Doing Business in 2005

Removing Obstacles to Growth

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Contents

Doing Business in 2005 is the second in a series of annual reports investigating the scope and manner of regulations that enhance business activity and those that constrain it. New quantitative indicators on business regulations and their enforcement can be compared across 145 countries—from Albania to Zimbabwe—and over time. *Doing Business in 2004: Understanding Regulation* presented indicators in 5 topics: starting a business, hiring and firing workers, enforcing contracts, getting credit and closing a business. *Doing Business in 2005* updates these measures and adds another two sets: registering property and protecting investors. The indicators are used to analyze economic and social outcomes, such as productivity, investment, informality, corruption, unemployment, and poverty, and identify what reforms have worked, where and why.

Removing obstacles to growth: an overview

What are the findings?

What to reform?

Which myths to dispel?

What to expect next?

The past year has been good for doing business in 58 of the 145 *Doing Business* sample countries. They simplified some aspect of business regulations, strengthened property rights or made it easier for businesses to raise financing. Slovakia was the leading reformer: introducing flexible working hours, easing the hiring of first-time workers, opening a private credit registry, cutting the time to start a business in half and, thanks to a new collateral law, reducing the time to recover debt by three-quarters. Colombia was the runner-up. Among the top 10 reformers, 2 other European Union entrants—Lithuania and Poland—significantly lightened the burden on businesses. India made progress in improving credit markets. Five other European countries—Belgium, Finland, Norway, Portugal, and Spain—reduced the cost of doing business and entered the top 10 list (table 1.1).

The major impetus for reform in 2003 was competition in the enlarged European Union. Seven of the top 10 reformers were incumbent or new European Union members. Thirty-six of 89 reforms—in starting a business, hiring and firing workers, enforcing a contract, getting credit and closing a business (topics in *Doing Business in 2004* and *2005*)—happened in EU countries. Reforms in registering property and protecting investors (new topics in *Doing Business in 2005)* are also taking place fast in the EU. Accession countries reformed ahead of the competitive pressures on their businesses in the larger European market. Incumbent members reformed to maintain their advantage in the presence of many low-wage producers from accession countries, producers that would now compete with them on equal terms.

Yet progress was uneven. Fewer than a third of poor countries reformed[1]. And those reformers concentrated on simplifying business entry and establishing or improving credit information systems (figure 1.1). Almost no reforms took place in making it easier to hire and fire workers or in closing down unviable businesses. Across regions, African countries reformed the least.

Many of the reforms in poor countries were spurred by the desire of governments and donors to quantify the impact of aid programs (figure 1.2). The main success story is that business start-up is now easier in borrowers from the International Development Association (IDA)—encouraged by performance targets set in the 13th IDA funding round and by the Millennium

TABLE 1.1

Top 10 reformers in 2003

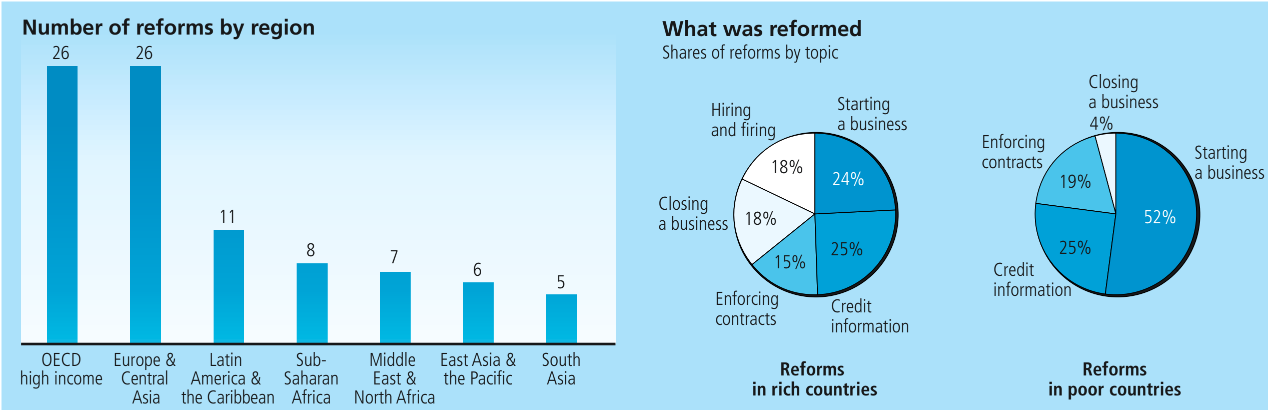
Reforms affecting *Doing Business* indicators on:

Country	Starting a business	Hiring and firing	Enforcing contracts	Getting credit	Closing a business
Slovakia	✓	✓	✓	✓	
Colombia	✓	✓	✓		
Belgium	✓	✓		✓	
Finland	✓		✓		✓
India			✓	✓	✓
Lithuania	✓		✓		✓
Norway		✓	✓		
Poland	✓	✓			✓
Portugal		✓	✓	✓	
Spain	✓			✓	✓

Note: The table identifies all reforms that took place in 2003 and had a measurable effect on the indicators constructed in this report. Countries are listed alphabetically, with the exception of Slovakia, the leading reformer, and Colombia, the runner-up.

Source: Doing Business database.

FIGURE 1.1
More reforms in rich countries



Note: Reforms affecting *Doing Business* indicators.
Source: Doing Business database.

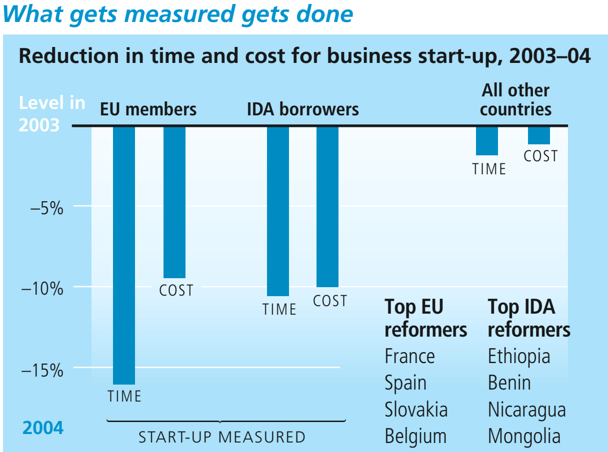
Challenge Account, an initiative of the United States government.[2] Measuring the initial burdens and the progress with reforms also spurred reforms in the European Union, labor reform in Colombia and bankruptcy reform in India.

Lithuania and Slovakia broke into the list of the 20 economies with the best business conditions as measured in this year's report.[3] New Zealand tops the list, followed by the United States, Singapore, Hong Kong (China) and Australia (table 1.2). Among developing countries, Botswana and Thailand scored best. Latvia, Chile, Malaysia, the Czech Republic, Estonia, South Africa, Tunisia and Jamaica follow. At the other end of the spectrum, 20 poor countries—four-fifths of them in sub-Saharan Africa—make up the list of economies with the most difficult business conditions. The list may change somewhat next year because of reforms and because new topics will be added to the rankings.

Being in the top 20 on the ease of doing business does not mean zero regulation. Few would argue it's every business for itself in New Zealand, that workers are abused in Norway or that creditors seize a debtor's assets without a fair process in the Netherlands. Indeed, for protecting property rights, more regulation is needed to make the top 20 list.

All the top countries regulate, but they do so in less costly and burdensome ways. And they focus their efforts more on protecting property rights than governments in other countries. If Australia needs only 2 procedures to start a business, why have 15 in Bolivia and 19 in Chad? If it takes 15 procedures to enforce a contract in Denmark, why have 53 in Lao PDR? If it takes 1 procedure to register property in Norway, why have 16 procedures in Algeria? And if laws require all 7 main types of disclosure to protect equity investors in Canada, why do those in Cambodia and Honduras provide none?

FIGURE 1.2
What gets measured gets done



Source: Doing Business database.

TABLE 1.2
Top 20 economies on the ease of doing business

1	New Zealand	11	Switzerland
2	United States	12	Denmark
3	Singapore	13	Netherlands
4	Hong Kong, China	14	Finland
5	Australia	15	Ireland
6	Norway	16	Belgium
7	United Kingdom	17	Lithuania
8	Canada	18	Slovakia
9	Sweden	19	Botswana
10	Japan	20	Thailand

Note: The ease of doing business measure is a simple average of the country's ranking in each of the 7 areas of business regulation and property rights protection measured in *Doing Business in 2005.*
Source: Doing Business database.

What are the findings?

The analysis leads to 3 main findings:

- Businesses in poor countries face much larger regulatory burdens than those in rich countries. They face 3 times the administrative costs, and nearly twice as many bureaucratic procedures and delays associated with them. And they have fewer than half the protections of property rights of rich countries.
- Heavy regulation and weak property rights exclude the poor from doing business. In poor countries 40% of the economy is informal. Women, young and low-skilled workers are hurt the most.
- The payoffs from reform appear large. A hypothetical improvement to the top quartile of countries on the ease of doing business is associated with up to 2 percentage points more annual economic growth.

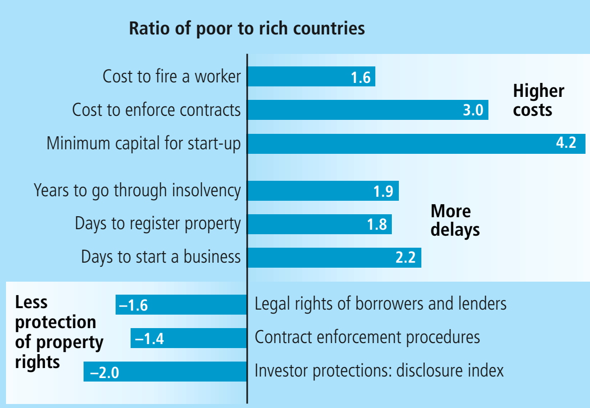
Businesses in poor countries face much larger regulatory burdens than those in rich countries

It takes 153 days to start a business in Maputo, but 2 days in Toronto. It costs $2,042 or 126% of the debt value to enforce a contract in Jakarta, but $1,300 or 5.4% of the debt value to do so in Seoul. It takes 21 procedures to register commercial property in Abuja, but 3 procedures in Helsinki. If a debtor becomes insolvent and enters bankruptcy, creditors would get 13 cents on the dollar in Mumbai, but more than 90 cents in Tokyo. Borrowers and lenders are entitled to 10 main types of legal rights in Singapore, but only 2 in Yemen.

These differences persist across the world: the countries that most need entrepreneurs to create jobs and boost growth—poor countries—put the most obstacles in their way (figure 1.3). The average difference between poor and rich countries on *Doing Business* cost indicators is threefold. Rich countries score twice poor ones on indicators relating to property rights—enforcing contracts, protecting investors and legal rights of borrowers and lenders. Latin American countries have very high regulatory obstacles to doing business. But African countries are even worse—and African countries reformed the least in 2003.

FIGURE 1.3

More regulatory obstacles in poor countries



Source: Doing Business database.

Heavy regulation and weak property rights exclude the poor from doing business

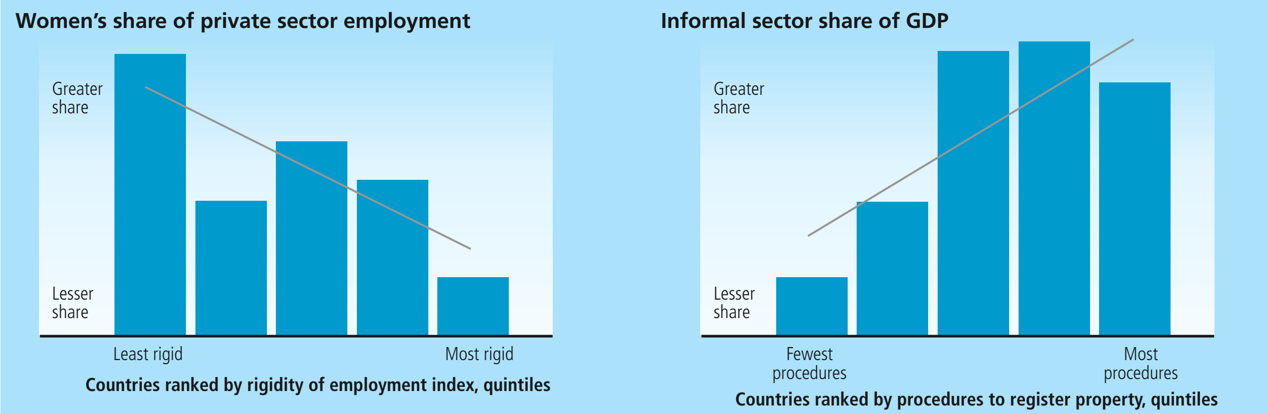
In *The Mystery of Capital*, Hernando de Soto exposed the damaging effects of heavy business regulation and weak property rights. With burdensome entry regulations, few businesses bother to register. Instead, they choose to operate in the informal economy. Facing high transaction costs to get formal property title, many would-be entrepreneurs own informal assets that cannot be used as collateral to obtain loans. De Soto calls this "dead capital." The solution: simplify business entry and get titles to property.

But many titling programs aimed at bringing assets into the formal sector have not had the lasting impact that reformers hoped for. *Doing Business in 2005* helps explain why. While it is critical to encourage registration of assets, it is as important—and harder—to stop them from slipping back into the informal sector and to use their formal status to gain access to credit.

Registering property—a new topic in this year's report—explains that when formalizing property rights is accompanied by improvements in the land registry, collateral registry, the courts, and employment regulation, the benefits are much greater. If the formal cost of selling the property is high, titles will lapse by being traded informally. In Nigeria and Senegal that cost amounts to about 30% of the property value. And even when a formal title is well-established, it will not help to increase access to credit if courts are inefficient, collateral laws are poor and there are no credit information systems, because no one would be willing to lend. Add to this rigid employment regulation, and few people will be hired. Women, young and low-skilled workers are hurt the most: their only choice is to seek jobs in the informal sector (figure 1.4).

Two examples. Nerma operates a small laboratory in Istanbul. She feels strongly about providing job opportunities for women but says employment legislation dis-

FIGURE 1.4
Complex regulations exclude the disadvantaged from doing business



Note: Relationships are significant at the 5% level, controlling for income per capita.
Source: Doing Business database, World Bank (2004a), WEF (2004).

courages it. When women marry they are given a year to decide whether to leave their job and if they choose to go, the employer is required to pay a severance payment based on years of service. And, if the business experiences a drop in demand, it costs the employer the equivalent of 112 weeks salary to dismiss a redundant worker. With such rigid regulation, employers choose conservatively. Only 16% of Turkish women are formally employed.

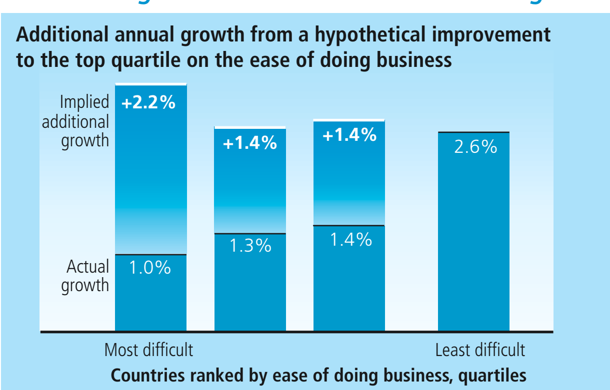
Rafael runs a trading business in Guatemala. A large customer refuses to pay for equipment delivered 2 months earlier. It would take more than 4 years to resolve the commercial dispute in the courts and even then the outcome is uncertain. Rafael has no choice but to negotiate with the customer and ends up getting only a third of the amount due. With no money to pay his taxes, Rafael closes the business and goes informal. He is not alone. More than half of economic activity in Guatemala is in the informal sector.

Payoffs from reform appear large

A hypothetical improvement on all aspects of the *Doing Business* indicators to reach the level of the top quartile of countries is associated with an estimated 1.4 to 2.2 percentage points in annual economic growth (figure 1.5).[4] This is after controlling for other factors, such as income, government expenditure, investment, education, inflation, conflict and geographic regions. In contrast, improving to the level of the top quartile of countries on macroeconomic and education indicators is associated with 0.4 to 1.0 additional percentage points in growth.

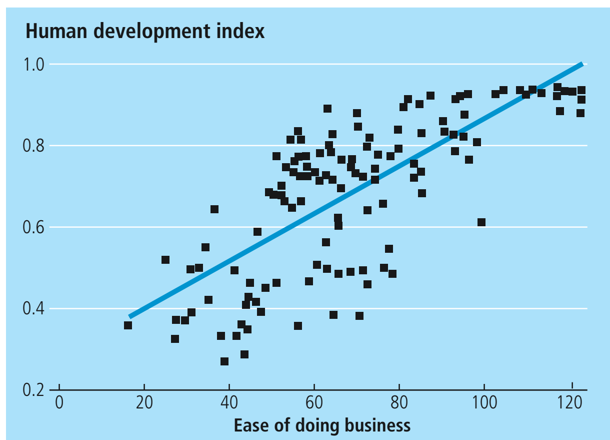
How significant is the impact of regulatory reform? Very. Only 24 of the 85 poor countries averaged at least 2% growth in the last 10 years. China, the most prominent among the 24, scores higher on the ease of doing business than Argentina, Brazil, Indonesia or Turkey.

FIGURE 1.5
Ease of doing business is associated with more growth



Note: Analysis controls for income, government expenditure, primary and secondary enrollment, inflation, investment, regions and civil conflict. Relationships are significant at the 5% level.
Source: Doing Business database, Djankov, McLiesh and Ramalho (2004).

FIGURE 1.6
Simpler business regulation, more human development



Source: Doing Business database, UNDP (2004).

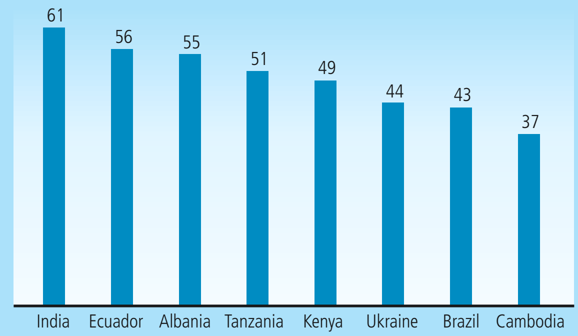
Economic growth is only one benefit of better business regulation and property protection. Human development indicators are higher as well (figure 1.6). Governments can use revenues to improve their health and education systems, rather than support an overblown bureaucracy.

The gains come from two sources. First, businesses spend less time and money on dealing with regulations and chasing after scarce sources of finance (figure 1.7). Instead, they spend their energies on producing and marketing their goods. Second, the government spends fewer resources regulating and more providing basic social services. Sweden, a top 10 country on the ease of doing business, spends $7 billion a year or 8% of the government budget, and employs an estimated 100,000 government officials to deal with business regulations.[5] The United Kingdom spends $56 billion a year, or nearly 10% of the budget, to administer business regulation.[6] The Netherlands spends $22 billion or 11% of its budget. Belgium, $10 billion. Norway, $6 billion.[7] In both countries, this amounts to about 9% of government spending.

What would happen if these countries were to reduce red tape by a moderate 15%? The savings would amount to between 1.2% and 1.8% of total government expenditures, or approximately half of the public health budget. Some governments are more ambitious. In 2002 the Dutch government set a goal of cutting expenditures on administrative burdens by 25% by 2006. Actal, an independent agency for cutting red tape, estimates that $2 billion has already been saved by doing impact assessments before new regulations reach the parliament. The Belgian government has set the same 25% reduction as a goal. Denmark, France, Italy and Norway have also set quantitative goals for reducing red tape.

FIGURE 1.7
High costs of dealing with business regulation

Percentage of firms reporting that government regulations occupy 10% or more of senior management time



Source: World Bank investment climate assessments.

What to reform?

The benefits of regulatory reform are likely to be even greater in developing countries, which regulate more. Yet few governments are eager to reform, arguing that they have limited capacity, that it takes a long time and that it costs a lot. In 2003 countries that scored the lowest on the ease of doing business measure reformed at one third the rate of countries in the top quartile.

Reform involves simplification. Governments would have more capacity and more money if they reformed. With so many examples of good practice to learn from, there is no reason to wait (table 1.3).

Imagine Namibia wants to be among the best in regulating business entry. A delegation from the company registrar's office could visit Australia, Canada or New Zealand and see how the process works there. To learn how reforms take place, it could travel to Serbia and Montenegro, which just passed legislation to move registration out of the courts—and to Italy, which made the entry process much easier by establishing a single access point. Or one could visit countries nearby—Botswana, South Africa and Uganda all have well-functioning business entry. The same approach could be followed for reforms of regulations of labor, credit, property, corporate governance, courts and bankruptcy.

To prioritize reform, governments can start by measuring regulatory costs and identifying the biggest opportunities for improvement. Belgium did so by introducing an annual survey of enterprises on the main regulatory obstacles they face. A total of 2,600 businesses participate in the survey, and the results are reported to the parliament. The process identified problems in company registration—a main reason for the 2003 reform—and in business licensing, where reform is ongoing. Actal, the independent agency in the Dutch government, performs cost-benefit analysis of regulatory proposals. Along with similar agencies in Denmark and Korea, it is among the best in measuring and reducing red tape. There are success stories in developing countries too. In Mozambique and Vietnam, the government regularly seeks advice from the business community on priorities for reform.

TABLE 1.3
Simple solutions and where they have worked

	Principles of good regulation
Starting a business	• Registration as an administrative process CANADA, CHILE, ITALY, SERBIA AND MONTENEGRO • Use of single identification number BELGIUM, ESTONIA, MOROCCO, TURKEY • No minimum capital requirement BOTSWANA, IRELAND, TANZANIA, THAILAND • Electronic application made possible LATVIA, MOLDOVA, SWEDEN, VIETNAM
Hiring and firing workers	• Long duration of fixed-term contracts AUSTRIA, COSTA RICA, DENMARK, MALAYSIA • Apprentice wages for young workers CHILE, ECUADOR, FINLAND, TUNISIA • Redundancy as grounds for dismissal ARMENIA, BOTSWANA, LEBANON, RUSSIA • Moderate severance pay for redundancy FINLAND, MADAGASCAR, NAMIBIA, URUGUAY
Registering property	• Consolidate procedures at the registry LITHUANIA, NORWAY, THAILAND • Unify or link the cadastre and property AUSTRALIA, NETHERLANDS, SLOVAKIA • Make the registry electronic ITALY, NEW ZEALAND, SINGAPORE • Complete the cadastre AUSTRIA, CZECH REPUBLIC, DENMARK, IRELAND
Enforcing contracts	• Summary proceedings for debt collection BOSNIA AND HERZEGOVINA, FINLAND, LITHUANIA, PHILIPPINES • Case management in courts INDIA, MALAYSIA, SLOVAKIA, UNITED STATES • Appeals are limited BOTSWANA, CHILE, ESTONIA, GREECE • Enforcement moved out of court HUNGARY, IRELAND, NETHERLANDS, SWEDEN
Getting credit	• Legal protections in collateral law ALBANIA, NEW ZEALAND, SLOVAKIA, UNITED STATES • No restrictions on assets for collateral AUSTRALIA, SINGAPORE, UNITED KINGDOM • Sharing of positive credit information GERMANY, HONG KONG (CHINA), MALAYSIA • Data protection laws to ensure quality ARGENTINA, BELGIUM, UNITED STATES
Protecting investors	• Derivative suits allowed CHILE, CZECH REPUBLIC, KOREA, NORWAY • Institutional investors active CHILE, KOREA, UNITED KINGDOM, UNITED STATES • Disclosure of family and indirect ownership DENMARK, SWEDEN, THAILAND, TUNISIA • Public access to ownership and financial data GERMANY, POLAND, SOUTH AFRICA
Closing a business	• Foreclosure focus in poor countries ARMENIA, KENYA, NEPAL, PARAGUAY • Specialized expertise in the courts COLOMBIA, INDIA, LATVIA, TANZANIA • Appeals are limited AUSTRALIA, ESTONIA, MEXICO, ROMANIA • Administrators are paid for maximizing value DENMARK, JAPAN, JORDAN, MALAYSIA

Source: Doing Business database.

Which myths to dispel?

This year's analysis has also dispelled some commonly held beliefs about the environment for doing business.

Myth #1 Regulatory reform is costly

The costs are modest for many of the reforms just outlined. Setting up a private credit bureau cost less than $2 million in Bosnia and Herzegovina. Setting up an administrative agency for business registration cost less than $2 million in Serbia and Montenegro. Integrating the business start-up process into a single access point cost $10 million in Turkey. Simple calculations from growth analysis suggest that the benefit-to-cost ratios of such reforms are on the order of 25:1.[8] Easing start-up was recently listed by a panel packed with Nobel laureates as one of the most cost-effective ways to spur development—ahead of investing in infrastructure, developing the financial sector and scaling up health services.[9]

Myth #2 Social protection requires more business regulation

Just look at the Nordic countries. All four Nordic economies in *Doing Business* are on the list of countries with the simplest business regulation: Norway (#5), Sweden (#9), Denmark (#12) and Finland (#14). Few would argue that they scrimp on social benefits relative to other countries, or regulate too little. Instead, they have simple regulations that allow businesses to be productive. And they focus regulation on where it counts—protecting property rights and providing social services. Estonia, Latvia and Lithuania, having learned much from their richer neighbors, are also among the countries with the best business environment. Heavier business regulation is not associated with better social outcomes.[10]

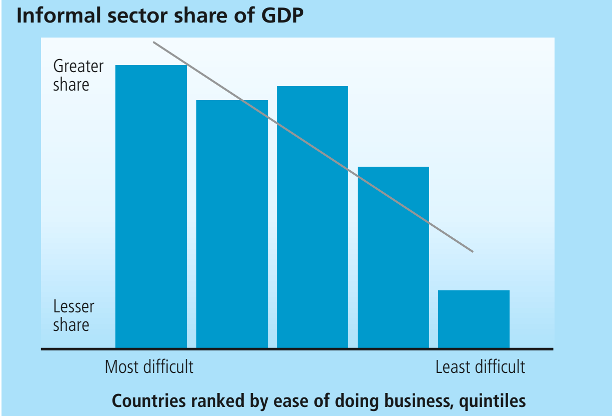
Myth #3 Entrepreneurs in developing countries face frequent changes in laws and regulations

Entrepreneurs complain of unpredictability. And governments complain of reform fatigue, blaming the development aid agencies. Yet reforms in developing countries are rare. Many have been stuck with the same laws and regulations for decades: Mozambique's company law dates from 1888, Angola's from 1901. No legal change there. The difficulties businesses face come from a lack of information and from discretion in enforcement. There are simple solutions. Online services in the company registrar can make it clear how to start a business. Disclosure laws can reveal company ownership and finances. And collateral and property registries can determine who owns what.

Myth #4 Regulation is irrelevant in developing countries because enforcement is poor

If it were, it would not be associated with so much informality (figure 1.8). Few businesses comply with all regulations in poor countries, since it is so prohibitively costly that entrepreneurs choose to operate in the informal economy. A large informal sector is bad for the economy: it creates distortions, reduces tax revenues and excludes many people from basic protections. If regulation were simplified, entrepreneurs would find benefits in moving to the formal sector, such as greater access to credit and to courts.

FIGURE 1.8
Heavier regulation—more informality



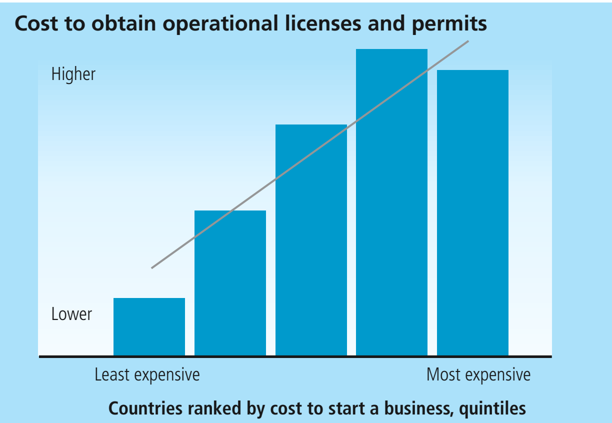
Source: Doing Business database.

What to expect next?

Three other areas of the business environment are being researched. First, dealing with business licenses. One argument that government officials give for why business entry is difficult is that they don't need to spend many resources on regulation once the worthy entrants are selected. Studying business licensing tests this argument—and the argument fails. The same countries that heavily regulate entry also have more complex and burdensome licensing regimes (figure 1.9). The data and analysis will be released in late 2004 on the *Doing Business* website.

Two new topics will be featured in *Doing Business in 2006*. One is trade logistics. What are the procedures, time and cost for an exporter to bring goods from the factory door to the ship, train or truck and across the border? What does it take to import a good and bring it to the store shelf? How to deal with customs, pre-shipment inspections and technical and quality certification?

FIGURE 1.9
Bureaucratic entry, bureaucratic operations



Source: Doing Business database.

The other is corporate taxation—its level, structure and administration. Tax reform has been hotly debated, especially in Europe, where several transition economies—Bulgaria, Poland, Russia and Slovakia—are moving to or have already adopted flat corporate and personal tax at rates lower than the ones in other European countries. Estonia has no tax on corporate earnings if they are re-invested. Whether lowering taxation spurs enough new business activity to make up for the loss of budget revenues is a question that will be addressed next year.

The number of sample countries will continue to expand. This year, Bhutan and Estonia were included in this report. Data for Fiji, Kiribati, the Maldives, the Marshall Islands, Micronesia, Palau, Samoa, the Solomon Islands, Tonga and Vanuatu are available on the *Doing Business* website. The governments of another dozen countries, such as Cape Verde and Tajikistan, have requested inclusion in next year's sample.

Beyond adding new topics and countries is the challenge of understanding how reform takes place. *Doing Business* started by studying what entrepreneurs go through in starting a business, hiring and firing workers, enforcing contracts, registering property, getting credit, protecting investors and closing a business. With time, the project is building more information on reforms—what motivates them, how to manage them and what their impact is. Coming in *Doing Business in 2006* are studies of what reformers go through to improve business conditions.

Notes

1. Poor countries are defined as low and lower middle income economies under World Bank Group income classifications.
2. As a part of the IDA13 round of funding, 39 IDA borrowers were monitored on the days and cost to start a business between January 2002 and January 2004. The population-weighted change during this period was –12% on days to start a business and –9% on cost to start a business.
3. The ease of doing business measure is the simple average of country rankings (from 1 to 135) in each of the 7 topics covered in Doing Business in 2005. The ranking for each topic is the simple average of rankings for each of the indicators—for example the starting a business ranking averages the country rankings on the procedures, days, cost and minimum capital requirement to register a business.
4. Based on a hypothetical improvement to the average of the top quartile of countries on the ease of doing business indicator. Standard growth regression analysis estimates the relationship between 10 year average annual GDP growth rates and the ease of doing business indicator. The analysis controls for income, government expenditure, primary and secondary school enrollment, inflation, investment, civil conflict and regions. The relationship is robust using 5, 15 and 20 year growth rates, as well as when controlling for trade, ethnolinguistic fractionalization, latitude, and in instrumental regressions. See Djankov, McLiesh and Ramalho (2004).
5. NNR (2003).
6. British Chamber of Commerce (2004).
7. The data for Belgium, the Netherlands, and Norway come from Danish Commerce and Companies Agency (2003).
8. Growth estimates implied from the analysis in Klapper, Laeven and Rajan (2004) suggest benefits of $48 million from the reforms implemented in Serbia and Montenegro, and $413 million in Turkey, in the first year alone.
9. Copenhagen Consensus (2004). Available at http://www.copenhagenconsensus.com/
10. Djankov and others (2002).

Acknowledgments

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