A Review of Doing Business

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In this note we provide an opinion on the future direction for the World Bank Group's Doing Business Report. The report has, again, come under scrutiny at the time of its 10th anniversary. The World Bank President has appointed a special commission to review the report and make recommendations. All options are on the table including, at the extreme, abolition of the report. We are concerned about this.

We believe the Doing Business data are informative. They shed light on important institutional features that matter for economic growth and poverty reduction. The data and the rankings provided by Doing Business make for a helpful benchmarking tool. They lead countries to consider and tackle important institutional challenges.

Precisely due to the power of the data criticism persists. We feel the arguments about the Doing Business Report are by now well known. The report itself provides a model of transparency about data sources, methodology, uses of data and limitations of the data. We believe the direction in which to take Doing Business is the generation of informative and helpful data for domains not yet covered by the current Report. The current data and rankings should be kept intact.

The following review of the well-trodden debates about Doing Business considers first the relevance of the Report, then the criticisms and concludes with recommendations for its future. The review was agreed by Daron Acemoglu (Professor at the Massachusetts Institute of Technology), Paul Collier (Professor at Oxford University, former Research Director at the World Bank), Simon Johnson (Professor at the Massachusetts Institute of Technology and former IMF Chief Economist), Michael Klein (former World Bank Group Vice-president and co-founder of Doing Business) and Graeme Wheeler (former Managing Director of the World Bank and now Governor of the Reserve Bank of New Zealand).

I. Relevance of the Doing Business Report

Why are we interested in a measure like Doing Business?

Existing state-of-the-art analysis shows that institutional arrangements critically matter for the way societies function, in particular for economic growth and the reduction of poverty. Doing Business provides a new method to characterize details of relevant institutions, notably rules of the game (property rights, contract enforcement) and mechanisms underlying competitive markets (entry restrictions for firms, ability for firms to access resources and exit mechanisms for underperforming firms such as bankruptcy). The Doing Business measures enable progress in research and inform policy debate on the critical matters of institutional reform underpinning growth and poverty reduction. The indicators also promote economic inclusion: success on the basis of rules, not connections (or corruption).

What has been the impact on research?

The very design process of the Doing Business indicators has been grounded in research establishing the relevance of the measures for economic outcomes of interest such as economic growth, the extent of informality or access to credit. The research has been recognized by publication of papers underlying the indicator design in prominent peer-reviewed academic journals. Since publication of the first Doing

Business report some 1,245 articles in peer-reviewed journals using the data have been published. The first so called impact analyses for policy reform have been rendered possible[1]. Such analyses improve our knowledge of causality and the effects deriving from institutional change. The transparency of the data and their public availability has been critical in enabling researchers to advance understanding of the relevance and importance of the domain covered by Doing Business.

What has been the impact on policymakers?

Doing business has attracted attention at the highest level of policy-making across the world. Numerous examples show that key policymakers, even heads-of-state, in countries of all types pay attention to the core messages of Doing Business. As Doing Business data measure the features of laws and regulations as they exist, they provide – by construction – a way to design actionable reform. Changing the substance of laws changes the data.

Reform programs in numerous countries use the Doing Business measures as an input into policy-making. Over 350 regulatory reforms across the World have been inspired by Doing Business since 2003. Some 35 governments currently maintain inter-ministerial committees considering reforms informed by Doing Business. More broadly every year many governments have undertaken reforms leading to improvements of the indicators without explicitly considering the Doing Business report. The total of reforms tracked by Doing Business annually exceeds 200 globally – over 2000 since the report tracks them. This suggests that between 15 and 20% of all such reforms were affected by the report itself. It also suggests that the direction of reform indicated by Doing Business is the revealed preference of most governments. Only Venezuela and Zimbabwe have systematically pursued reforms complicating life for small and medium-sized businesses.

What can we say about the effect of reforms inspired by Doing Business?

The original research underpinning Doing Business and the preponderance of the evidence since suggest that reforms tend, for example, to increase the creation of formal businesses and formal employment, provide greater access to credit, enhance trade, stimulate competition and limit the market power of incumbent firms. Findings also suggest a number of other effects, for example, that tax simplification reduces burdens on individual firms while raising overall government tax revenues as more firms come into being and pay taxes. Improvements in contract enforcement seem to support the maxim that "justice delayed is justice denied" – faster contract enforcement seems to go together with perceptions of improved fairness. Corruption tends to be reduced as rules become less onerous.

The first impact analysis on Mexico exploits natural experiments among states in the country and suggests that business registration reform raised the number of formal firms by 5% and employment by 2.2%. At the same time it led to product price decreases of 0.6% and revenue for incumbent businesses fell by 3.2%. To get a sense of the potential significance of the impact consider the following: If the Mexico example were representative for other countries, the reforms that other countries actually undertook over the last 10 years the impact on employment would have provided additional formal employment for 10s of millions of people. Of course, the impact of reforms will vary across countries as different factors are likely to be binding constraints in different circumstances.

[1] Miriam Bruhn (2011) "License to Sell: The Effect of Business Registration Reform on Entrepreneurial Activity in Mexico" in *The Review of Economics and Statistics* February, Vol. 93, No. 1

The evidence also suggests that moving up the rankings in Doing Business is associated with stronger economic growth. The key here is not the position in aggregate rankings but the reform efforts improving on the status quo. It is thus, for example, no particular surprise that a country like China has experienced strong growth while being ranked low on the Doing Business aggregate measure. China has consistently improved its regulations for business as captured by the Doing Business metrics.

II. Criticisms of Doing Business

Precisely because of the prominence of Doing Business it has attracted persistent criticism as well. Critics argue a number of points: i) that the data are not robust and lack information content, ii) that the measures are biased in various ways and iii) that the measures are misleading and distort policy-making.

Are the Doing Business data informative?

Doing Business codes what governments make – rules for small- and medium-sized businesses laid down in laws, regulations or decrees. Behind the data are thus texts that can be checked. Data derived from texts also only change when the text is changed. Once the baseline data are correct, only changes need to be considered.

Eight of the eleven sub-indicators of Doing Business measure not only features laid down in the text of laws or regulations. They estimate also the time certain regulatory processes take. The time estimates are provided by the almost 10,000 respondents that provide the Doing Business data from around the world. The respondents are, for example, law firms, notaries, consulting firms or freight-forwarders that are familiar with the whole process covered by regulations captured, for example, the registration of a firm. The estimates of time benefit from the experience of the respondents. Over time the number of respondents has been increased to get several estimates per country and indicator. Time estimates are provided for each component of a process. Like in time-and-motion studies accuracy is thus enhanced. However, time estimates remain subject to estimation error.

The possible existence of such estimation error has been used to question the reliability of the Doing Business indicators. We believe the current method still provides useful estimates. The response to the potential existence of estimation errors should be as follows. In line with good practice in regulatory management, agencies administering certain processes should set standards for process completion and monitor adherence to those standards in verifiable databases. The direction should thus be not to reject data due to potential inadequacy but to strengthen mechanisms of service delivery and measurement of actual practice by the agencies concerned.

The transparency of data collection for the Doing Business report is exemplary. We know of no other economic data set systematically following similar standards of transparency.

Are the Doing Business data inherently biased or do they reflect useful concepts?

A whole series of biases have been alleged. We consider them in turn.

- **Doing Business measures the official rules, but not actual practice.**

Divergence between what is "on the books" and what happens in practice is always an issue. The relevant question is whether what is on the books matters. Rule-making is an important part of policy-making and affects institutional arrangements. Nobody suggests that policy-makers forget about making good rules, because there may be enforcement issues. Evidence suggests also that better rules improve enforcement.

The most detailed study on the divergence of rules from practice confronts Doing Business data with experience reported by firms under the World Bank's enterprise survey program[2]. The authors find that firms follow the rules when they are not too onerous. When they are complicated and otherwise onerous there is no clear relationship between rules and practice. We note that the World Bank pursues the enterprise survey program in parallel to Doing Business precisely to help shed light on such issues and improve policy analysis.

- **Doing Business does not cover the reality of small firms in developing economies because most operate in the informal sector**

This critique is related to the previous one. Doing Business does, indeed, not characterize the conditions reigning in the informal sector. However, Doing Business covers regulations that determine whether people decide to operate formally or informally i.e. the benefits of being formal (e.g. ability to trade, protect property or enforce contracts) and the costs of being formal (e.g. burdens imposed by processes and tax obligations). By the same token Doing Business covers key policy levers that determine the extent of informality.

- **Doing Business does not deal with corruption**

This critique is related to both preceding ones. Existing analyses suggest that more complex regulation is associated with increased corruption as measured by perception indices. Doing Business thus sheds light on some of the potential causes of corruption and helps inform possible measures to reduce it. In this way Doing Business usefully complements perception indicators such as those generated by Transparency International. The spirit of the Doing Business method has also stimulated the development of measures that promise to shed further light on corruption, notably an indicator on transparency of the financial and business interests of politicians[3].

- **Doing Business promotes the abolition of regulation**

Several indicators explicitly promote stronger regulation (protection of property for creditors and investors). The other indicators start with the premise that particular regulatory goals make sense. They benchmark countries on how efficiently they achieve the goals. For example, the business registration indicators takes as given that governments have legitimate regulatory goals, namely the establishment of identity for purposes of taxation and social security systems. The question then is

[2] Hallward-Driemeier, M. and L. Pritchett, Lant (2011) "How business is done and the'doing business' indicators : the investment climate when firms have climate control," Policy Research Working Paper Series 5563, The World Bank

[3] Djankov, S., R. La Porta, F.Lopez-de-Silanes, and A. Shleifer (2010) "Disclosure by Politicians." *American Economic Journal: Applied Economics*, 2(2): 179-209

how to achieve this most efficiently. Comparison between countries allows learning about how to achieve the relevant goal. In no case does Doing Business argue for the complete abolition of systems of contracts or regulation. The highest ranked countries are not known for an absence of regulation, notably the Scandinavian countries which are all among the top-ranked 15 countries.

- **Doing Business favors the interest of business over that of citizens more broadly**

The indicators aim at creating an equal playing field and competition. They thus promote rule-making that can challenge the position of protected incumbents and favors consumers. The focus of the indicators is on rules for domestic small and medium-sized business, contrary to prior efforts which tended to look at rules for foreign investors. Reform indicated by the indicators tends to help move people out of informality and promote success on the basis of good rules rather than on the basis of connections. This is a program of economic inclusion. Related to the previous criticism, the example of the Scandinavian economies suggests that the ability of countries to provide a sound safety net for citizens is enhanced when regulations for business are improved.

- **Doing Business reflects a "western agenda" and a preference for "common law".**

We see no reason to characterize Doing Business as particularly "western". As mentioned before with the exception of two countries all other 183 countries covered by the report have demonstrated that they share the basic philosophy of the report, including presumably all the countries that have been the most vocal critics of the Doing Business approach.

The legal origin of a country is no hindrance to good regulation. Again the Scandinavian countries provide examples of civil law countries that do better than most common law regimes. France itself has been one of the most consistent reformers among OECD economies during the last 10 years, demonstrating that civil law is just as capable as common law to deal with the regulatory challenges measured by Doing Business.

- **Doing Business advocates a "one-size fits all" ideology**

Doing Business aims at a particular functionality of rules, for example, how to establish identity in business registration or how to minimize asset destruction during bankruptcy. Improvements have been made to reflect this philosophy. How that functionality is achieved can vary substantially among countries. In that sense there is no one-size-fits-all philosophy. Whether the functionality is at all required or important or misleading is discussed below when dealing with criticism that Doing Business is misleading.

- **Individual indicators are inadequate**

Two indicators have attracted persistent criticism – the indicator on employing workers and on paying taxes.

The ***employing worker data*** measure how flexible labor market contracts can be. In response to early criticism the Doing Business data were coded in such a way that flexibility that goes beyond baselines set by all the 189 ILO conventions did not lead to improved rankings. In recent years the employing worker indicators have been taken out of the aggregate ranking pending consideration of additional measures to code employee protections in addition to the existing measures of flexibility.

One option would be to code whether countries' regulations live up to the core labor standards set by the ILO.

Notably, the employing workers indicators have seen very limited reform efforts compared to others and several countries have reduced labor flexibility over the years. This goes to show that the mere fact of being ranked in a particular way in the Doing Business report is not enough to get reforms. Unsurprisingly, it all depends on the country's stance.

Overall, labor flexibility matters. An indicator capturing flexibility remains useful. This turns out to be relevant not only in advanced economies in Europe where reforms are currently being pursued but also in some of the poorest countries. In addition coding of specific protections such as the ILO core labor standards would help improve the ability to assess what a good balance of protections and flexibility is.

The ***indicator on "paying taxes"*** has two basic components – measures of complications of paying taxes and a measure of the total tax rate for businesses. Debate has centered on the total tax rate. Critics argue that a higher tax rate on business need not be bad. In fact, taxation of business might be a useful tool in the tax policy arsenal. In addition, countries relying heavily on oil or mineral revenues may be able to afford a very low rate of tax on businesses, but this advantage should not lead to improved ranking. In response the indicator has been revised so as not to improve ranking when the total tax rate falls below the level charged by 85 percent of countries. Currently that translates into total tax rate of about 25%.

The indicator reflects incentives to evade taxes. Empirical analyses has shown that over the range of existing tax regimes a simplification of tax regimes and lowering of the rate has typically led overall to increased government revenue. It remains a useful tool to assess the impact of tax policy for businesses an area which is often a key constraint for small and medium businesses as evidenced in firm-level surveys.

Finally, Doing Business does not prejudice countries' efforts to introduce progressivity into taxation. It captures features of taxation of small and medium firms. By necessity, firms pass on taxes to consumers. The key tool that establishes progressivity of taxation remains personal income taxation, which is not covered by Doing Business.

Are the Doing Business indicators likely to mislead policymakers?

- **The indicators omit relevant factors of a country's business environment**

Indeed, factors such as social stability, the quality of macro-economic policy, the state of infrastructure or education levels are not covered by Doing Business. Yet they all matter for investors. Doing Business is not an "investor attraction" index. Rather it aims at measuring key features of rules governing businesses. This is an important factor for the investment climate, but not everything. This has to be recognized. Even when it comes to the regulatory environment Doing Business covers only a part. The EU's acquis communautaire, which member countries need to adopt, comprises, for example, some 14,500 rules. Doing Business just covers over a hundred rules omitting, for example, health and safety or environmental regulation. Within the domain covered by Doing Business it focuses on select issues. For example, the "protecting investors" indicator captures some key aspect of corporate governance rules but by no means all. The academic papers written for the indicator design establish that nevertheless the Doing Business indicators are relevant measures of business regulation.

To-date there is only one other methodology that captures similar issues as Doing Business, the OECD's product market regulation (PMR) indicators. These have been calculated three times in five year intervals, last in 2008. They cover a much broader range of regulations than Doing Business, over 800 sub-indicators. The country rankings that the OECD produces nevertheless correlate significantly with the Doing Business rankings. The evidence so far is that Doing Business is informative and relevant, but one needs to understand what it measures and what not. The Doing Business report, more than other reports, sets out in detail its limitations.

- **The rankings provided by Doing Business mislead policymakers**

One of the most contentious debates is about the overall country ranking of Doing Business. An understanding of ranking starts with a distinction between what is "informative" and what is "desirable". The Doing Business indicators need to reflect reality to be informative, and they do as discussed above.

Each individual data point reflects a piece of information. The eleven sub-indicators and the overall index aggregate the detailed data points into summary measures about aspects of a country's regulatory environment for businesses. Aggregation of data leads to indices that are informative as well. Broader aggregates can capture interactions between detailed data and provide a useful, more general characterization of features of the business environment. For example, the getting credit indicators are usefully complemented by the one on contract enforcement and bankruptcy. Each captures aspects that are relevant for access to credit. The overall "ease of doing business" indicator has been analyzed statistically (factor analysis and omitted variable analysis). It provides information not contained in the individual component indicators.

The research papers underpinning Doing Business make the case that empirically an improvement in the rankings lead to desired outcomes such as growth, greater formal employment or access to credit. But this is not a logically necessary feature of the aggregate indicators. In fact, it would be a drawback to the method if it did nothing more than capture self-evident relations between policy inputs and desired outcomes.

The aggregate measures are benchmarking tools like other such tools used in the management of any organization. They shed light, they help compare, and they help learn from others. They do not automatically imply that improving on an indicator is the best course of action for a particular country at a particular moment in time. But it is only by summarizing indicators in a "rankable" fashion that benchmarking becomes feasible. In addition, simple summary measures direct attention to potential issues that are otherwise neglected, in this case in a morass of detailed regulatory arrangements.

- **Do the indicators mislead governments?**

The practical question is whether the indicators with all their limitations actually mislead governments. The typical reaction by governments to the indicators is skepticism, if not denial. Governments do not just accept them. They challenge and argue. What the summary measures do is to get the debate on the agenda. Governments also take a deliberate approach to decide whether to tackle certain reforms and in what way. As mentioned above, few governments tackle labor contract flexibility. Many reform registration requirements for small businesses.

Most reforms affect existing interest groups. These often mobilize against reform. Once one starts reform in one area, links with related areas are highlighted and broaden the debate. It is our judgment that typically a good tension emerges leading to sensible reforms that might well not have taken place without the indicators. That was also the judgment of the World Bank's Independent Evaluation Group in their exhaustive review in 2008. As time goes by, it is possible that some governments mechanically focus on reforms to "move the indicators" without making significant changes. It would be helpful to continue to assess whether one could in practice distinguish such cases from the more meaningful ones.

III. Direction for Doing Business

Doing Business has been reviewed several times and faces constant detailed data reviews with governments. The indicators have been improved as a result of these reviews and their transparency is unparalleled. A review of the World Bank's research program covering the period 1998 to 2005 concluded that the Doing Business indicators were among the very best products of the World Bank. An exhaustive review by the Bank's Independent Evaluation Group (IEG) made a number of detailed suggestions for improvement which have mostly been adopted, except for the recommendation to drop the total tax rate measure. The IEG review concluded that overall more measures like Doing Business should be undertaken to shed light on areas of institutional underpinnings of economies. The upshot from the official reviews and the ongoing debates with governments has been a series of improvements.

The debate about Doing Business is conceptually similar to debates about other economic indicators. For example, the Report of the Commission on the Measurement of Economic Performance and Social Progress, chaired by Joseph Stiglitz, recently assessed GDP, the by now ubiquitous measure of production of an economy. GDP also has issues with data quality, for example, the measurement of prices. In some countries these may be based on deficient product information, on information in just one city; they may not reflect quality changes and unable to cover the value of services that are free or not traded. GDP as a measure also has certain biases. It may not cover costs of pollution or resource extraction. The country rankings derived from GDP measures may not adequately reflect the quality and sustainability of development. It does not measure quality of life. As the Commission pointed out "the way in which statistical figures are reported or used may provide a distorted view of the trends of economic phenomena". Yet, it concludes that GDP is useful and that "GDP is not wrong as such, but [may be] wrongly used. What is needed is a better understanding of the appropriate use of each measure."

We take a similar view on Doing Business. The fundamental question is whether the approach taken by Doing Business is a step forward, not whether it measures everything or perfectly. In our view it represents a clear step forward, because it is informative about a number of important aspects of laws and regulations, it is useful as a benchmarking tool for policy-makers and because it exemplifies a method to cover a potentially large variety of rules and institutional arrangements.