes or delay plans for tax rate reductions—for example in Israel. Conversely, some countries, notably Jordan, are considering immediate reductions in tax rates as part of their fiscal stimulus. Egypt, which has risen rapidly up the rankings in the historical period owing to its explicitly business-friendly policies, is delaying the introduction of its new property tax as part of a strategy of bolstering consumption and investment during the downturn.

Most countries in the Middle East score well in the two categories of policy towards foreign direct investment and foreign trade and exchange controls. The main exceptions are Algeria, Libya and Iran. Algeria is the only country in the Middle East to have adopted policies aimed against foreign investors in recent years—with the imposition of a new tax on dividends, a ban on majority foreign ownership of projects and preventing foreign investors from owning land. The business environment in Iran has worsened as a result of international sanctions. Conditions in Libya have improved—it has moved off the bottom rung in the regional ranking, with Iran moving down—but from a very low base.

The Middle East's average score rises, closing the gap with other regions

Overall, despite modest falls recorded in the scores for a number of categories, MENA's overall average score rises between the forecast and historical periods, from 5.81 to 6.03. This is because the moderate falls in areas such as economic stability and market opportunities have been offset by significant improvements in certain categories, as governments across the region seek to build on recent improvements in business environments from what is generally a low base, and also try to support economic growth during the downturn. Thus there is an increase in the average scores for categories such as infrastructure, foreign trade and exchange controls, and policy towards private enterprise and competition. Nevertheless, progress in most of these areas will be more modest than in 2004-08.

Sub-Saharan Africa

Business environment scores and rankings

	2004-08 Total score (out of 10)	Global rank (out of 82)	2009-13 Total score (out of 10)	Global rank (out of 82)	Change in total score	Change in rank
Angola	3.65	82	3.89	82	0.24	0
Kenya	4.23	80	4.50	77	0.27	3
Nigeria	4.41	78	4.30	79	-0.11	-1
South Africa	6.34	45	6.05	51	-0.28	-6
Regional average	**4.66**	**-**	**4.69**	**-**	**0.03**	**-**

Source: Economist Intelligence Unit.

Quality of the regional business environment stagnates

The average business environment score for Sub-Saharan Africa in 2009-13 remains virtually unchanged compared with 2004-08. Expected improvements in Angola and Kenya offset a deterioration in the region's two largest economies, Nigeria and South Africa. The average quality of the region's investment environment continues to be poor. However, despite the problems of operating in the region, for those companies that can master the complicated political environment and the difficult regulatory climate rates of return are potentially high. This is especially the case in the oil producers, Angola and Nigeria.

Of the four Sub-Sharan African countries covered by our model, South Africa has by far the most attractive business environment. However, the quality of its business environment deteriorates in 2009-13 and its global ranking slips by six places from 45th in 2004-08 to 51st in 2009-13, owing to a worsening macroeconomic environment, lower capital inflows and weakening market opportunities. The return of another African National Congress government in April 2009 implies policy continuity. Policymakers will continue to improvise in response to events, thereby contributing to investors' wariness about South Africa. As in many other countries, the present crisis will necessitate a rethink of some infrastructure development plans.

Nigeria's business environment deteriorates

Nigeria's business environment also deteriorates over the forecast period, keeping the country near the bottom of the global rankings. Low oil prices, a poor infrastructure and a fractious political scene mean that the business environment remains highly challenging. Lower oil prices will reduce interest from investors in the hydrocarbons sector, while restricted access to finance will also affect investment. Slow reform and high corruption will have the same effect. Government revenue is highly dependent on oil income and lower prices will also necessitate spending restraint. In addition to ongoing security concerns in the Niger Delta, social unrest will be a persistent risk as a result of popular disillusionment with the political elite and the poor economic outlook.

Kenya remains among the least attractive investment destinations globally in 2009-13, although its business environment improves somewhat, lifting the country's global ranking to 77th in 2009-13 from 80th in 2004-08. Kenya will be less damaged by the global slump than industrialised economies. The government will gradually push ahead with some market reforms. Kenya's two biggest weaknesses remain its political environment and poor infrastructure. The grand coalition government, formed in April 2008, may survive (the next election is due in 2012), although there is a risk of renewed instability.

Although Angola improves over the forecast period, the rate of improvement will be slower than in many other countries and Angola remains rooted to the bottom of the rankings. Negligible progress in structural reforms is expected, but growing market opportunities will be underpinned by the expected growth in oil and diamond output. The rapidly growing population and rising GDP per head mean that the country's rank in the market opportunities category jumps from 57th in 2004-08 to 31st in 2009-13. However, the quality of the overall business environment remains very low as a result of the absence of effective government institutions and very poor infrastructure. Investment opportunities outside of the oil and diamond sectors will remain very limited.

Guide to the business rankings model

Outline of the model

The business rankings model measures the quality or attractiveness of the business environment in the 82 countries covered by *Country Forecasts* using a standard analytical framework. It is designed to reflect the main criteria used by companies to formulate their global business strategies, and is based not only on historical conditions but also on expectations about conditions prevailing over the next five years. This allows the Economist Intelligence Unit to utilise the regularity, depth and detail of its forecasting work to generate a unique set of forward-looking business environment rankings on a regional and global basis.

The business rankings model examines ten separate criteria or categories, covering the political environment, the macroeconomic environment, market opportunities, policy towards free enterprise and competition, policy towards foreign investment, foreign trade and exchange controls, taxes, financing, the labour market and infrastructure. Each category contains a number of indicators that are assessed by the Economist Intelligence Unit for the last five years and the next five years. The number of indicators in each category varies from five (foreign trade and exchange regimes) to 16 (infrastructure), and there are 91 indicators in total.

Almost half of the indicators are based on quantitative data (eg, GDP growth), and are mostly drawn from national and international statistical sources for the historical period (2004-08) and from Economist Intelligence Unit assessments for the forecast period (2009-13). The other indicators are qualitative in nature (eg, quality of the financial regulatory system), and are drawn from a range of data sources and business surveys adjusted by the Economist Intelligence Unit, for 2004-08. All forecasts for the qualitative indicators covering 2009-13 are based on Economist Intelligence Unit assessments.

The main sources used in the business rankings model include CIA, *World Factbook*; Economist Intelligence Unit, *Country Risk Service*, *Country Finance*, *Country Commerce*; Freedom House, *Annual Survey of Political Rights and Civil Liberties*; Heritage Foundation, *Index of Economic Freedom*; IMF, *Annual Report on Foreign Exchange Restrictions*; International Institute for Management Development, *World Competitiveness Yearbook*; International Labour Organisation, *International Labour Statistics Yearbook*; UN, *Human Development Report*; US Social Security Administration, *Social Security Programs Throughout the World*; World Bank, *World Development Report*; World Development Indicators; World Economic Forum, *Global Competitiveness Report*.

Calculating the rankings

The rankings are calculated in several stages. First, each of the 91 indicators is scored on a scale from 1 (very bad for business) to 5 (very good for business). The aggregate category scores are derived on the basis of simple or weighted averages of the indicator scores within a given category. These are then adjusted, on the basis of a linear transformation, to produce index values on a 1-10 scale. An arithmetic average of the ten category index values is then calculated to yield the aggregate business environment score for each country, again on a 1-10 scale.

The use of equal weights for the categories to derive the overall score reflects in part the theoretical uncertainty about the relative importance of the primary determinants of investment. Surveys of foreign direct investors' intentions yield widely differing results on the relative importance of different factors. Weighted scores for individual categories based on correlation coefficients of recent foreign direct investment inflows do not in any case produce overall results that are significantly different to those derived from a system based on equal weights.

For most quantitative indicators the data are arrayed in ascending or descending order and split into five bands (quintiles). The countries falling in the first quintile are assigned scores of 5, those falling in the second quintile score 4 and so on. The cut-off points between bands are based on the average of the raw indicator values for the top and bottom countries in adjacent quintiles. The 2004-08 ranges are then used to derive 2009-13 scores. This allows for intertemporal as well as cross-country comparisons of the indicator and category scores.

Measurement and grading issues

The indices and rankings attempt to measure the average quality of the business environment over the entire historical or forecast period, not simply at the start or at the end of the period. Thus in the forecast we assign an average grade to elements of the business environment over 2009-13, not to the likely situation in 2013 only.

The scores based on quantitative data are usually calculated on the basis of the numeric average for an indicator over the period. In some cases, the “average” is represented, as an approximation, by the recorded value at the mid-point of the period (2006 or 2011). In only a few cases is the relevant variable appropriately measured by the value at the start of the period (eg, educational attainments). For one indicator (the natural resources endowment), the score remains constant for both the historical and forecast periods.

List of indicators in the business rankings model

Political environment
1. Risk of armed conflict
2. Risk of social unrest
3. Constitutional mechanisms for the orderly transfer of power
4. Threat of politically motivated violence
5. International disputes or tensions
6. Government policy towards business
7. Effectiveness of political system in policy formulation and execution
8. Quality of the bureaucracy
9. Transparency and fairness of political system
10. Corruption
11. Impact of crime

Macroeconomic environment
*1. Inflation
*2. Budget balance as % of GDP
*3. Government debt as % of GDP
*4. Exchange-rate volatility
*5. Current-account balance as % of GDP

Market opportunities
*1. GDP, US$ bn at PPP
*2. GDP per head, US$ at PPP
*3. Real GDP growth
*4. Share of world merchandise trade
*5. Average annual rate of growth of exports
*6. Average annual rate of growth of imports
*7. The natural resource endowment
*8. Profitability

Policy towards private enterprise and competition
1. Degree to which private property rights are protected
2. Government regulation on setting up new private businesses
3. Freedom of existing businesses to compete
4. Promotion of competition
5. Protection of intellectual property
6. Price controls
7. Distortions arising from lobbying by special interest groups
8. Distortions arising from state ownership/control

Policy towards foreign investment
1. Government policy towards foreign capital
2. Openness of national culture to foreign influences
3. Risk of expropriation of foreign assets
4. Availability of investment protection schemes

Foreign trade and exchange controls
1. Capital-account liberalisation
**2. Tariff and non-tariff protection
*3. Openness of trade
4. Restrictions on the current account

Taxes
**1. The corporate tax burden
*2. The top marginal personal income tax
*3. Value-added tax
*4. Employers' social security contributions
5. Degree to which fiscal regime encourages new investment
6. Consistency and fairness of the tax system

Financing
1. Openness of banking sector
2. Stockmarket capitalisation
**3. Distortions in financial markets
4. Quality of the financial regulatory system
5. Access of foreigners to local capital market
6. Access to medium-term finance for investment

The labour market
**1. Incidence of strikes
*2. Labour costs adjusted for productivity
*3. Availability of skilled labour
4. Quality of workforce
5. Restrictiveness of labour laws
6. Extent of wage regulation
7. Hiring of foreign nationals
*8. Cost of living

Infrastructure
*1. Telephone density
**2. Reliability of telecoms network
**3. Extent and quality of road network
*4. Production of electricity per head
**5. The infrastructure for retail and wholesale distribution
**6. Extent and quality of the rail network
7. Quality of ports infrastructure
*8. Stock of personal computers
*9. R&D expenditure as % of GDP
*10. Rents of office space

Note. A single asterisk (*) denotes a purely quantitative indicator. Indicators with a double asterisk (**) are partly based on data. All other indicators are qualitative in nature.

