

Chapter 3

Evaluation Highlights

- For the most part, the indicators measure legal regulations and informed estimates of practice, as distinct from opinion.
- There are some systematic differences in rankings associated with countries' legal origins and policy choices; these do not undermine DB's validity.
- Inaccurate nomenclature and overstated claims of the indicators' explanatory power have provoked criticism.
- The subindicator on total tax rate is anomalous because it goes beyond regulatory burden.
- The *employing workers* indicator is consistent with relevant ILO conventions, even though it gives higher scores to countries with lower job protections.



Merchant buying oranges for his fruit stall, Epping Market, Cape Town, South Africa. Photo reproduced by permission of Gideon Mendel/Corbis.

What Do the Indicators Measure?

This chapter reviews key characteristics of the DB indicators as a group, and then focuses on issues that emerge from five indicators—*starting a business, paying taxes, employing workers, enforcing contracts, and getting credit*.

General Characteristics of the Indicators

Is DB rules-based?

DB states that it differs from other surveys because it collects information about a country's laws and regulations, as distinct from people's views, estimates, or perceptions.¹ The evaluation team analyzed the questionnaires for the 2007 and 2008 DB reports to determine the share of questions that required responses based:

- Solely on written laws or regulations
- On a combination of written law and the informant's experience
- Solely on the informant's judgment or experience.

The 2008 questionnaires contain 87 questions that generate data used to calculate the rankings for the 10 indicators and the aggregate EODB. Of these, 70 questions (80 percent) ask solely about the law as written.² For example, for *getting credit*, a question about the strength of legal rights index asks whether management is allowed to remain in control of a company during reorganization.³ The remaining 17 questions on time and cost in the 2008 questionnaires

require a response that combines the law as written with an estimate of what happens in practice.⁴ For example, on *enforcing contracts*, informants are asked the cost of resolving a commercial dispute, including both court fees and estimated average attorney fees.⁵

The 2008 questionnaires contain an additional 188 questions (109 additional questions in 2007) that are not used in the calculation of ratings or rankings. The responses are used to provide ideas for future work and additional insights into country issues. Of the 188 supplemental questions in 2008, 77 ask solely about the law, 67 ask about a combination of law and practice, and 44 ask for the informant's judgment or opinion. For example, the legal rights index questionnaire for the *getting credit* indicator asks informants' opinions about the main areas that require reform.⁶ For *starting a business*, it seeks informants' opinions about how the registration process has changed since the previous year, as well as their suggestions for reforms.⁷

Thus, while DB's ratings and rankings are grounded predominantly in

Ratings and rankings are grounded in written laws and estimates of practice; opinions are collected but do not feature in the rankings.

formal rules and regulations, DB also gathers informants' opinions or perceptions through these supplementary questions. The practice of asking extra questions adds to the complexity of the questionnaire, which may be a deterrent for potential contributors.⁸ It may also give informants and readers the impression that DB rankings are based more on opinions than they actually are.

Nomenclature

The names of several indicators overstate what they actually measure.

The names of some indicators—getting credit, dealing with licenses, and employing workers—overstate what they measure.

- **Getting credit** does not measure firms' access to credit, which depends largely on macroeconomic and structural factors such as depth of financial intermediation and interest rates. It simply measures the availability of credit history information to lenders and the legal rights of lenders and borrowers should there be a default on the repayment of a loan.
- **Dealing with licenses** measures the ease of obtaining a construction permit, and not the wide range of licenses, permits, and authorizations required in all sectors for a wide variety of reasons.
- **Employing workers** measures the rules governing hiring, firing, and paying workers, but not other aspects of the labor market such as wages, mobility, and qualifications.
- **Registering property** measures the procedures to transfer the property title of land and a building between two businesses, and not the procedures to obtain a title for the property the first time.

Such broadly framed names might be justified if the indicators were proxies for broad but difficult-to-measure phenomena; DB has not systematically demonstrated that this is the case. Interviews with operational staff and stakeholders confirm that the simplicity of the names is helpful in getting the attention of ministers and other nonspecialist audiences. But even though DB's documentation makes amply clear what DB actually measures, country authorities, Bank Group staff, and other stakeholders have also criticized the DB for promising more explanatory power than it delivers. For instance, a donor

official noted, "*dealing with licenses* has been problematic because it has a broad name for what is a very narrow focus on construction permits and thus may be misleading." Bank staff and others who interpret the rankings to country authorities have urged DB to give a more accurate signal of what it measures. More precise nomenclature could help.

Legal origin

DB's 2004 inaugural report asserted that countries' regulatory regimes are strongly determined by their legal origin, as noted in box 3.1. This assertion, especially DB's contrast of the common and civil law systems, has spawned a debate on DB's treatment of countries with a civil law tradition, specifically of French legal origin.

Among the 175 economies covered by DB 2007, 76 trace their laws governing commerce and property to the Napoleonic Code, while 59 have a system based in common law.⁹ Consistent with the assertion in *Doing Business 2004*, countries with a common law tradition occupy 8 of the top 10 spots for EODB. Of the 44 countries in the top quartile, 19 are common law and 14 are civil law countries. In the bottom quartile, 30 countries have a civil law origin, and these include all 17 members of Organization for the Harmonization of Business Law in Africa (OHADA).¹⁰

Box 3.1: Civil and Common Law Approaches to Regulation

The inaugural *Doing Business* report stated, "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 policy choice or the pressures toward regulatory efficiency. Common law countries regulate the least. Countries in the French civil law tradition the most."

Source: Doing Business 2004, p. xiv.

The evaluation analyzed the specific issues on which the civil law countries as a group score lower than common law countries.¹¹ On 13 subindicators listed on the left in table 3.1, civil law countries scored significantly lower. Six of these significant differences relate to the number of procedural steps, commonly regarded as excessive in the French system. Four differences relate to the greater protection of debtors and the lesser protection of minority investors that characterize the civil law;¹² the DB indexes award points for attributes found primarily in common law.¹³ Three differences relate to job protection, which may derive not from legal origin, but rather from policy choices made by this set of countries (see appendix D).

Even though some aspects of the civil law system are ranked lower on the DB indicator criteria, civil law countries can still score well on the DB indicators, as outlined in box 3.2.

Are the DB indicators adding new information?

A cross-country indicator whose rankings were perfectly correlated with per capita income (or some other underlying characteristic) would not add new information; one could predict a country's ranking by knowing its per capita income. For DB indicators, per capita income levels only partly explain the rankings. The overall EODB ranking and income per capita have a relatively high rank correlation coefficient of 0.77.¹⁴ There is lower correlation (0.65) with per capita income in the low- and middle-income countries.¹⁵ As shown in figure 3.1, countries with similar levels of gross national income (GNI) per capita, such as Peru and Brazil or Kenya and Mauritania, can have very different regulatory environments as measured by the DB indicators. Indeed, the rank correlation between DB indicators and GNI per capita is highest, at 0.89, for

On 13 of 32 subindicators, civil law countries score significantly lower than common law countries . . .

. . . nonetheless, civil law countries can still score well on the DB indicators.

Table 3.1: Do Civil Law Countries Score Lower Than Common Law Countries?

Differences are significant		Differences are not significant	
Indicator	Subindicator	Indicator	Subindicator
Highly significant^a		Dealing with licenses	Procedures (number)
Employing workers	Difficulty of hiring index	Dealing with licenses	Cost (% of income per capita)
Employing workers	Rigidity of hours index	Employing workers	Firing costs (weeks of wages)
Employing workers	Difficulty of firing index	Registering property	Procedures (number)
Getting credit	Credit information index ^b	Registering property	Time (days)
Getting credit	Legal rights index	Registering property	Cost (% of property value)
Protecting investors	Director liability index	Protecting investors	Disclosure Index
Protecting investors	Shareholder suits index	Paying taxes	Total tax rate (% profit)
Starting a business	Procedures (number)	Trading across borders	Documents for export (number)
Starting a business	Cost (% of income per capita)	Trading across borders	Time for export (days)
Starting a business	Min. capital (% of income per capita)	Trading across borders	Cost to export (US\$ per container)
Paying taxes	Time (hours)	Trading across borders	Documents for import (number)
		Trading across borders	Time for import (days)
		Trading across borders	Cost to import (US\$ per container)
Significant^a		Enforcing contracts	Procedures (number)
Paying taxes	Payments (number)	Enforcing contracts	Time (days)
Starting a business	Time (days)	Enforcing contracts	Cost (% of debt)
Dealing with licenses	Time (days)	Closing a business	Recovery rate (cents on the dollar)

a. Significance level set at 95 percent. Highly significant differences set at 99 percent.

b. All statistically significant differences favor English common law countries except for the credit information index.

Box 3.2: Can a Civil Law Country Succeed in a “Doing Business” World?

Having a civil law regime does not prevent a country from scoring well on the DB rankings. France, for example, ranks twelfth in *starting a business*; it has fast and inexpensive processes and no minimum capital requirement. It also ranks fourteenth in *enforcing contracts*. Countries can improve their scores and rankings within a civil law framework. Take, for example, Tunisia, a middle-income civil law country ranked eighty-eighth on EODB:

- If it improved its score on difficulty of firing to the same level as Belgium, it could improve its EODB ranking by 16 positions.
- Opening a business in Tunisia is fairly efficient in time and cost. If Tunisia eliminated the minimum capital requirement, like France, it would further improve its EODB ranking by 11 positions.

Even countries at the bottom of the rankings can improve. Of the 26 Sub-Saharan countries with a civil law tradition, 24 are in the bottom quartile of the overall ranking. Mali, ranked one-hundred and fifty-eighth in EODB, could improve substantially by following the model of Morocco or Tunisia. For example, if Mali reduced the number of procedures, days, and minimum capital requirement to start a business to the level of Morocco, it would improve 13 positions in the overall ranking. Likewise, improving the procedures for *enforcing contracts* and *trading across borders* to the level of Tunisia would improve Mali’s overall ranking by 26 positions, allowing it to move out of the bottom quartile.

If a hypothetical civil law economy were constructed combining the scores of the highest-scoring civil law country on each indicator, it would place third in the overall ranking.

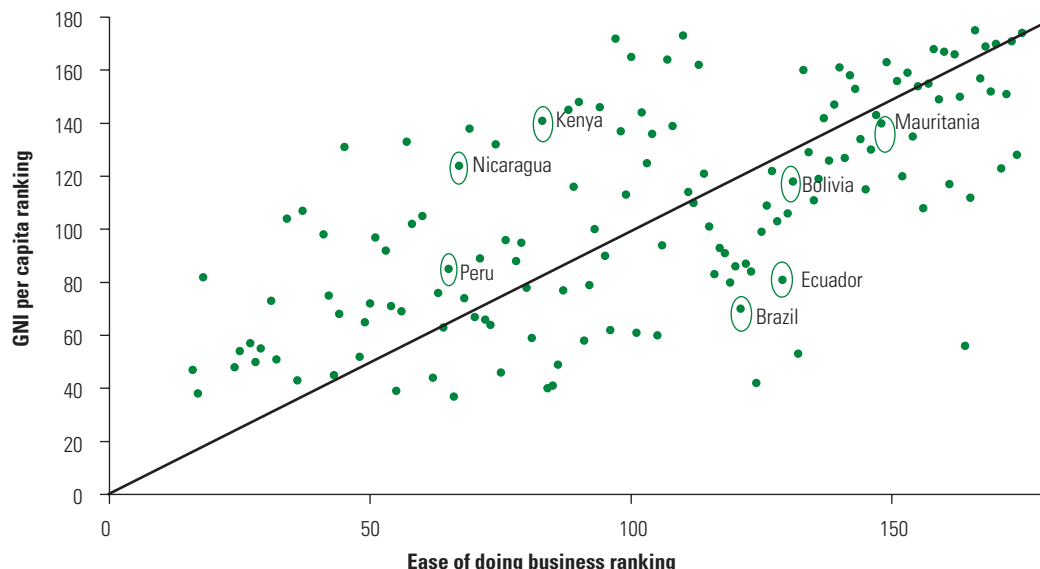
Note: Calculations based on the Doing Business 2008 data.

Per capita incomes only partly explain the DB indicator rankings.

the richest and poorest countries¹⁶; for countries in the middle, it is 0.52. Many Bank Group clients thus have scope to reduce the burden of business regulations even at their current income levels.

DB includes 32 subindicators, as detailed in chapter 1. The rank correlation among them is generally low, suggesting that they are capturing different dimensions of the regulatory environment.¹⁷ Out of a possible 509 pair-wise correla-

Figure 3.1: Countries with Similar GNI Can Have Different DB Indicator Scores



Sources: *Doing Business 2007* and DB Web site.

tions, only 6 have correlation coefficients above 0.60, and 16 are between 0.5 and 0.6. Only the subindicators of the *trading across borders* indicator (DB's most recently added indicator) are so highly correlated with each other as to suggest that some may be redundant. For example, time to import and time to export have a correlation of 0.91. The DB team could consider dropping any such overlapping subindicators.

Key Features of Selected Indicators

The evaluation took an in-depth look at five DB indicators to identify what they really measure and to assess how the rankings track with reality in the case study countries.

Starting a business

Starting a business is one of the five original DB indicators and the first to have been developed by Djankov and others (2002).¹⁸ It aims to measure how efficiently an entrepreneur can complete all officially required procedures to formally operate an industrial or commercial business. A country's ranking is the average of its percentile rankings on the four subindicators shown in table 3.2.

The underlying logic is that more onerous and costly entry regulations make opening a business more difficult, and thus fewer entrepreneurs will do so (at least in the formal sector). The DB reports note that "cumbersome entry procedures push entrepreneurs into the informal economy,

even after controlling for income per capita" (World Bank-IFC 2004, p. 22). DB states that informal businesses tend to lack worker protection and benefits, to have substandard product quality, and to face difficulty in securing bank credit and using courts to resolve disputes. Formalization is beneficial because "the establishment of a legal entity makes every business venture less risky and increases its longevity and its likelihood of success" (World Bank-IFC 2004, p. 17).

The time subindicator captures only the duration necessary to complete procedures; it excludes the time an entrepreneur may spend gathering information, which varies widely and cannot be reliably estimated with few data points. Opaque systems may require more time than transparent systems. Analysis using firm-level data suggests that this "time tax" may be large and important (Hellman and Schankerman 2000).

Doing Business 2004 asserts that just two procedures ought to be sufficient for regulating business start-up: the notification of existence and the tax and social security registration. While the report acknowledges that other procedures, such as registering with the statistical office, obtaining environmental permits, or registering workers for health benefits "seem to be socially desirable" (World Bank-IFC 2004, p. 21), DB

The logic behind the starting a business indicator is that more onerous and costly entry regulations result in fewer entrepreneurs opening businesses.

Table 3.2: The Starting a Business Indicator

Subindicator	Mean	Median	Min	Max	Standard deviation
Number of required pre- and post-incorporation procedures officially required to formally operate a business	9	9	2	20	3
Time to complete the procedures (calendar days)	44	31	2	694	61
Cost to comply with procedures (percentage of the country's income per capita)	61	21	0	1,075	122
Paid-in minimum capital that the entrepreneur must deposit in a bank before registration begins (percentage of the country's income per capita)	116	8	0	3,673	353

Source: *Doing Business 2008*.

awards higher ratings to countries without these procedures than to those with them (holding all other subindicators constant). At the extreme, the best performer for this subindicator would be a country that required just the above-mentioned two procedures, even though firms themselves may value the worker satisfaction or social benefits arising from other procedures.

Most popular indicator for reform

Since *Doing Business 2005*, the *starting a business* indicator has produced the most reforms annually as measured by DB. Reducing business entry regulations may be easier politically and less expensive than progress on other indicators, such as *employing workers*, that require political trade-offs. Further, since 2005, two subindicators—the days and cost of starting a business—have been used by the United States' Millennium Challenge Corporation (MCC) in its formula for determining countries' eligibility status for grants, and also

The starting a business indicator has produced the most reforms as measured by DB. features as a guidepost under the Bank's Country Performance and Institutional Assessment (CPIA) component on the "business regulatory environment." The time and cost to start a business are also used as 2 of the 14 "outcome" indicators in the "IDA results framework"¹⁹ (see chapter 4).

One-stop shop: DB reports promote the creation of one-stop shops as a single access point for entrepreneurs to comply with entry regulations.²⁰ But a review of one-stop shops by the Foreign Investment Advisory Service (FIAS) finds that "such a mechanism works in barely any country of the world" (Sader 2002, p. 3). They tend to generate turf battles if a single agency gains control over all the various licenses, permits, and clearances formerly granted by different agencies.

In this instance, DB's one-stop shop often becomes a "one-more-stop shop." The paper also notes that where one-stop shops have worked (such as in Ireland, Malaysia, and Singapore), the senior level of government had committed to investment climate reforms and made increased foreign

Box 3.3: A Paper "Reform" in Afghanistan

Afghanistan was the top reformer for *starting a business* in *Doing Business 2006* because it reduced the number of procedures from 28 to 1, and time from 90 to 7 days. Literature and key informants note that the authorities simply pushed all important procedures to a stage after the legal registration of a business.

Sources: Arruñada 2007 and interviews.

direct investment (FDI) a central pillar of their development strategies. Thus, new one-stop agencies in these countries benefited from an environment where fewer licenses, approvals, and permits were deemed a necessary and important component of investment climate reforms.

Is it relevant and important for economic outcomes?

Doing Business 2007 claims two economic benefits of formally registered businesses: they grow larger and they pay taxes (World Bank-IFC 2006b). Literature and cross-country studies have established the importance of higher entry rates of new businesses for increased competition and economic growth (see, for example, Klapper, Laeven, and Rajan 2006). To what extent do registration procedures affect the entry of new businesses? After all, no matter how complicated and time-consuming they are, each business must endure them only once.

Cross-country studies have established a correlation between the number of small and medium-size enterprises or new firm registrations and less business entry regulation, but have not yet demonstrated causality (De Sa 2005, p. 4). For example, while Klapper and others (2007) find that barriers to starting a business are significantly and negatively correlated with the number of registered businesses and new registrations of companies, they acknowledge that they cannot postulate on the direction of causality.²¹ Recent country-level studies have begun to address causality but depict a mixed picture. While in Russia and Brazil,²² reform of specific regulatory procedures was linked to enhanced formaliza-

Literature is not conclusive about whether business registration reform encourages greater formalization and the creation of new formal businesses.

Box 3.4: Does Simplifying Business Registration Encourage Formalization?

Mexico implemented a program to simplify municipal licensing, one of several registration procedures for selected types of businesses. Firm registration increased between 4 and 5.6 percent in the eligible industries. Kaplan and others (2007) found that the increase was temporary and concentrated in the first 10 months after program implementation, leading the authors to conjecture that “the program mostly affects the existing stock of informal firms and has a smaller effect on the creation of ‘truly’ new firms” (pp. 4–5) as the program cleared a backlog of applications. Using household data, Bruhn (2007) found that while employment in eligible industries rose, the increase in firm registration comes “exclusively from former wage earners opening businesses” (p. 3). Rather than encouraging movement from the informal to the formal sector, registration benefited those already in the formal sector.^a

Sources: Kaplan and others 2007; Bruhn 2007.

a. The authors conjectured that greater effects may have been seen if more comprehensive reforms had taken place.

tion and the creation of new businesses, respectively, two other studies in Mexico note the limited impact of business registration reforms, as illustrated in box 3.4.

Paying taxes

Paying taxes measures both the total taxes paid by a firm and the administrative efficiency of making the payments. A country’s ranking is the average of its rankings on the three equally weighted subindicators, shown in table 3.3.

The lower the total taxes on firms, the higher a country scores on the total tax rate subindicator

(see box 3.5). This subindicator, *The total tax rate subindicator goes beyond regulatory efficiency to include judgment about fiscal policy.* unlike most other dimensions of DB, does not measure regulatory burden alone; it also involves implicit judgments on complex issues of fiscal efficiency and equity. The lower the taxes paid by the corporate sector, the more revenues need to be raised from other sources to reach a given revenue target. A country’s preferred combination of corporate, sales, personal income, VAT, and trade taxes should represent a blend of revenue-generating capacity, efficiency, equity, transparency, and reasonable overall tax burden (IMF 2007). A lower tax rate on the corporate sector is not necessarily beneficial for the economy as a whole; assessments of tax regimes “need to be undertaken in an intertemporal, general equilibrium framework to capture the full impact of each choice” (OECD 2007a).

DB’s partnership with PricewaterhouseCoopers (PwC):

The total tax paid, as measured by DB, includes not only corporate profit taxes, but also the social security and labor, property, capital gains, and dividend taxes that are paid by the firm. This comprehensive definition of taxes paid by the firm is based on a methodology initially devised by PwC, the global accounting partnership. PwC’s objective in developing its “total tax contribution” framework was to persuade tax authorities—notably in the United Kingdom—that firms actually contribute more to the public coffers than is indicated by corporate tax rates alone.²³ DB adopted a version of PwC’s methodology in 2005. (PwC 2007; World Bank-IFC 2007b, p. 77). The methodology is the most complex of all DB indicators, because it requires detailed calculations of a variety of taxes for a standard firm.

The methodology is based on a complex framework developed by PricewaterhouseCoopers.

Table 3.3: The *Paying Taxes* Indicator

Subindicator	Mean	Median	Min	Max	Standard deviation
Number of yearly payments	34	32	1	124	21
Time required (in calendar days)	323	242	0	2,600	322
Total tax rate as a share of firm profits	51	44	8	287	38

Source: *Doing Business 2008*.

Box 3.5: Can a Tax Haven Be a Global Leader on Taxation?

Kuwait, Maldives, United Arab Emirates (UAE), and Vanuatu are DB's four top-ranked countries on total tax rate in the 2008 report. Each has a special characteristic that enables it to avoid imposing taxes on firms. Vanuatu, a small Pacific island that has set itself up as a tax haven, does not impose personal or corporate income tax, capital gains tax, or withholding taxes. It raises revenues mostly from indirect sources, principally import duties and value added tax (VAT). Maldives also has no corporate income tax. Instead, the government raises revenues from tourism by charging lease rents on the land occupied by resorts. The government of Maldives is reviewing its dependence on these lease rents. Kuwait and UAE, for their part, derive most of their public revenues from oil and do not impose corporate, personal, or VAT taxes on domestic firms. These top-ranked countries cannot feasibly serve as role models for other countries seeking an optimal level of corporate taxation.

Sources: Heritage Foundation 2007; Maldives government 2007; Vanuatu government 2007.

The data for *paying taxes* are furnished to DB by PwC's partner offices in 142 countries.²⁴ This work is done under the terms of an agreement that PwC is DB's sole informant about taxes in all countries where it does business. PwC donates this work in return for the opportunity to co-publish the rankings jointly with DB, as part of its "thought leadership" activities.²⁵ This relationship offers DB the advantage of a ready-made stable of qualified informants. But DB's reliance on a single partner, combined with the complexity of the questionnaire, makes validation of information more difficult. Informants in Algeria, China, Mongolia, Netherlands, and Spain all noted errors in the tax data; thus reliability cannot be guaranteed.

The procedure for collecting complex data for the total tax rate subindicator entails two risks for DB: (a) the reputational risk arising from partnering

Table 3.4: The *Employing Workers* Indicator

Subindicator (lower score is always better)	Mean	Median	Min	Max	Standard deviation
Difficulty of hiring index (0–100)	32	33	0	100	27
Restriction on when term contracts can be used					
Maximum duration of term contracts					
Minimum wage (% of value added per worker)					
Rigidity of hours index (0–100)	39	40	0	80	23
Legal maximum of hours and days worked per week					
Restrictions on night and weekend work					
Paid vacation more than 3 weeks (score 1 for 22 days or more, 0 otherwise)					
Difficulty of firing index (0–100)	31	30	0	100	23
Steps required to fire 1 or a group of redundant workers – index contains 8 criteria dealing with required notifications and priority rules for redundancy					
Firing cost (weeks of salary)	48	35	0	446	50
Cost of advance notice required, severance payments, and penalties (score 0 if cost is 8 weeks' salary cost, or less; score number of weeks if more than 8 weeks salary)					
Nonwage labor cost^a	15	14	0	55	11
Social security and similar payments (percent of salary)					

Source: *Doing Business 2008*.

a. Measured but not included in the calculation of rankings.

with an advocate of a particular policy stance, and (b) the operational risk of depending on a single source of data.²⁶ Since the subindicator itself is anomalous within the DB framework, it would be advisable for DB to reformulate the *paying taxes* indicator to include only measurements of regulatory burden such as the total cost of compliance. Since corporate tax rates are undeniably important for business, DB should continue to collect tax rate information separately and more simply, but exclude it from the rankings. This would also help to simplify the questionnaire, permit more informants to contribute, and make the data more understandable to users.

Employing workers

Employing workers rates the laws and regulations that govern how firms hire and fire workers: the length of the workday, week, and year and the minimum wage firms have to pay. The underlying

assumption is that less regulation will result in higher employment rates and, in some contexts, lower shares of informal to formal employment.

A country's ranking on *employing workers* is the average of the percentile rankings on four equally weighted subindicators, listed in table 3.4. Firing workers is the focus of two of the subindicators, giving this dimension a 50 percent weight in the indicator. Three subindicators are indexes, each containing several criteria. With 15 criteria in all, *employing workers* is one of the more complex DB indicators.

The indicator and its components measure the costs of selected regulations but not their benefits. Since the stylized case involves a firm with 201

The reliance on a single global partner for the tax indicator makes validation difficult and cannot guarantee reliability.

The assumption underlying the employing workers indicator is that less regulation will result in higher rates of employment and more formal employment.

Table 3.5: Employing Workers: Highest- and Lowest-Ranked Countries

Top 20	DB 2008 rank	DB 2007 rank	Lowest 20	DB 2008 rank	DB 2007 rank
Singapore	1	1	Peru	159	160
United States	1	1	Senegal	160	163
Marshall Islands	1	1	Niger	161	161
Tonga	4	4	Mozambique	161	162
Brunei	4	<i>n.a.</i>	Gabon	163	166
Georgia	4	4	Luxembourg	164	<i>n.a.</i>
Maldives	7	7	Morocco	165	165
Australia	8	8	Slovenia	166	159
Palau	9	9	Congo, Rep.	167	167
Denmark	10	10	Ecuador	168	168
Uganda	11	11	Sierra Leone	169	169
Micronesia	12	12	Panama	170	170
New Zealand	13	13	Congo, Dem. Rep.	171	174
Bhutan	14	<i>n.a.</i>	Angola	172	171
Samoa	15	14	Paraguay	173	172
Fiji	16	15	Guinea-Bissau	174	173
Japan	17	20	Equatorial Guinea	175	175
St. Kitts and Nevis	18	16	São Tomé and Príncipe	176	176
Canada	19	17	Venezuela	177	177
Switzerland	20	39	Bolivia	177	178

Source: *Doing Business 2008*.

The indicator measures costs but not benefits of regulation or other dimensions of labor market flexibility.

Numerous small island states among the top 20 may reflect poorly developed labor legislation, yet they appear alongside countries with well-developed labor legislation.

unionized employees, it does not capture the laws and rules that affect smaller and nonunionized firms. Nor does it capture other dimensions of labor market flexibility, such as information, enforcement, and tied versus monetized benefits such as housing, pensions, worker health and safety regulations, and so on. *Employing workers* has been DB's most controversial indicator, perhaps because it delivers low rankings for some countries that have made policy choices favoring extensive job protection (see table 3.5).

The 20 lowest-ranked countries, displayed in the table, include Luxembourg, and France and Germany

also rank low at 144 and 137, respectively. As for the 20 highest-ranked countries, they include a surprising number of small island states—indeed, the Marshall Islands shares the top spot with Singapore and the United States. This may reflect the small islands' poorly developed labor legislation, as illustrated in box 3.6. Yet countries with well-developed labor legislation also appear in the top 20, including Australia, Canada, Denmark, Japan, and New Zealand. This reflects their mature public and private labor market institutions, which facilitate mobility with minimal regulation.

Eight countries are reported to have made positive reforms on *employing workers* overall in *Doing Business 2007*, making this the DB indicator with the fewest reforms (World Bank-IFC 2006b, p. 4; 2007b, p. 4). Georgia, though,

Box 3.6: Does Top-Ranked Imply “Well Regulated” . . . or “Unregulated”?

Because DB counts the number of regulations, it is difficult to tell whether top-ranked countries have efficient and responsible regulations or simply inadequate regulation. For example, on

the *employing workers* indicator, Singapore and the Marshall Islands are both ranked number 1 (along with the United States), but their labor regulations are very different.

Singapore has strong labor regulations, effectively enforced

Marshall Islands, a recent member of ILO, has important gaps in labor legislation

The Right of Association

Singapore's constitution provides all citizens the right to form associations, including trade unions. But the Parliament may impose restrictions based on security, public order, or morality grounds. In 2004, approximately 20 percent of the national labor force was represented by 68 unions.

The law provides for the right of free association in general, and the government interpreted this right as allowing the existence of labor unions, although none has been formed. With few major employers, there were few opportunities for workers to unionize, and the country has no history or culture of organized labor.

Prohibition of Forced or Compulsory Labor

The law prohibits forced or compulsory labor, including by children, and there are no reports of such practices.

The law does not specifically prohibit forced and compulsory labor by children; however, there were no reports that such practices occurred.

Prohibition of Child Labor and Minimum Age for Employment

The law prohibits the employment of children under the age of 12, and restrictions on employing children between ages 12 and 16 are rigorous and strictly enforced.

There is no law or regulation setting a minimum age for employment of children. Children typically were not employed in the wage economy, but some assisted in family enterprises.

Acceptable Conditions of Work

The law sets the standard legal workweek at 44 hours and one rest day for each week.

There is no legislation on maximum hours of work or occupational safety and health.

Source: Bureau of Democracy, Human Rights, and Labor, U.S. State Department 2007 <<http://www.state.gov/g/drl>>.

improved dramatically from a rank of 71 to 6 as a result of a new labor code and flexible labor rules.²⁷ Reforms in this area are difficult because where organized labor is strong, they typically engage competing interests. Even where it is weak, as in many low-income countries, labor market reforms simply take low priority.

Is employing workers consistent with accepted labor standards?

Critics of DB have argued that the *employing workers* indicator rewards employment practices that are inimical to workers' interests (see, for example, Berg and Cazes 2007). They consider that regulations on job conditions, hiring, and firing are needed for the protection of workers. In response to these criticisms, DB has stated that the components of this indicator have recently been made consistent with the core labor standards of the International Labor Organization (ILO) (World Bank-IFC 2007a).

The evaluation examined this assertion and found it generally valid because:

- The ease of hiring index measures the ease and flexibility of using term contracts to employ

workers. This issue is not covered by any ILO conventions.

- The rigidity in hours of work index consists of 5 components that are all consistent with the provisions of the ILO conventions.
- The firing cost and ease of firing index are based on responses to 10 questions, of which 6 are fully consistent with the respective ILO conventions, and 4 are consistent with the letter of the relevant ILO provisions, but not with their spirit, as shown in box 3.7.

The ILO provisions, with which DB is consistent, represent a baseline degree of labor protection agreed to by the international community. Many countries' laws offer more extensive or generous job protections as a matter of national policy, and DB penalizes more generous provisions. For example, France and Germany, whose laws

require 22 or more days of vacation, score worse on rigidity of hours than Australia or Italy, which require 21 days or fewer. This is what gives France, Greece, Spain, and

This indicator is associated with the fewest reforms.

The employing workers indicator is consistent with the letter of ILO provisions, but four measures do not reflect their spirit.

Box 3.7: Measures on the Costs and Difficulty of Firing Workers and the ILO Conventions

There are four measures of DB's *employing workers* indicator that are consistent with the letter, but do not reflect the spirit, of the relevant ILO provisions:

Must the employer consider reassignment or retraining activities before redundancy termination? The ILO convention does not require, but asks the employer to provide, in accordance with national laws and practice, an opportunity for consultation with worker representatives about measures to mitigate the adverse effect of termination. DB gives a higher rating to countries that do not require the employer to make such consultations.

Are there clearly established criteria applying to redundancies? Although the ILO does not require application of clearly established criteria, it does recommend that employers select workers to be made redundant on that basis. The DB gives a higher rating to countries that do not require such criteria.

How much severance pay must a redundant worker get? The ILO stipulates that a redundant worker should be provided separation or severance pay based on seniority, wage level, and other unspecified criteria. DB sets its own cut-off, and in DB 2008, a country requiring up to eight weeks of severance pay gets the best score. All countries that require severance pay greater than eight weeks get the worst score.

Must the employer notify a third party before terminating a group of workers? ILO Convention 158 requires that the employer notify a competent authority about a termination of a group of workers. The convention does not specify the cut-off number or percentage of workers and leaves this to be determined in accordance with national laws and practice. Again, DB sets its own cut-off. In DB 2008, a country gets the worst score if it requires notification for terminating a group of fewer than 25 workers. In 2007, DB's cut-off was a group of 20 workers.

other European countries their low overall rankings on *employing workers*.

Enforcing contracts

The *enforcing contracts* indicator aims to measure how efficiently a commercial dispute can be resolved. The underlying logic is that a higher degree of contract enforceability encourages firms to develop relationships with a larger number of suppliers and customers, fostering profitability and incentives to engage with more advanced technologies (Commander and Tinn 2007). This indicator (like most DB indicators) is linear; that is, fewer procedures are always considered better. It does not consider that some judicial procedures may help ensure transparency, accountability, and fairness to the parties.

The informants—lawyers and notaries—base their answers on a scenario involving a seller of goods suing a buyer who does not pay for the goods, citing poor quality. The amount in dispute is 200 percent of the country's per capita GNI. The ranking on *enforcing contracts* is the average of the country rankings on the three subindicators, as shown in table 3.6.

DB periodically changes the methodology for some indicators (for example, World Bank-IFC 2007b, p. 62), and the methodology for *enforcing contracts* has changed more than most. In the 2007 report, the scenario was changed from a bounced check to

a commercial dispute,²⁸ which prevents the construction of a consistent time series for this indicator. Further changes were made for the 2008 report, and the 2007 ratings were retroactively revised.²⁹ These changes had a significant impact on the ratings and rankings. For example, Tunisia, praised in *Doing Business 2006* as one of the easiest places to enforce contracts (World Bank-IFC 2005, p. 61) and ranked fortieth in *Doing Business 2007*, now ranks a mediocre eightieth in *Doing Business 2008*. These changes were explained by changes to the methodology. Such large changes in the data from one year to the next make data on individual countries and the rankings less than fully reliable, as discussed in chapter 2.

Most disputes do not wind up in court

All the DB indicators attempt to measure the law as distinct from actual practice. In the case of *enforcing contracts*, the gap between law and practice is particularly wide. The indicator measures only contract enforcement through the court system, and not other formal and informal resolution methods commonly used in many countries. In practice, a lawyer will select the most cost-effective legal strategy to help a client recoup funds. The 2005 Business Enterprise Surveys (covering 38 countries) found that two-thirds of business owners said they had resolved their most recent dispute over the payment of an overdue bill without resorting to the courts. In the United States, only about 10 percent of the civil cases in state courts go to court (Davis and Kruse 2007), while in Romania, about one-third of such cases go to court.³⁰ The

The enforcing contracts indicator considers that it is always better to have fewer procedures.

The methodology for the enforcing contracts indicator changed substantially, resulting in large changes in rankings.

Table 3.6: The Enforcing Contracts Indicator

Subindicator	Mean	Median	Min	Max	Standard deviation
Number of required procedures between filing a suit and enforcement of judgment	38	38	20	55	7
Time taken to resolve the dispute (in calendar days)	605	543	120	1,800	308
Cost to defendant and plaintiff including attorney and court fees, expressed as a percentage of the claim value	34	26	0	163	28

Source: *Doing Business 2008*.

indicator, therefore, tends to overstate the burden of court procedures across the board, and disproportionately more in those countries where noncourt mechanisms are used the most. To partially correct this, the 2008 DB survey introduced a one-procedure “credit” to the score of countries with specialized commercial courts. This change reduced the counted number of procedures in 11 countries.

Stakeholders confirmed that DB data on contract enforcement diverge from practice. Moldova’s high rank of 17 does not reflect the reality that few disputes wind up in court. Indeed, a Bank-supported analysis finds that the main reasons Moldovan businesses do not resort to courts are the long duration of the process for settling disputes and the high cost of legal services (World Bank 2007d, p. 68). In Peru, although specialized commercial courts have reduced the number of procedures and time needed to resolve a dispute, interviewees noted that the type of case specified under the DB methodology would not necessarily go to court.

Is it important for economic outcomes?

The DB 2006 and 2007 reports suggest that the ease of enforcing commercial disputes in courts is important because it is associated with higher lending from commercial banks, increases in the number of new firms and new hires in established firms, and reduced demands on court budgets. The underlying research, Djankov and others (2002), finds excessive formalism in judicial procedures in countries. Djankov and others (2006) construct a debt enforceability index that is found to be correlated with income per capita, credit market development, and legal origins.

A background paper commissioned for this evaluation found no significant association between the *enforcing contracts* indicator and a range of intermediate outcomes—research and development, investment, domestic credit, gross capital fixed formation, domestic bank credit, gross capital inflows, or foreign direct investment (see Commander and Tinn 2007). The analysis also found little association between the *enforc-*

ing contracts indicator and measures obtained from firm-level surveys on aspects of the legal systems for *enforcing contracts* and loans given with collateral.

While there may be some time lag between improvements in the DB indicator and outcome measures, the DB report needs to be cautious when making associations or implying causality between the *enforcing contracts* indicator and outcomes such as enhanced foreign direct investment (see World Bank-IFC 2006b, p. 48, for example).

Getting credit

The *getting credit* indicator measures two things: the legal rights of borrowers and lenders (strength of legal rights index) and the availability of credit information about firms and individuals (depth of credit information index).

The strength of legal rights index measures how well collateral and bankruptcy laws facilitate lending. It assigns a country one point for each of seven attributes of collateral law and three of bankruptcy law, based on information provided by financial lawyers. Hong Kong and the United Kingdom have the highest score of 10, and Afghanistan and Cambodia have the lowest score of 0.

The depth of credit information index measures the quality, scope, and accessibility of credit information through public and private credit registries. The data are derived from banking supervision authorities and credit registries. The depth of credit information index assigns one point for each of six features of a credit information system. Twenty-one countries have the highest score of 6, and 56 countries have the lowest score of 0. The top 10 countries for *getting credit* are all high-income countries, except Malaysia and the Slovak Republic.

Additionally, DB gathers data on the share of the population covered by public credit registries

Stakeholders note that the scenario for this indicator diverges significantly from practice.

IEG analysis found no significant association between the enforcing contracts indicator and a range of intermediate outcomes.

The getting credit indicator measures borrower and lender legal rights and the availability of credit information.

Table 3.7: The *Getting Credit* Indicator

Subindicator	Mean	Median	Min	Max	Standard deviation
Strength of legal rights index (0–10) Index contains 10 criteria dealing with collateral and bankruptcy laws to protect borrowers and lenders	5	4	0	10	2
Depth of credit information index (0–6) Index contains 6 criteria dealing with the scope, accessibility, and quality of information available through public or private credit registries	3	3	0	6	2

Source: *Doing Business 2008*.

and private bureaus, but these data are not included in the calculation of the overall EODB ranking.

According to *Doing Business 2004*, two factors expand access to credit and improve its allocation: credit information registries and creditor rights in the country's secured-transactions and bankruptcy laws. Good credit institutions protect both creditors and debtors and make everyone better off. Because credit histories are available, borrowers benefit from lower interest rates, as banks compete for good clients.

There is research support for this argument. Love and Mylenko (2003) found that private credit registries are positively related to availability of bank financing for small and medium-size

firms and that stronger rule of law is associated with more effective private credit registries. Nevertheless, they note that there is no evidence of causality between the creation of private registries and their effects on financing constraints. Jappelli and Pagano (2002) found that bank

lending is higher and credit risk lower in countries where lenders share information, regardless of the private or public nature of the information-sharing mechanism. Dorbec (2006) concluded that credit information sharing between lenders increases the supply of financing, decreases defaults, and enhances monitoring of the risks taken by the financial system. A

background paper commissioned for this evaluation found better legal rights of borrowers and lenders to be positively associated with private credit, gross private capital flows, and net foreign direct investment (Commander and Tinn 2007).

A 2007 World Bank review of financing constraints suggests that information-sharing mechanisms matter most in low-income countries, while enforcement of creditor rights is more important in high-income countries (World Bank 2007a). Other nonprice factors include: more important limitations on access to credit, including geography (or lack of physical access); lack of proper customer documentation for identification, especially in low-income countries; and high minimum account balance requirements (World Bank 2007a).

In sum, the DB indicators are designed to measure dimensions of the regulatory environment that are indeed important, although not equally important in all countries. The total tax rate is anomalous, because although it is important to business owners, it does not measure regulatory burden like the rest of the DB indicators. For the most part, the indicators measure actual legal rules and regulations and informed estimates of practice, as distinct from opinion. Their relevance in a particular country setting depends on the extent to which the laws are applied, which DB does not measure. Although in many circumstances it is the law on the books that causes inefficient outcomes,

The literature supports the argument that credit information registries and creditors' legal rights help expand access to credit.

understanding what actually happens on the ground is essential (La Porta and others 2007). The impact of a given reform will likewise vary across countries.

There are a few systematic differences in country rankings associated with legal origins. These are consistent with the ideas behind the DB

framework and they have little impact on the overall rankings or the validity of the exercise. The *employing workers* indicator is consistent with relevant ILO conventions, but it does give higher scores to countries with lower job protections. Inaccurate nomenclature and overstated claims of the indicators' explanatory power provoke considerable criticism and should be rectified.