Chapter 5

Wig shop owner using laptop. Photo reproduced by permission of Cat Gwynn/Corbis.

Findings and Recommendations

Doing Business has contributed to the development landscape in three main ways. For country authorities, it sheds a bright, sometimes unflattering, light on regulatory aspects of their business climate. For business interests, it has helped to catalyze debates and dialogue about reform. For the Bank Group, it demonstrates an ability to provide global knowledge, independent of resource transfer and conditionality. The annual exercise generates information that is relevant and useful. But it has several weaknesses in process, content, and presentation that should be rectified soon if it is to maintain its credibility and usefulness.

The Framework Underlying the DB Indicators

The DB indicators are anchored in research that links characteristics of the regulatory environment to firm performance, and thence to macroeconomic outcomes. Although some research has convincingly demonstrated these associations, any research relating the regulatory environment to economic outcomes is necessarily partial. It does not capture the influence of all the other determinants, nor can it pin down the direction of causality. Even where an association *is* demonstrated, the policy implications are not self-evident, since regulations deliver benefits as well as costs. What is good for a firm (or firms) may not be good for firms at large, or the economy and society as a whole. The right balance for any country is a matter of political choice.

The DB exercise reflects these inherent limitations. As an exercise in cross-country comparison, it is not intended to capture country nuances and nonlinear relationships. It measures selected dimensions of the regulatory environment, some of which are bound to be irrelevant in some countries. It notes the costs of regulation but not the benefits. Seven of DB's 10 indicators presume that lessening regulation is always desirable, whether a country starts with a little or a lot of regulation. These limitations do not invalidate the exercise, because the scope and thrust of DB are consistent with a credible view that less burdensome business regulation is associated with better private sector performance. But they underscore the need to use caution in interpreting the results and for the DB indicators to be used in conjunction with complementary tools such as Investment Climate Assessments.

The Scope of the Indicators

The indicators are consistent with their claim of measuring the content of rules and laws, as distinct from perception. The dimensions of the regulatory environment that they measure are important in the aggregate—but not all indicators are important in all countries. The relevance of an indicator in a particular country setting will depend partly on the extent to which the law is actually applied, which DB does not measure. The impact of a given reform will likewise vary across countries. While the addition of new indicators would expand the coverage of issues addressed, by itself this would not make the DB indicators more reliable or useful. The more immediate challenge is to enhance reliability of the underlying information, as discussed below.

The *employing workers* indicator is consistent with the letter of ILO provisions, but four measures do not reflect their spirit. Beyond these minimum standards, the DB criteria give lower scores to countries that have opted for policies of greater job protection. There are a few systematic differences in country rankings associated with legal origins in civil or common law. These are consistent with the stated ideas behind the DB framework and they have little impact on the overall rankings or the validity of the exercise. DB's measurement of the total tax rate is anomalous because unlike DB's other subindicators, it does not measure regulatory burden alone. It derives from a country's fiscal requirements and policy context. Moreover, the complexity of this subindicator necessitates DB's reliance on PwC as virtually the sole informant—a reliance that entails risk to the exercise. Because tax rates are important for investors, information about them should be collected and presented, but not included in the rankings.

Inaccurate nomenclature and overstated claims of the indicators' explanatory power have provoked considerable criticism from stakeholders. DB reports should seek to retain their clarity while using less sweeping language.

Reliability of Information

DB has created a unique information-gathering process based on a global network of volunteer informants. This process is capable of generating reliable data, but three areas of vulnerability need to be addressed.

First, the database is too dependent on a small number of informants, with some data points generated by just one or two firms. For the information about taxes, DB's exclusive reliance on a single global firm for both the underlying methodology and the data from 142 countries poses extra risks. The number and diversity of informants should be increased and their information validated more systematically. An increase in the informant base will require a systematic vetting process. Simplifying the questionnaire may also help to encourage more informants to contribute.

Second, DB makes easily available a great deal of data and explanatory material—arguably more than most comparable exercises. Yet it remains insufficiently transparent about the number and types of informants for each indicator in a country, the adjustments staff make to the information supplied by informants, and the changes made to previously published data. It does not adequately point out the possibilities of errors and biases.

Third, DB makes much of its country rankings. The rankings entail three weaknesses. Because most DB indicators presume that less regulation is better, it is difficult to tell whether the top-ranked countries have good and efficient regulations or simply inadequate regulation. The small informant base makes it difficult to measure confidence in the accuracy of the individual indicator values, and thus in the aggregate rankings. Finally, changes in a country's ranking depend importantly on where it sits on the distribution; small changes can produce large ranking jumps, and vice versa. These factors contribute to anomalies in rankings.

These issues may not in and of themselves jeopardize DB's reliability, but the lack of transparency about them undermines DB's credibility and goodwill. In addition, the lack of stability in the data and the failure to make available prior versions of data that have been adjusted limit DB's usefulness for research. DB's documents and presentations should include full explanations and cautions on these points.

Motivating and Designing Reforms

The DB indicators have been influential in motivating policy makers to discuss and consider business regulation issues. Its active dissemination in easy-to-understand language permits widespread press coverage and generates interest from businesses, NGOs, and senior policy makers.

The DB indicators have had less influence on the choice and design of specific reform programs. Most Bank Group staff and country stakeholders report that they draw on a range of analytical material to determine the nature, sequence, and direction of reforms; the DB indicators have limited use in this regard. There is little evidence that the DB indicators have distorted policy priorities in the countries or in the Bank Group's programs, or that countries have implemented reforms with insincere motives. The DB indicators do not play a role in IDA's resource allocation process. Their use by the United States' MCC as a basis for resource allocation poses some risk to the MCC because of the continuous revision of DB data after publication.

Implications for the Bank Group

In addition to the findings for the design and use of the DB exercise itself, the evaluation has generated two implications for the Bank Group more broadly.

The Bank Group, by so prominently recognizing DB's highly ranked countries, may be inadvertently signaling that it values reduced regulatory burdens more than its other development goals. Although the Bank Group's approach entails helping countries achieve a wide range of objectives, it has no comparable way of celebrating improvements in other important development outcomes such as poverty reduction, public sector effectiveness, or the Millennium Development Goals.

The DB exercise has demonstrated that a cross-country ranking exercise can be effective in spurring dialogue and motivating interest and action. Can it be extended to other topics and issues? It can be used for issues that meet two conditions. There must be measurable indicators to serve as agreed proxies for the target

Box 5.1: If DB Were to Be Extended to Other Topics

Bank Group management may consider building on DB's experience by creating indicators on additional development topics. If so, the evaluation offers five lessons:

- ***Choose what to measure and start small:*** Use existing or new research to identify a few issues within a sector/theme that can serve as at least partial proxies for development. Then specify some quantitative variables that can be measured relatively easily, have an intuitive appeal, and are easily understood. This implies accepting that the indicators will be limited in scope, not comprehensive.
- ***Look for efficiency in data collection and processing:*** Data collection methods need to be simple. Use an appropriately diverse range of expert informants and provide informants with a common reference point such as a hypothetical scenario.
- ***Identify target audience:*** Country benchmarking can be an effective door-opener and motivate a wider dialogue. Consider in advance who the indicators should aim to influence and who could participate in the dialogue.
- ***Create and maintain competitive pressure:*** Any indicator can be effective only to the extent it is widely communicated and understood by the target audience and can generate competition among countries and pressure to reform. The DB's assertive marketing and communication strategy combined with its use of rankings helped to generate and maintain country interest.
- ***Do not overstate the implications of the rankings:*** Cross-country rankings inherently miss country-specific issue nuances. They have to be used in conjunction with other analyses to help countries determine the direction, nature, and sequence of reforms.

outcomes. And the direction of improvement must be the same across countries starting at widely different levels. For many development issues, the trajectories for change are not linear, but U-shaped. (For example, automated teller machines are an indicator of efficient financial services. At an earlier stage of development, more automated teller machines are better, but in mature economies, too many can be a sign of inadequate interbank networking). Further lessons from the evaluation are distilled in box 5.1.

Recommendations

1. **To improve the credibility and quality of the rankings,** the DB team should:
   a. **Take a strategic approach** to selecting and increasing the number of informants:
      – Establish and disclose selection criteria for informants.
      – Focus on the indicators with fewest informants and countries with the least reliable information.
      – Formalize the contributions of the supplemental informants by having them fill out the questionnaire.
      – Involve Bank Group staff more actively to help identify informants.

   b. **Be more transparent** on the following aspects of the process:
      – *Informant base:* Disclose the number of informants for each indicator at the country level, differentiating between those who complete questionnaires and those who provide "supplemental" information.
      – *Changes in data:* Disclose a list of all data corrections and changes as they are made. Explain their effect on the rankings, and, to facilitate research, make available all previously published data sets.
      – *Use of the indicators:* Be clear about the limitations in the use of the indicators for a broader policy dialogue on a country's development priorities.

   c. **Revise the *paying taxes* indicator to include only measures of administrative burden.** Since the tax rate is an important part of the business climate, DB should continue to collect and present simple information on corporate tax rates, but exclude it from the rankings (as it does for the information it collects on nonwage labor costs in the *employing workers* indicator). A wider range of informants should also be engaged in supplying information for the *paying taxes* indicator.

2. **To make its reform analysis more meaningful,** the DB team should:
   a. **Make clear that DB measures improvements to regulatory burdens and costs,** which is only one dimension of any overall reform effort of the investment climate for private sector growth. The DB indicators measure reductions in regulatory burdens and should be recognized and rewarded as such. These improvements should not be characterized as reforms of the overall business climate, which reflects a number of non-DB-measured aspects, as noted in figure 1.1.

   b. **Trace the impact of DB reforms at the country level.** The DB team should work with country units to analyze the effects of implementing the reforms measured by the DB indicators (such as revised legislation or streamlined processes) on: (i) firm performance, (ii) perceptions of business managers on related regulatory burdens, and (iii) the efficiency of the regulatory environment in the country.

3. **To plan additions to or modifications of the indicators,** the DB team should:
   a. **Use Bank analyses to drive the choice of DB indicators.** These would include Business Enterprise Surveys, Investment Climate Assessments, and other relevant Bank analyses to assess what stakeholders deem to be important priorities for domestic private sector growth. The DB team should use such analyses to determine the choice of new indicators and periodically reassess its current set.

   b. **Pilot and stabilize the methodology before including new indicators in rankings.** Frequent changes in methodology make comparison across time less meaningful. New indicators should be piloted—that is, data collected and published for comment, but not factored into the rankings—until the methodology is validated and stabilized.