

Doing business in 2004

Understanding Regulation

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1818 H Street NW
Washington, D.C. 20433
Telephone 202-473-1000
Internet www.worldbank.org
E-mail feedback@worldbank.org

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Doing Business in 2004 was prepared by a team led by Simeon Djankov. Caralee McLiesh co-managed development and production of the report. The work was carried out under the general direction of Michael Klein. Simeon Djankov coordinated the work on starting a business and hiring and firing workers. Caralee McLiesh led the work on getting finance. Tatiana Nenova designed and implemented the study on closing a business. Simeon Djankov and Stefka Slavova coordinated the work on enforcing a contract. The team also comprised Ziad Azar, Geronimo Frigerio, Joanna Kata-Blackman, and Lihong Wang and was assisted by Bekhzod Abdurazzakov, Yanni Chen, Marcelo Lu, Totka Naneva, and Tania Yancheva. Zai Fanai and Grace Sorensen provided administrative support.

Andrei Shleifer co-authored the main background studies and provided valuable suggestions throughout the writing of the report. Florencio Lopez-de-Silanes and Rafael La Porta co-authored the background studies on starting a business, hiring and firing workers, and enforcing a contract. Oliver Hart co-authored the background study on closing a business. Bruce Ross-Larson edited the manuscript. Nataliya Mylenko contributed to the research and chapter on getting credit. The survey of credit registries was developed in cooperation with the Credit Reporting Systems Project in the World Bank, and the survey on closing a business was developed with the assistance of Selinda Melnik. Nicola Jentzsch and Fredrich Schneider wrote background papers on the regulation of credit information and the informal economy, respectively. Leszek Balcerowicz, Hernando de Soto, Bradford DeLong, and Andrei Shleifer contributed lectures on the scope of government.

Preparation of the report was made possible by the contributions of more than 2,000 judges, lawyers, accountants, credit registry representatives, business consultants, and government officials from around the world. Many of the contributors are partners in Lex Mundi law firms or are members of the International Bar Association. Their names are listed in the Contributors' section and their contact details are on the *Doing Business* web site.

Individual chapters were refereed by: Elizabeth Adu, Asya Akhlaque, Gordon Betcherman, Harry Broadman, Gerard Byam, Gerard Caprio, Amanda Carlier, Jacqueline Coolidge, Asli Demirguc-Kunt, Julia Devlin, Michael Fuchs, Luke Haggarty, Mary Hallward-Driemeier, Linn Hammergren, Eric Haythorne, Aart Kraay, Peter Kyle, Katarina Mathernova, Richard Messick, Margaret Miller, Claudio Montenegro, Reema Nayar, S. Ramachandran, Jan Rutkowski, Stefano Scarpetta, Peer Stein, Ahmet Soylemezoglu, Andrew Stone, and Stoyan Tenev. A draft report was reviewed by David Dollar, Cheryl Gray, W. Paatii Oforu-Amaah, Guy Pfeffermann, and Sanjay Pradhan. Axel Peuker, Neil Roger, and Suzanne Smith provided advice and comments throughout the development of the report. Tercan Baysan, Najy Benhassine, Vinay Bhargava, Harry Broadman, Gerard Caprio, Mierta Capaul, David Dollar, Qimiao Fan, Caroline Freund, Alan Gelb, Indermit Gill, Frannie Leautier, Syed Mahmood, Andrei Michnev, John Page, Sanjay Pradhan, Mohammad Zia M. Qureshi, Stoyan Tenev, Cornelius van der Meer, and Gerald West read the penultimate draft and suggested changes. The online service of the *Doing Business* database is sponsored by the Rapid Response Unit of the World Bank Group.

A vibrant private sector—with firms making investments, creating jobs, and improving productivity—promotes growth and expands opportunities for poor people. To create one, governments around the world have implemented wide-ranging reforms, including macro-stabilization programs, price liberalization, privatization, and trade-barrier reductions. In many countries, however, entrepreneurial activity remains limited, poverty high, and growth stagnant. And other countries have spurned orthodox macro reforms and done well. How so?

Although macro policies are unquestionably important, there is a growing consensus that the quality of business regulation and the institutions that enforce it are a major determinant of prosperity. Hong Kong (China)'s economic success, Botswana's stellar growth performance, and Hungary's smooth transition experience have all been stimulated by a good regulatory environment. But little research has measured specific aspects of regulation and analyzed their impact on economic outcomes such as productivity, investment, informality, corruption, unemployment, and poverty. The lack of systematic knowledge prevents policymakers from assessing how good legal and regulatory systems are and determining what to reform.

Doing Business in 2004: Understanding Regulation is the first in a series of annual reports investigating the scope and manner of regulations that enhance business activity and those that constrain it. The present volume compares more than 130 countries—from Albania to Zimbabwe—on the basis of new quantitative indicators of business regulations. The indicators are used to analyze economic outcomes and identify what reforms have worked, where, and why.

What Is New?

Many sources of data help explain the business environment. More than a dozen organizations—such as Freedom House, the Heritage Foundation, and the World Economic Forum—produce and periodically update indicators on country risk, economic freedom, and international competitiveness. As gauges of general economic and policy conditions, these indicators help identify broad priorities for reform. But few indicators focus on the poorest countries, and most of them are designed to inform foreign investors. Yet it is local firms, which are responsible for most economic activity in developing countries, that could benefit the most from reforms. Moreover, many existing indicators rely on perceptions, notoriously difficult to compare across countries or translate into policy recommendations. According to one survey, Belarus and Uzbekistan rank ahead of France, Germany, and Sweden in firms' satisfaction with the efficiency of government. Most important, no indicators assess specific laws and regulations regarding business activity or the public institutions that enforce them. So these indicators provide insufficient detail to guide reform of the scope and efficiency of government regulation.

The indicators in the present volume represent a new approach to measurement. The focus is on domestic, primarily smaller, companies. The analysis is based on assessments of laws and regulations, with input from and verification by local experts who deal with practical situations of the type covered in the report.

This methodology offers several advantages. It is based on factual information concerning laws and regulations in force. It is transparent and easily replicable—allowing broad country coverage, annual updates, and ready extension to new locations. It covers regulatory outcomes, such as the time and cost of meeting regulatory requirements to register a business, as well as measures of actual regulations, such as an index of the rigidity of employment law or the procedures to enforce a contract. It also investigates the efficiency of government institutions, including business registries, courts, and public credit registries. Most important, the methodology builds on extensive and detailed information on regulations—information directly relevant to identifying specific problems and designing reforms.

The *Doing Business* series represents a collaborative effort. The *Doing Business* team works with leading scholars in the development of indicators. This cooperation provides academic rigor and links theory to practice. For this year's report, Professor Andrei Shleifer (Harvard University) served as adviser on all projects. Professor Oliver Hart (Harvard University) advised on the bankruptcy project, and Professor Florencio Lopez-de-Silanes (International Institute of Corporate Governance, Yale School of Management) and Professor Rafael La Porta (Dartmouth) advised on the business registration, contract enforcement, and labor projects.

Each project involves a partnership with an association of practitioners or an international company. For example, the contract enforcement project was conducted with Lex Mundi, the largest international association of private law firms. The project on credit market institutions benefited from collaboration with the law firm of Baker and McKenzie, the International Bar Association Committee on International Financial Law Reform, and Dun and Bradstreet. The bankruptcy project was conducted with the help of the Insolvency Committee of the International Bar Association.

The *Doing Business* project receives the invaluable cooperation of local partners—municipal officials, registrars, tax officers, labor lawyers and labor ministry officials, credit registry managers, financial lawyers, incorporation lawyers in the case of business

start-ups, bankruptcy lawyers, and judges. Only those with extensive professional knowledge and experience provide data, and the indicators build on local knowledge.

Once the analysis is completed, the results are subject to a peer-review process in leading academic journals. Simultaneously, the background research is presented at conferences and seminars organized with private-sector partners. For example, preliminary results of the bankruptcy project were discussed with members of the International Bar Association at the association's meetings in Dublin (Ireland), Durban (South Africa), Rome (Italy), and New York (United States). The data are posted on the web (<http://rru.worldbank.org/doingbusiness>), so anyone can check and challenge their veracity. This continual process of refinement produces indicators that have been scrutinized by the academic community, government officials, and local professionals.

What Does *Doing Business* Aim to Achieve?

Two years ago, the World Bank Group outlined a new strategy for tapping private initiative to reduce poverty. The *Doing Business* project aims to advance the World Bank Group's private sector development agenda:

- *Motivating reforms through country benchmarking.* Around the world, international and local benchmarking has proved to be a powerful force for mobilizing society to demand improved public services, enhanced political accountability, and better economic policy. Transparent scoring on macroeconomic and social indicators has intensified the desire for change—witness the impact of the human development index, developed by the United Nations' Development Programme, on getting countries to emphasize health and education in their development strategies. The *Doing Business* data provide reformers with comparisons on a different dimension: the regulatory environment for business.
- *Informing the design of reforms.* The data analyzed in *Doing Business* highlight specifically what needs

to be changed when reforms are designed, because the indicators are backed by an extensive description of regulations. Reformers can also benefit from reviewing the experience of countries that perform well according to the indicators.

- *Enriching international initiatives on development effectiveness.* Recognizing that aid works best in good institutional environments, international donors are moving toward more extensive monitoring of aid effectiveness and performance-based funding. The U.S. government's Millennium Challenge Account and the International Development Association's performance-based funding allocations are two examples. It is essential that such efforts be based on good-quality data that can be influenced directly by policy reform. This is exactly what *Doing Business* indicators provide.
- *Informing theory.* Regulatory economics is largely theoretical. By producing new indicators that quantify various aspects of regulation, *Doing Business* facilitates tests of existing theories and contributes to the empirical foundation for new theoretical work on the relation between regulation and development.

What to Expect Next

This report summarizes the results of the first year of the *Doing Business* project. The volume is only the first product of an ambitious study of the determinants of private sector development. About a dozen topics in the business environment will be developed over three years. This year, five topics are analyzed. They cover the fundamental aspects of a firm's life cycle: starting a business, hiring and firing workers, enforcing contracts, getting credit, and closing a business. Over the next two years, *Doing Business* will extend the coverage of topics. *Doing Business in 2005* will discuss three new topics—registering property, dealing with government licenses and

inspections, and protecting investors. *Doing Business in 2006* will study three other topics: paying taxes, trading across borders, and improving law and order.

The indicators will be updated annually to provide time-series data on progress with reform. Currently the *Doing Business* project does not focus on the political economy of reform. As more data become available, the project will include exploration of political economy issues and measurement of reform impact, as well as the cross-section analysis that this report presents.

The project will also create case studies of reform. It will document past experiences, the forces behind reform, and the features responsible for reforms' ultimate success or failure. This information will help policymakers design and manage reform.

The impact of regulations is measured by their relationship to economic outcomes. Although data on some outcomes such as income growth and employment are readily available, data on others are not. The *Doing Business* project has begun to address this gap by supporting work on the size of the informal business sector and the determinants of entrepreneurship. In future years, other economic outcome variables will be analyzed.

The new data and analysis deepen our understanding of productivity growth and the optimal scope for government in regulating business activity. Under the auspices of the *Doing Business* project, Dr. Leszek Balcerowicz (National Bank of Poland), Professor Bradford DeLong (University of California at Berkeley), Hernando de Soto (Institute of Liberty and Democracy in Lima, Peru), and Professor Andrei Shleifer (Harvard University) have been invited to give lectures on government regulation of business. In coming years other outstanding economic thinkers will be invited to give lectures on *Doing Business* topics.

Updated indicators and analysis of topics, as well as any revisions of or corrections to the printed data, are available on the *Doing Business* Web site: <http://rru.worldbank.org/doingbusiness>.

Teuku, an entrepreneur in Jakarta, wants to open a textile factory. He has customers lined up, imported machinery, and a promising business plan. Teuku's first encounter with the government is when registering his business. He gets the standard forms from the Ministry of Justice, and completes and notarizes them. Teuku proves that he is a local resident and does not have a criminal record. He obtains a tax number, applies for a business license, and deposits the minimum capital (three times national income per capita) in the bank. He then publishes the articles of association in the official gazette, pays a stamp fee, registers at the ministry of justice, and waits 90 days before filing for social security. One hundred sixty-eight days after he commences the process, Teuku can legally start operations. In the meantime, his customers have contracted with another business.

In Panama, another entrepreneur, Ina, registers her construction company in only 19 days. Business is booming and Ina wants to hire someone for a two-year appointment. But the employment law only allows fixed-term appointments for specific tasks, and even then requires a maximum term of one year. At the same time, one of her current workers often leaves early, with no excuse, and makes costly mistakes. To replace him, Ina needs to notify and get approval from the union, and pay five months' severance pay. Ina rejects the more qualified applicant she would like to hire and keeps the underperforming worker on staff.

Ali, a trader in the United Arab Emirates, can hire and fire with ease. But one of his customers refuses to pay for equipment delivered three months earlier. It takes 27 procedures and more than 550 days to resolve

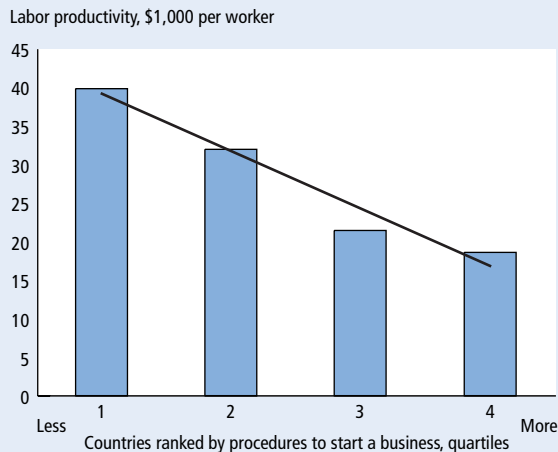
the payment dispute in court. Almost all procedures must be made in writing, and require extensive legal justification and the use of lawyers. After this experience, Ali decides to deal only with customers he knows well.

Timnit, a young entrepreneur in Ethiopia, wants to expand her successful consulting business by taking a loan. But she has no proof of good credit history because there are no credit information registries. Although her business has substantial assets in accounts receivable, laws restrict her bank from using these as collateral. The bank knows it cannot recover the debt if Timnit defaults, because courts are inefficient and laws give creditors few powers. Credit is denied. The business stays small.

Having registered, hired workers, enforced contracts, and obtained credit, Avik, a businessman in India, cannot make a profit and goes out of business. Faced with a 10-year-long process of going through bankruptcy, Avik absconds, leaving his workers, the bank, and the tax agency with nothing.

Does cumbersome business regulation matter? Yes, and particularly for poor people. In much of Africa, Latin America, and the former Soviet Union, excessive regulation stifles productive activity (figure 1). And government does not focus on what it should—defining and protecting property rights. These are the regions where growth stagnates, few new jobs are created, and poverty has risen. In Africa, poverty rates have increased in the last three decades, with more than 40 percent of the population now living on less than one dollar a day. Two decades of macroeconomic reform in Latin America have not slowed the rise in poverty. And in most former Soviet

Figure 1
Cumbersome Regulation Is Associated with Lower Productivity



Sources: *Doing Business* database; *World Development Indicators* 2003.

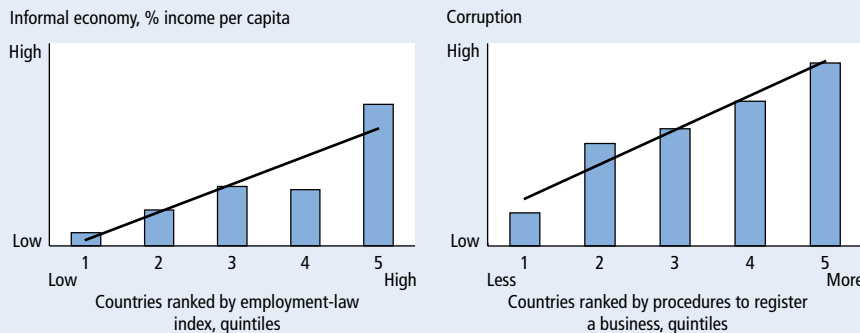
find a decent job. Studies using household survey data confirm this—the vast majority of people who escape from poverty do so by taking up new employment opportunities.

Not any job will lead out of poverty. If it were simply a matter of creating jobs, having the state employ everyone would do the trick. This has been tried in some parts of the world, notably in communist regimes. What is needed is to create productive jobs and new businesses that create wealth. For this, companies need to adjust to new market conditions and seize opportunities for growth. But all too frequently this flexibility is taken away by cumbersome regulation. Productive businesses thrive where government focuses on the definition and protection of property rights. But where the government regulates every aspect of business activity heavily, businesses operate in the informal economy.

Regulatory intervention is particularly damaging in countries where its enforcement is subject to abuse and corruption (figure 2).

To document the regulation of business and investigate the effect of regulation on such economic outcomes as productivity, unemployment, growth, poverty, and informality, the *Doing Business* team collected and analyzed data on five topics—starting a business, hiring and firing workers, enforcing a contract, getting credit, and

Figure 2
Heavier Regulation Is Associated with Informality and Corruption



Note: The correlations shown in these figures control for income. Relationships are significant at the 1 percent level.

Sources: *Doing Business* database; Schneider 2002; Kaufmann, Kraay, and Mastruzzi 2003.

countries, poverty increased in the decade prior to the fall of communism, and even faster thereafter. In 2003, the number of people earning less than a dollar a day remains at 1.2 billion and the number earning less than two dollars a day at 2.8 billion.

“First, I would like to have work of any kind,” says an 18-year-old Ecuadorian. The quotation is from *Voices of the Poor*, a World Bank survey capturing the perspectives of poor people around the world. People know how to escape poverty. What they need is to

closing a business. The efficiency of the enforcement institutions—commercial registries; municipal offices; tax, fire-and-safety, and labor inspectorates; credit and collateral registries; and courts—has also been assessed.

Doing Business starts by asking five questions. Are there significant differences in business regulation across countries? If so, what explains these differences? What types of regulation lead to improved economic and social outcomes? What are the most successful

regulatory models? And, more generally, what is the scope for government in facilitating business activity? As the coverage of topics expands in future editions of *Doing Business*, these questions will be further explored. The analysis in this year's report yields some preliminary answers.

Poor Countries Regulate Business the Most

It takes 2 days to start a business in Australia, but 203 days in Haiti and 215 days in the Democratic Republic of Congo. There are no monetary costs to start a new business in Denmark, but it costs more than 5 times income per capita in Cambodia and over 13 times in Sierra Leone. Hong Kong (China), Singapore, Thailand, and more than three dozen other economies require no minimum capital from start-ups. In contrast, in Syria the capital requirement is equivalent to 56 times income per capita, in Ethiopia and Yemen, 17 times, in Mali, 6 times.

Businesses in the Czech Republic and Denmark can hire workers on part-time or fixed-term contracts for any job, without specifying maximum duration of the contract. Part-time work, exempt from some regulations, is less costly to terminate than full-time employment. In contrast, employment laws in El Salvador allow fixed-term contracts only for specific jobs, and set their duration to be at most one year. Part-time workers receive the benefits of full-time workers, and are subject to the same regulation on procedures for dismissal.

A simple commercial contract is enforced in 7 days in Tunisia and 39 days in the Netherlands, but takes almost 1,500 days in Guatemala. The cost of enforcement is less than 1 percent of the disputed amount in Austria, Canada, and the United Kingdom,

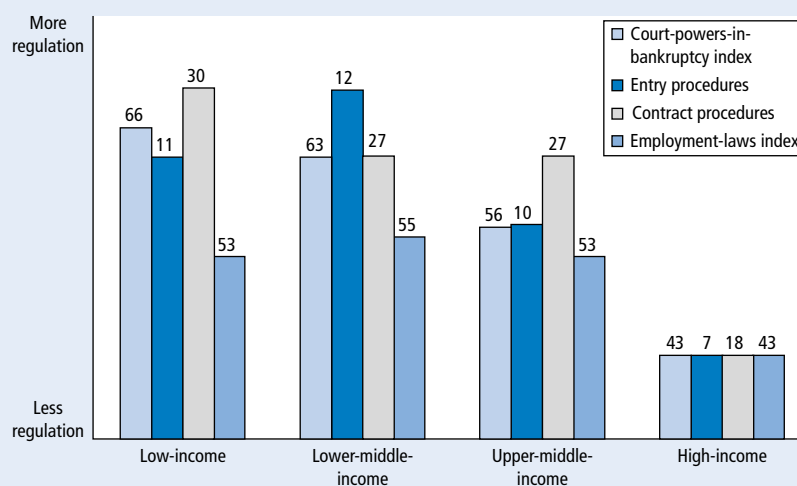
but more than 100 percent in Burkina Faso, the Dominican Republic, Indonesia, the Kyrgyz Republic, Madagascar, Malawi, and the Philippines.

Credit bureaus contain credit histories on almost every adult in New Zealand, Norway, and the United States. But the credit registries in Cameroon, Ghana, Pakistan, Nigeria, and Serbia and Montenegro have credit histories for less than 1 percent of adults. In the United Kingdom, laws on collateral and bankruptcy give creditors strong powers to recover their money if a debtor defaults. In Colombia, the Republic of Congo, Mexico, Oman, and Tunisia, a creditor has no such rights.

It takes less than six months to go through bankruptcy proceedings in Ireland and Japan, but more than 10 years in Brazil and India. It costs less than 1 percent of the value of the estate to resolve insolvency in Finland, the Netherlands, Norway, and Singapore—and nearly half the estate value in Chad, Panama, Macedonia, Venezuela, Serbia and Montenegro, and Sierra Leone.

Regulation in poor countries is more cumbersome in all aspects of business activity (figure 3). Across all five sets of indicators, Bolivia, Burkina Faso, Chad,

Figure 3
Poor Countries Regulate Business the Most



Note: The indicators for high-income countries are used as benchmarks. The average value of the indicator is shown above each column.

Source: *Doing Business* database.

Costa Rica, Guatemala, Mali, Mozambique, Paraguay, the Philippines, and Venezuela regulate the most. Australia, Canada, Denmark, Hong Kong (China), Jamaica, the Netherlands, New Zealand, Singapore, Sweden, and the United Kingdom regulate the least. There are exceptions. Among the least regulated economies, Jamaica has aggressively adopted best-practice regulation over the last two decades. Contract enforcement, for example, has been improved in line with the latest reforms in the United Kingdom, and bankruptcy law has been revised following the Australian reforms of 1992.

Another important variable in explaining different levels of regulatory intervention is legal origin. Together, income and legal origin account for more than 60 percent of the variation in regulation. While country wealth has long been recognized as a determinant of the quality of institutions (for example, in the writings of Nobel laureate Douglass North), the importance of legal origin has only recently been investigated. The regulatory regimes of most developing countries are not indigenous—they are shaped by their colonial heritage. When the English, French, Spaniards, Dutch, Germans, and Portuguese colonized much of the world, they brought with them their laws and institutions. After

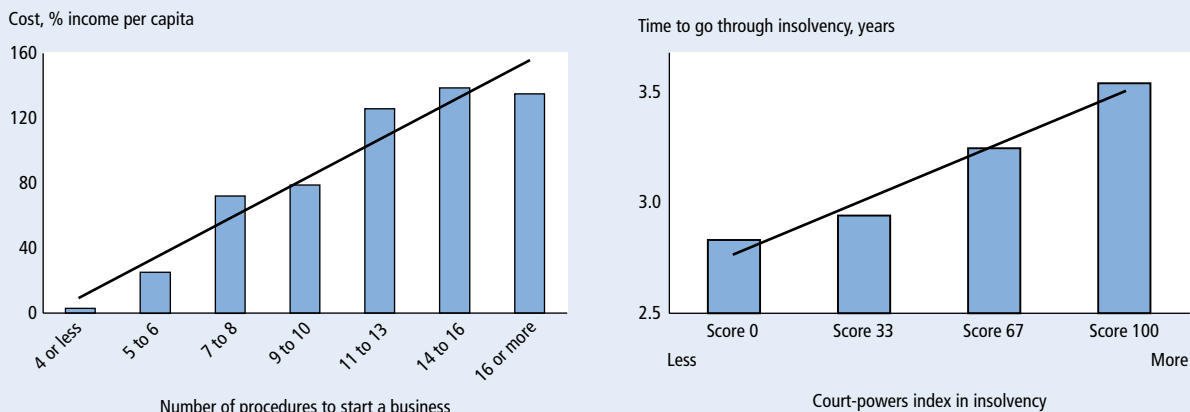
independence, many countries revised legislation, but in only a few cases have they strayed far from the original. These channels of transplantation bring about systematic variations in regulation that are not a consequence of either domestic political choice or the pressures toward regulatory efficiency. Common law countries regulate the least. Countries in the French civil law tradition the most.

However, heritage is not destiny. Tunisia, for example, is among the least regulated and most efficient countries in the area of contract enforcement. Uruguay is among the least regulated economies in the hiring and firing of workers. In contrast, Sierra Leone, a common law country, heavily regulates business entry. India, another common law country, has one of the more regulated labor markets and most inefficient insolvency systems.

Heavier Regulation Brings Bad Outcomes

Heavier regulation is generally associated with more inefficiency in public institutions—longer delays and higher cost (figure 4)—and more unemployed people, corruption, less productivity and investment, but not with better quality of private or public goods. The countries that regulate the most—poor

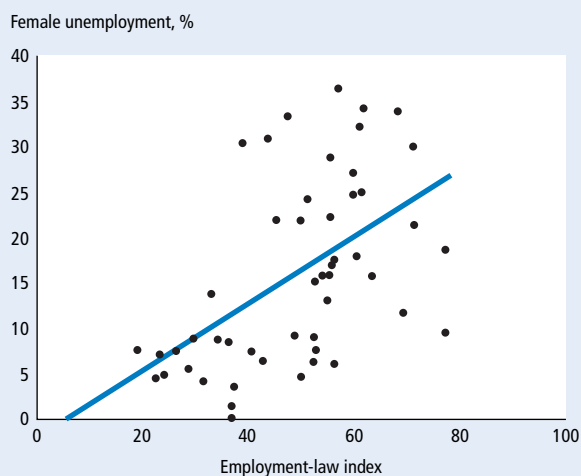
Figure 4
More Regulation Is Associated with Higher Costs and Delays



Note: The correlations shown in these figures are significant at the 10 percent level.

Source: *Doing Business* database.

Figure 5
More Rigid Employment Regulation Is Associated with Higher Female Unemployment



Note: The correlation shown in this figure remains statistically significant when controlling for income.

Sources: *Doing Business* database; *World Development Indicators* 2003.

countries—have the least enforcement capacity and the fewest checks and balances in government to ensure that regulatory discretion is not used to abuse businesses and extract bribes.

Excessive regulation has a perverse effect on the very people it is meant to protect. The rich and connected may be able to avoid cumbersome rules, or even be protected by them. Others are the hardest hit. For example, rigid employment laws are associated especially strongly with fewer job opportunities for women (figure 5). And fewer regulatory restrictions on sharing credit information benefits small firms' access to finance the most. Heavy regulation also encourages entrepreneurs to operate in the informal economy. In Bolivia, one of the most heavily regulated economies in the world, an estimated 82 percent of business activity takes place in the informal sector. There, workers enjoy no social benefits and cannot use pension plans and school funds for their children. Businesses do not pay taxes, reducing the resources for the delivery of basic infrastructure. There is no quality control for products. And entrepreneurs, fearful of inspectors and the police, keep operations below efficient production size.

Critics argue that in developing countries regulation is rarely enforced and plays no role in the conduct of everyday business. Our analysis suggests otherwise. And if it is the case that regulation is irrelevant in poor countries, why not just remove it? A doctor can be hired in place of every government official regulating business activity or compliance with employment laws. A textbook can be printed in place of every batch of paperwork required for this or that license for running a business.

Good regulation does not mean zero regulation. In all countries, the government is involved in various aspects of control of business. The optimal level of regulation is not none, but may be less than what is currently found in most countries, and especially poor ones. For business entry, two procedures—registering for statistical purposes, and for tax and social security—are necessary to fulfill the social functions of the process. Australia limits entry procedures to these two. Sweden has three, including registration with the labor office. New Zealand, the least regulated economy in the world, has 19 procedures to enforce a contract. For employment regulation, Denmark regulates the work week to 37 hours, the premium for overtime pay to 50 percent, the minimum annual paid leave to 27 days, and the severance pay of a worker with 20 or more years of experience to 10 months' wages. It also regulates other aspects of hiring and firing, and the conditions of employment. No one thinks that Danish workers are discriminated against. Yet Denmark is among the countries with the most flexible employment regulation. The Danish example is also an illustration of the difference between rigidity of regulation and social protection. Cumbersome regulation is often an inappropriate tool for protecting weak groups in society.

Instead of spending resources on more regulation, governments are better off defining the property rights of their citizens and protecting them against injury from other citizens and from the state. In *Doing Business*, two examples of such rights are creditor rights—the legal rights of lenders to recover their investment if the borrower defaults—and the efficiency of enforcing property rights through the courts. Countries that protect such rights—rich

countries like New Zealand and the United Kingdom, and poor countries like Botswana, Thailand, and South Africa—achieve better economic and social outcomes. In credit markets, assuring lenders of fair returns on investment increases the depth of credit markets and the productivity of investment, even after controlling for income, income growth, inflation, and contract enforcement. Such assurance also increases access to these markets, since lenders are willing to extend credit beyond large and connected firms if they know that their rights to recover loans are secure.

One Size Can Fit All—in the Manner of Business Regulation

Many times what works in developed countries works well in developing countries, too, defying the often-used saying, “one size doesn’t fit all.” In entry regulations, reducing the number of procedures to only those truly necessary—statistical registration, and tax and social security registration—and using the latest technology to make the registration process electronic, have produced excellent results in Canada and Singapore, Latvia and Mexico—but also in Honduras, Vietnam, Moldova, and Pakistan. Similarly, designing credit information registries has democratized credit markets in Belgium and Taiwan (China), but also in Mozambique, Namibia, Nepal, Nicaragua, and Poland.

Countries like Australia, Denmark, the Netherlands, and Sweden present best practices in business regulation, meaning regulation that fulfills the task of essential controls of business without imposing an unnecessary burden. In these countries, high levels of human capital in the public administration, and the use of modern technology, minimize the regulatory burden on businesses. And where private markets are functioning, competition is a substitute for regulation. By combining simple regulation with good definition and protection of property rights, they achieve what many others strive to do: having government regulators serve as public servants, not public masters.

Aside from how much and what they regulate, good practice countries share common elements in how they regulate. For example, countries with the least time to register a business, such as Canada, have

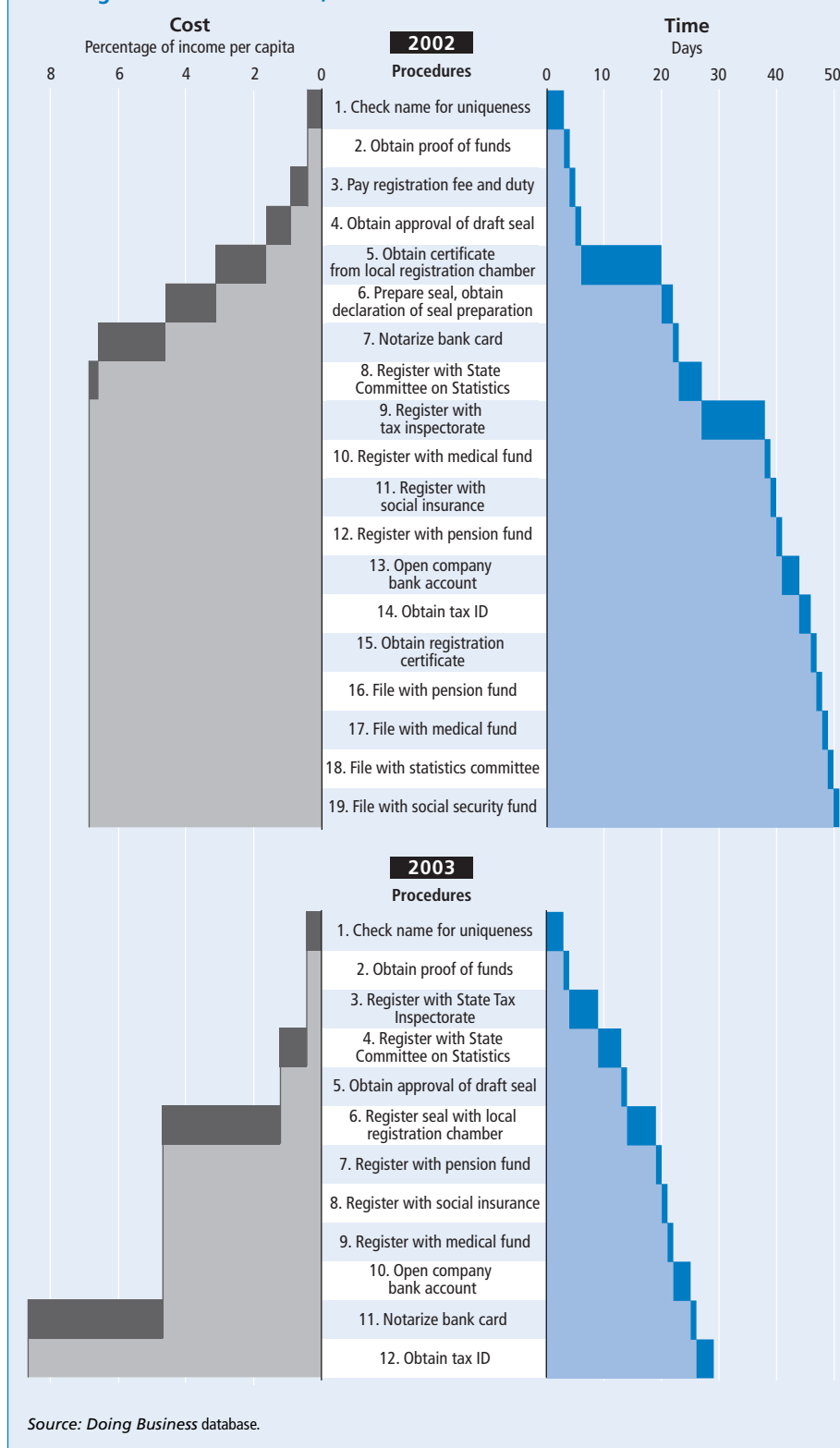
single registration forms accessible over the Internet. Countries that take the least time to enforce a collateral agreement, Germany, Thailand, and the United States, for example, allow out-of-court enforcement. The design of regulation determines the efficiency of economic and social outcomes.

Good practice is not limited to rich countries or countries where comprehensive regulatory reform has taken place. In many instances, reform in some areas of business regulation has been successful. Tunisia has one of the best contract enforcement systems in the world. Latvia is among the most efficient countries in entry regulation. In 2002, Pakistan electronically connected all tax offices in the country, and streamlined business registration. As a result, the time to start a business was reduced from 53 to 22 days. The Slovak Republic recently implemented best-practice laws on collateral. Vietnam revised its Enterprise Law in 1999 to enhance growth in private business activity.

Such partial reforms may lead to a virtuous cycle where the success of one reform emboldens policymakers to pursue further reforms. The Russian Federation simplified business entry in the past year, reducing the number of procedures from 19 to 12, and the associated time from 51 days to 29 days (figure 6). The reforms led to the creation of a large number of new private businesses, which in turn became the constituency for improvements in other regulatory practices. Employment law has since been revised, resulting in more flexibility in hiring and firing workers.

But reform options are not always the same across rich and poor countries. There are cases where good practices in developed countries are difficult to transplant to poor countries. Bankruptcy is one example where the establishment of a sophisticated bankruptcy regime in a developing country generally results in inefficiency and even corruption. Both lenders and businesses suffer. In such instances, developing countries could simplify the models used in rich countries to make them workable with less capacity and fewer resources. In the poorest countries, it is better not to develop a sophisticated bankruptcy system and to rely instead on existing contract-enforcement mechanisms or negotiations between private parties. Similarly, specialized commercial courts

Figure 6
Starting a Business in Russia, before and after Reforms



work best in countries with more resources and administrative capacity. Poor countries can implement reforms with the same principle—specialization—but with specialized judges or specialized sections within general jurisdiction courts.

Reform Practice

Regulatory reform has been continuous in most developed countries, improving the environment for doing business.

- Australia has built in regulatory reform by including “sunset” provisions in new regulations, with the regulation automatically expiring after a certain period unless renewed by Parliament. Also, the Office of Regulation Review vets each proposed regulation using a “minimum necessary regulation” principle. In 1996, the office was charged with cutting the regulatory burden on small businesses in half, with annual reviews of progress achieved.
- Denmark revised its business entry regulation in 1996 by removing several procedures, making the process electronic, and eliminating all fees. Since then, a cost-benefit analysis of proposed new regulation is conducted,

resulting in two of every five proposed regulations being shelved.

- In the Netherlands, much of the work on reducing administrative costs is done by an independent agency, ACTAL (Advisory Committee on the Testing of Administrative Burdens). Established in 2000, ACTAL has only nine staff members and is empowered to advise on all proposed laws and regulations. To date, simplification of administrative procedures has been achieved in the areas of corporate taxation, social security, environmental regulation, and statistical requirements. The estimated savings are US\$600 million from streamlining the tax requirements alone.
- Sweden has a “guillotine” approach for regulatory reform, in which hundreds of obsolete regulations are cancelled after the government periodically requires regulatory agencies to register all essential regulations.

But there has been much less reform in developing countries, with the result that businesses are sometimes burdened by outdated regulation. For example, the company law regulating business entry dates back to 1884 in the Dominican Republic, to 1901 in Angola, and to 1916 in Burkina Faso. But OECD countries have all revised their laws in the last two decades. Similarly, employment regulation in Africa often dates to colonial times or was revised just after independence. On average, it is over three decades old. This is evidence against the “reform fatigue” in developing countries, often attributed to the work of international aid agencies.

With laws to meet the needs of business developed decades or even a century earlier, it is hardly surprising that those laws often impose unnecessary burdens on business today. But this is also grounds for optimism: outdated regulation is often the result of inertia or a lack of capacity to reform, not of entrenched business or government interests.

There are many reforms where the regulatory burden on business can be reduced, while the government can redirect much-needed resources toward the tasks that really count—such as providing basic social services. Indeed, some countries have recently modernized

many aspects of their business regulation, including Jamaica, the Republic of Korea, and Thailand. There is no reason why others should not follow. The benefits can be enormous. So are the costs of not reforming.

Of course, reforms are not always easy. There are also instances where powerful lobbies prevent or reverse regulatory reform. In 1996, the Peruvian government tried to reduce mandatory severance payments by 50 percent. The uproar with unions made the government withdraw the proposal quickly. Instead, severance payments were increased. The German government, in May 2003, proposed far-reaching reforms aimed at making labor markets more flexible. Such proposals have previously been withdrawn after threats of worker strikes. Another ill-fated reform comes from Croatia, where the private notaries’ profession has for years undermined the government’s efforts to simplify business entry procedures and collateral enforcement. Simplification would mean more competition and a loss of profits for the private notaries. Although *Doing Business* does not address political economy of reform, the report gives other examples of reforms gone awry due to opposing interests.

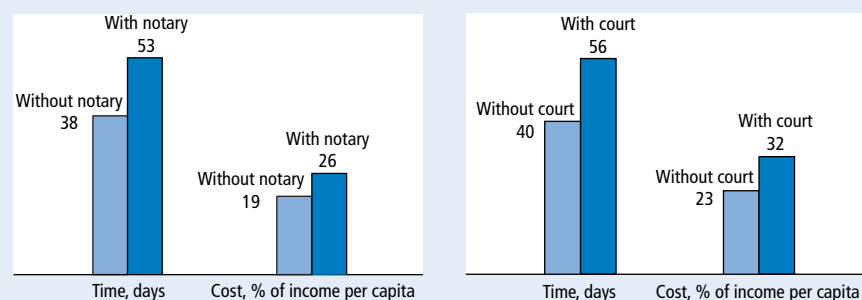
The analysis presented in this report suggests specific policy reforms (table 1) that illustrate two main themes: first, that poor countries have the furthest to go, and second, that when it comes to the manner of regulation, one size often fits all (in many cases there really is one best practice). The list of reform examples is still incomplete. Future reports aim to enlarge it.

In business entry, reforms that are easy to implement include the adoption of better information and intragovernment communications technology—to inform prospective entrepreneurs and to serve as a virtual one-stop shop for business registration. The introduction of a single registration form and silent consent in approving registration have had enormous success. Reducing the number of procedures to statistical and tax registration and abolishing the minimum capital requirement lighten the burden on entrepreneurs and have been associated with the creation of larger numbers of new businesses. Other reforms that require legislative change include introducing a general-objects clause in the articles of incorporation and

Table 1
Examples of Good Reform Practices

Principles of Regulation	Some Examples
Starting a Business	
<ul style="list-style-type: none"> • Registration is an administrative, not judicial, process • Use of single business identification number • Electronic application made possible • Statistical and tax registration sufficient to start operations • No minimum capital requirement 	<ul style="list-style-type: none"> • China, United States • Denmark, Turkey • Latvia, Sweden, Singapore • Australia, Canada, New Zealand • Chile, Ireland, Jamaica
Hiring and Firing Workers	
<ul style="list-style-type: none"> • Contracts “at will” between employers and employees • No limits on fixed-term contracts • Apprentice wages for young workers • Shift work between slow and peak periods 	<ul style="list-style-type: none"> • Denmark, Ireland, Singapore • Australia, Denmark, Israel • Chile, Colombia, Poland • Hungary, Poland
Enforcing a Contract	
<ul style="list-style-type: none"> • Judiciary has a system for tracking cases • Summary procedure in the general court • Simplified procedure in commercial courts • Attorney representation not mandatory 	<ul style="list-style-type: none"> • Slovak Republic, Singapore • Botswana, New Zealand, Netherlands • Australia, Ireland, Papua New Guinea • Lebanon, Tunisia
Getting Credit	
<ul style="list-style-type: none"> • Strong creditor protection in collateral and bankruptcy laws • No restrictions on assets that may be used as collateral • Out of court or summary judgments for enforcing collateral • Regulations provide incentives for sharing and proper use of credit information 	<ul style="list-style-type: none"> • New Zealand, United Kingdom • Slovak Republic, Hong Kong (China) • Germany, Malaysia, Moldova • Belgium, Singapore, United States
Closing a Business	
<ul style="list-style-type: none"> • Limited court powers • Bankruptcy administrator files report with creditors • Continued education for bankruptcy administrators 	<ul style="list-style-type: none"> • Australia, Finland, United Kingdom • Botswana, Germany, Hungary • Argentina, France, Netherlands

Figure 7
Courts and Notaries Are Bottlenecks to Business Start-Up



Note: Bars shown in these figures represent median values for countries with and without notary involvement in business registration. Differences in medians are statistically significant at the 1 percent level for the time measures but significant only at the 13 percent level for the cost measure.

Source: *Doing Business* database.

removing notarial authorizations and court use from the registration process (figure 7). Such reforms may be difficult to implement, as political

will in government and the private sector may waver, but they have beneficial effects beyond business entry.

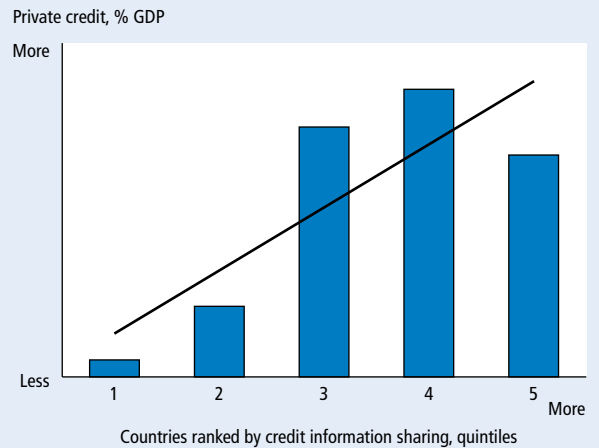
In employment regulation, five types of reform ease the burden on businesses and provide better job opportunities for the poor.

- First, in most developing countries a general reform toward reduction of the scope of employment regulation has yielded positive results. The deregulation

experience in Latin America (Chile, Colombia, Guyana, and Uruguay) as well as in transition economies (Estonia) provides many lessons.

- Second, many OECD countries have focused on introducing flexible part-time and fixed-term contracts. These contracts bring groups that are less likely to find jobs (women and youths) into the labor market. Germany has raised the duration of fixed-term contracts to eight years, while Poland does not mandate any duration limit.
- Third, several countries have either reduced the minimum wage (Colombia) or lowered the minimum wage limit for new entrants (Chile).
- Fourth, some countries (Hungary) have made it possible for employers to shift work time between periods of slow demand and peak periods, without the need for overtime payment.
- Fifth, other countries have focused on easing regulation on firing. The most far-reaching reform was recently implemented in Serbia and Montenegro, where the severance payment for a worker with 20 years' tenure was reduced from 36 months to 4 months.

Figure 8
Credit Bureaus Are Associated with More Credit



Note: The correlation between private credit to GDP and private credit bureaus shown in this figure controls for national income, income growth, inflation, rule-of-law index, creditor-rights index, the presence of a public registry, and legal origin. The relationship is statistically significant at the 5 percent level.

Source: Doing Business database.

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In contract enforcement, establishing information systems on caseload and judicial statistics has had a large payoff. Judiciaries that have established such systems, as in the Slovak Republic, can identify their primary users and the biggest bottlenecks. Simplifying procedures is also often warranted. For example, summary debt collection proceedings of the type recently established in Mexico alleviate court congestion by reducing procedural complexity. When default judgments—automatic judgments if the defendant does not appear in court—are introduced as well, delays are cut significantly.

The structure of the judiciary can also be modified to allow for small claims and specialized commercial courts. Several countries that have small claims courts (Japan, New Zealand, the United Kingdom) have recently increased the maximum claim eligible for hearing at the court. However, the manner of regulation of the judicial process in developing countries may need to be different. Where the judiciary is still in its early stages of development, as in Angola, Mozambique, or Nepal, specialized courts may be premature. There, reformers can establish a specialized section dealing

with commercial cases within the general court or train specialized judges.

Simplification of judicial procedures is associated with less time and cost. For example, in some countries, such as Argentina, Bolivia, Morocco, and Spain, businesses are obliged to hire lawyers when resolving commercial disputes. This increases the cost of enforcing contracts, sometimes unnecessarily. In many instances, the manager may simply present to the judge proof of delivery of goods and require payment.

Establishing appropriate regulation and incentives to facilitate private credit bureaus is an essential start to encouraging access to credit (figure 8). In some cases—especially in poor countries where commercial incentives for private bureaus are low—setting up public credit registries has helped remedy the lack of private information sharing, albeit second best to an effective private bureau. The design of credit information regulations influences the impact of bureaus: broader coverage of borrowers and good regulations on collection, distribution, and quality of information (including privacy and data protection) are associated with better functioning credit markets.

Legal creditor protections can be improved by reforming collateral law: introducing out of court or summary enforcement proceedings, eliminating restrictions on which assets may be used as security for loans, and improving the clarity of creditors' liens through collateral registries and clear laws on who has priority in a disputed claim to collateral. Stronger powers for creditors to recover their claims in insolvency are associated with more access to credit.

Three areas of bankruptcy reform give the most promise. The first is choosing the appropriate insolvency law given a country's income and institutional capacity. Ill-functioning judiciaries are better off without pouring resources into sophisticated bankruptcy systems. There is a general misperception that bankruptcy laws are needed to enforce creditor

rights. In practice, they often add to legal uncertainty and delays in developing countries. Private negotiations of debt restructuring under contract and secured transactions law and the introduction of summary judgments, like those for simple contract enforcement, will do. The second is increasing the involvement of stakeholders in the insolvency process rather than relying on the court for making business decisions. The third is training judges and bankruptcy administrators in insolvency law and practice

Of course, for governments to undertake reform there needs to be a strong constituency interested in change, so that inertia and the lobbying of entrenched political or business groups can be overcome. By bringing evidence to the debate, *Doing Business* motivates the need for change and informs the design of new regulations and institutions.