

The second in our new series of impact notes highlights an example of ex-post evaluation of regulatory reform. While ideally one would like to build in an evaluation strategy before a new policy is introduced, much can still be achieved ex-post in cases where existing data collection covers those affected by the policy (and a comparison group of those not affected).

Does Business Registration Reform Increase Entrepreneurial Activity?

Miriam Bruhn

The view that burdensome regulations are an important barrier to private sector development was famously expressed by Hernando de Soto, who calculated that it would take 289 days, 11 permits, and over \$1,000 to legally register a small business in Peru. This emphasis on regulatory reform has been further spurred by the World Bank's *Doing Business* project. The 2009 report notes that in the past six years almost 1000 reforms have occurred in the areas measured by Doing Business, with the most common reform being one which makes it easier to start a business by reducing the costs and number of procedures needed. Despite the huge number of reforms, there is almost no rigorous impact evaluation of these reforms. One exception is a recent study that investigates the effects of a business registration reform in Mexico.

One-stop shop business registration in Mexico

In 2002, the Mexican government started implementing a business registration reform which greatly simplified municipal procedures required for obtaining an operating license. This reform was initiated by a federal agency that then worked with municipal governments at implementing it. Staffing constraints in the federal agency implied that they could not work with all municipalities at once, leading them to

introduce the reform first in some municipalities and then later in others. Before the reform, different municipalities had different registration procedures, but after the reform procedures were mostly unified. On average, the reform reduced the number of procedures from 8 to less than 3. Another feature of the reform was that it created a one-stop shop solution where businesses could complete federal, state and municipal registration procedures all in one office.

Measuring Impact

The variation across time and municipalities in the implementation of the reform provides an opportunity for measuring its effects through a *matched difference-in-difference* strategy. The change in outcomes of interest in municipalities that have already implemented the reform can be compared to the change in outcomes of similar municipalities that have not yet implemented the reform. This comparison gives valid results if the characteristics of the municipalities that adopted the reform early are similar to the ones of the municipalities that adopted the reform later. In Mexico, this was the case for the municipalities that implemented the reform in the first couple of years.

Positive effects on the number of registered businesses

A cross-municipality, cross-time comparison of outcome variables from the Mexican Labor Market Survey, shows that:

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- The reform increased the number of registered business by 5 percent in eligible industries.
- Employment increased by 3 percent.
- Consumer prices decreased, presumably due to the increase in competition from new businesses.
- Incumbent businesses saw a drop in their income of about 3 percent.

Are newly registered firms new firms or existing, but previously informal, firms?

In addition to establishing that the reform increased the number of registered businesses, it is also important to investigate whether this effect is due new firm creation or due to existing informal firms registering. It is commonly argued that informal firms should register when it becomes easier to do so. This is, however, not what the evidence from Mexico suggests. An in-depth analysis shows that informal firms are not more likely to register their business after the reform than they were before the reform. Instead, the individuals who previously worked as wage earners open new registered firms after the reform. This contradicts the view that informal small business owners are individuals who wish to become formal, but are being held back by high barriers to registration

Only men open new firms

Breaking down the effect by gender reveals that only the number of male-owned businesses increased after the reform, while there was no effect on the number of female-owned businesses. However, employment for women increased because women were more likely to work as wage earners in eligible industries after the reform. This is consistent with administrative data which indicate that many of the newly created businesses after the reform were in sectors

that typically employ women, such as small grocery stores, clothing stores, home-style food-to-go vendors, and beauty salons.

Policy implications

1. Simplification of entry regulation appears to be an effective policy for fostering entrepreneurial activity. In Mexico, simplifying business registration procedures led to an increase in the number of registered firms. This effect was larger in municipalities where the reduction in registration procedures was larger, implying that governments should strive to simplify entry regulation as much as possible.

2. Business registration reform also has positive effects on the economy as a whole. The reform in Mexico increased employment, providing employment to individuals who were previously not employed. The reform also lowered prices, presumably due to an increase in business competition. Overall, this suggest that this type of reform has the potential to increase growth, although this could not be measured directly in Mexico since municipal level GDP data is only available every five years.

3. Complex business registration does not seem to be the binding constraint that prevents informal firms from formalizing. There is no evidence that informal businesses register after the reform. This could be due to other important constraints that may be preventing informal firms from becoming formal. After a firm is registered, it has to pay taxes and comply with labor regulation (even though compliance is far from universal in Mexico). The associated costs could be so big that changing registration procedures may not be enough to push informal businesses over the threshold to formality.

For further reading see:

Bruhn, Miriam (2008). "License to Sell: The Effect of Business Registration Reform on Entrepreneurial Activity in Mexico." *World Bank Policy Research Working Paper* 4538.