Preface

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.