Reforming through Difficult Times

Doing Business 2010 Report

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Overview

The past year was a tough one for doing business. Firms around the world had to cope with the effects of a financial crisis that started in rich economies but led to a global economic downturn. Access to finance became more difficult. Demand for many products fell in domestic and international markets, and trade slowed globally. Policy makers and governments also faced big challenges—from stabilizing the financial sector and restoring confidence and trust to countering rising unemployment and providing necessary safety nets as an estimated 50 million people risked losing their jobs as a result of the crisis. And all this in the face of rising public debt as fiscal stimulus packages collided with tightening fiscal revenues.

Despite the many challenges, in 2008/09 more governments implemented regulatory reforms aimed at making it easier to do business than in any year since 2004, when *Doing Business* started to track reforms through its indicators. *Doing Business* recorded 287 such reforms in 131 economies between June 2008 and May 2009, 20% more than in the year before. Reformers focused on making it easier to start and operate a business, strengthening property rights and improving the efficiency of commercial dispute resolution and bankruptcy procedures.

Reforming business regulation on its own is not a recipe for recovery from financial or economic distress. Many other factors come into play. The *Doing Business* indicators do not assess market regulation or the strength of the financial infrastructure, both important factors in understanding some of the underlying causes of the global financial crisis. Nor do they account for other factors important for business at any time, such as macroeconomic conditions, infrastructure, workforce skills or security.

But the regulatory environment for businesses can influence how well firms cope with the crisis and are able to seize opportunities when recovery begins. Where business regulation is transparent and efficient, it is easier for firms to reorient themselves and for new firms to start up. Efficient court and bankruptcy procedures help ensure that assets can be reallocated quickly. And strong property rights and investor protections can help establish the basis for trust when investors start investing again.

Recognizing the importance of firms—especially small and medium size enterprises—for creating jobs and revenue, some governments, including those of China, the Republic of Korea, Malaysia and the Russian Federation, have included reforms of business regulation in their economic recovery plans. But most reforms recorded in 2008/09 were part of longer-term efforts to increase competitiveness and encourage firm and job creation by improving the regulatory environment for businesses. And most took place in developing economies.

Low- and lower-middle-income economies accounted for two-thirds of reforms recorded by *Doing Business* in 2008/09, continuing a trend that started 3 years ago. Indeed, three-quarters of such economies covered by *Doing Business* reformed. And for the first time a Sub-Saharan African economy, Rwanda, led the world in *Doing Business* reforms.

Rwanda has steadily reformed its commercial laws and institutions since 2001. In the past year it introduced a new company law that simplified business start-up and strengthened minority shareholder protections. Entrepreneurs can now start a business in 2 procedures and 3 days. Related party transactions are subject to stricter approval and disclosure requirements. Legal provisions determining directors' liability in case of prejudicial transactions between interested parties were also tightened.

Rwanda improved regulations to ease access to credit through 2 new laws. Its new secured transactions act facilitates secured lending by allowing a wider range of assets to be used as collateral. The law also makes out-of-court enforcement of movable collateral available to secured creditors and gives them absolute priority within bankruptcy. Rwanda's new insolvency law streamlined reorganization procedures.

Reforms also included measures to speed up trade and property registration. Delays at the borders were reduced thanks to longer operating hours and simpler requirements for documents. Reforms removed bottlenecks at the property registry and the revenue authority, reducing the time required to register property by 255 days. Five other low- or lower-middle income economies—the Arab Republic of Egypt, Liberia, Moldova, the Kyrgyz Republic and Tajikistan—joined Rwanda on the list of global top reformers. These top 10 reformers are economies that, thanks to reforms in 3 or more of the 10 areas covered by *Doing Business*, improved the most on the ease of doing business. An economy's ranking on the ease of doing business does not tell the whole story about its business environment.

And opportunities for reform remain—Liberia, for example, still ranks 149, and Tajikistan 152. Yet an improvement in this ranking does indicate that the government is taking action to make the local regulatory environment more conducive to doing business. Such reforms are as timely as ever. Many firms in developing economies have been affected by lower demand for their exports and a drop in capital flows and remittances. At the same time businesses in low-income economies on average still face more than twice the regulatory burden that their counterparts in high-income economies do when starting a business, transferring property, filing taxes or resolving a commercial dispute through the courts. Only 2% of adults on average have a credit history in low-income economies, compared with 52% of adults in high-income economies. Developed economies have on average 10 times as many newly registered firms per adult as Africa and the Middle East—and a business density 4 times that in developing economies.

Regulatory burdens can push firms—and employment—into the informal sector. There, firms are not registered, do not pay taxes and have limited access to formal credit and institutions—and workers do not benefit from the protections that the law provides. The global crisis is expected to further increase informal activity. Almost two-thirds of the world's workers are already estimated to be employed in the informal sector. Most are in low- and lower-middle-income economies. And a disproportionate share are from already vulnerable groups, such as youth and women. Most *Doing Business* reforms in developing economies still focus on cutting red tape and simplifying bureaucratic formalities. Over the past 6 years 80% of reforms in low- and lower-middle income economies were aimed at reducing the administrative burden for firms, mostly by easing business start-up and trade. This makes sense and addresses important needs. When informal firms were asked in 2008 about obstacles to formally registering their business, 67% in Côte d'Ivoire and 57% in Madagascar cited registration fees as a major or very severe obstacle.

In easing business start-up and trade, much can be achieved through cost-effective administrative reforms. The one-stop shop for starting a business in Burkina Faso cost $200,000. Azerbaijan's cost $5 million. And the costs are far outweighed by the estimated savings for businesses—estimated at $1.7 million a year in Burkina Faso, $8.4 million in Azerbaijan. Efficient systems also facilitate enforcement, a particular challenge in many developing economies where resources are scarce. Risk-based inspection systems at customs or in the construction sector allow public officials to focus their resources and attention where they are most needed.

Some reforming governments have gone further, introducing new legislation to strengthen property rights and increase legal protections for investors. Several post conflict economies, including Afghanistan, Rwanda and Sierra Leone, introduced new company and collateral laws, laying the legal foundations for future markets. Of course, many challenges remain. Banks in Afghanistan will not increase secured lending tomorrow just because of new legislation on the use of movable collateral. To be effective, new legislation must be well publicized and adopted by both the public and the private sector. Moreover, regulatory reform does not operate in a vacuum. New evidence suggests that an economy's governance structure and natural resources influence the motivation for reform.

But even in difficult circumstances, creating a regulatory environment with efficient administrative processes and strong protection of property rights can set the stage for firms and investors to take opportunities as the economy develops. New research suggests that given the right conditions, particularly in low-income economies, simple measures can make a difference. Analysis of 6 years of *Doing Business* reforms finds that in relatively poor but well-governed economies, a 10-day reduction in startup time was associated with an increase of 0.4 percentage points in the growth rate and 0.27 percentage points in the investment rate.

In 2008/09 *Doing Business* reforms picked up around the world, with at least 60% of economies reforming in every region. Reformers were particularly active in 2 regions, Eastern Europe and Central Asia and the Middle East and North Africa. In both, competition among neighbors played a part in motivating reforms.

Economies in Eastern Europe and Central Asia, the region most affected by the crisis, were the most active reformers for the sixth year in a row. Twenty-six of the region's 27 economies reformed business regulation in at least one area covered by *Doing Business*. In 2004/05 and 2005/06 the 10 European Union accession economies accounted for 84 reforms, 60% of the total in the region. Others followed, with some good results. Since 2004 private credit bureaus have opened in 16 of the region's economies. Today 94% of adults in Serbia, 77% in Croatia and 30% in Kazakhstan and Romania have a credit history. Five years ago, none did. Enterprise surveys show that in 2008 fewer than 6% of firms expected to make informal payments to get things done in Estonia, Slovenia and the Slovak Republic—a far cry from the 18%, 14% and 33% in 2005.8 In the past 3 years reforms have been moving eastward from the European Union. Albania, Belarus, the Kyrgyz Republic and the former Yugoslav Republic of Macedonia implemented reforms in several areas for the third year in row. Inspired by their neighbors, Kazakhstan, Montenegro and Tajikistan increased reform efforts this past year. Governments in the Middle East and North Africa are now reforming at a rate similar to those in Eastern Europe and Central Asia. Seventeen of 19 economies reformed in 2008/09. Egypt, Jordan and the United Arab Emirates were among the most active reformers. In recent years economies in the region have increasingly picked up reform practices from one another. Eight of the region's economies have reduced or eliminated their minimum capital requirement since 2005. Five of these 8 used to have among the highest requirements in the world—up to $120,000 in Saudi Arabia until 2007. Egypt, Jordan, Morocco, Saudi Arabia, Tunisia, the United Arab Emirates and the Republic of Yemen all operate one-stop shops for starting a business. In 2008/09 reforms also intensified in other areas, simplifying processes for getting construction permits, for trading across borders and for enforcing contracts through the courts.

Reforms in Latin America and the Caribbean also intensified, with 19 of 32 economies reforming. Colombia, Guatemala and Peru each reformed in at least 4 areas. And 3 Caribbean island states reformed for the first time—Grenada, St. Kitts and Nevis and St. Lucia. In Sub-Saharan Africa 29 of 46 economies reformed in 2008/09, implementing 67 reforms. As in the previous year, nearly half the reforms in the region focused on making it easier to start a business or trade across borders. In South Asia 6 of 8 economies reformed. In East Asia and the Pacific 17 of 24 did.

Among OECD high-income economies 17 reformed, focusing mostly on easing the corporate tax burden and improving property registration systems. Germany created a new form of limited liability company, doing away with start-up requirements that were more than 100 years old. Germany is no stranger to regulatory competition. In recent years, taking advantage of the common EU market, German limited liability companies increasingly registered in the United Kingdom, where registration was easier and less costly, rather than in Germany. The new law may reverse this trend.

Regulatory reform can be difficult and take time, particularly if legal changes are involved. Some reforms also require difficult political trade-offs. It is not surprising that most reforms recorded by *Doing Business* in 2008/09 were aimed at reducing administrative burdens. At least 30 economies improved processes for construction permitting, property registration or trading across borders, while 61 eased business start-up. By contrast, only 8 economies amended collateral or secured transactions laws—and only 11 amended labor regulations, 7 making them more flexible, 4 opting for more rigidity. Outside pressures are often required to push through substantial legislative changes. In this sense the current crisis may represent an opportunity.

Historically, many reforms have been prompted by recession or financial crisis. The East Asian crisis motivated many economies to reengineer their bankruptcy systems. Some, such as Singapore and Thailand, reformed laws to strengthen investor protections. Post crisis bankruptcy reforms were also carried out in Turkey in 2003/04 and in Colombia in 1999. In the United States the Great Depression prompted the country's first comprehensive bankruptcy reform in 50 years. This past year 18 economies reformed their bankruptcy regimes, as measured by *Doing Business*. This number may increase in the future as economies face the need to deal with systemic distress. In times of recession, keeping viable companies operating as a going concern and preserving jobs becomes especially important. And the more quickly the assets of nonviable firms can be freed up, the easier it is to remobilize those assets.

France and Germany were among the first to reform bankruptcy systems in response to the current crisis. In Eastern Europe and Central Asia several economies have recently started to do so. Latvia's new insolvency law became effective in January 2008, Lithuania's in July 2008. And in December 2008 Estonia adopted a new reorganization act that establishes a legal procedure enabling distressed companies on the verge of insolvency to reorganize themselves, restructure their debt and take other measures to restore their financial health and profitability. Such efforts are timely. The region's average recovery rate following bankruptcy is 32%, far lower than the 69% in OECD high-income economies.

As *Doing Business* has tracked regulatory reforms over the past 6 years, some patterns have started to emerge. Regulatory reform tends to pick up when pressure rises. One reason can be increasing competition as economies join a common market or trade agreement, such as the European Union or the U.S.–Central American Free Trade Agreement. Financial crisis and economic downturn are another strong motivation for reform. So is the need to rebuild an economy following conflict, as in Liberia, Rwanda and Sierra Leone.

Whatever the motivation, governments that succeed in sustaining reform programs, as measured by *Doing Business*, tend to have common features. To begin with, they follow a longer-term agenda aimed at increasing the competitiveness of their firms and economy.

Colombia, Egypt, Malaysia and Rwanda are all examples of economies incorporating business regulation reforms into a broader competitiveness agenda. Such reformers continually push forward and stay proactive. Singapore and Hong Kong (China) rank among the top economies on the ease of doing business and are also some of the most consistent reformers. This year Singapore once again tops the rankings on the ease of doing business—for the fourth year in a row. And in the past year it continued with reforms, implementing online and computer-based services to make it easier to start a business, deal with construction permits and transfer property.

But while successful reformers follow a clear direction in their policy agenda, they do not hesitate to respond to new economic realities. Mauritius, the top-ranked economy in Sub-Saharan Africa, just announced a new insolvency act "to maintain the viability of the commercial system in the country."

Successful *Doing Business* reformers are comprehensive. Over the past 5 years Colombia, Egypt, Georgia, FYR Macedonia, Mauritius and Rwanda each implemented at least 19 reforms, covering 8 or more of the 10 areas measured by *Doing Business*. This broad approach increases the chances of success and impact. Recent research suggests that reforms in different areas tend to be complementary. One study finds that after reforms reducing barriers to entry in India, states with more flexible employment regulations saw a 25% larger decrease in informal firms. Other studies show that when economies open up their product markets to international competition, the benefits are greater if the cost of entry is lower. Lower barriers to entry allow firms to move more easily toward industries that most benefit from trade openness.

Consistent reformers are inclusive. They involve all relevant public agencies and private sector representatives and institutionalize reform at the highest level. Colombia and Rwanda have formed regulatory reform committees reporting directly to the president or prime minister. More than 20 other economies, including Burkina Faso, India, Liberia, FYR Macedonia, the Syrian Arab Republic and Vietnam, have formed committees at the ministerial level. Reforms in Egypt involved 32 government agencies supported by the parliament. Successful reformers stay focused thanks to a long-term vision supported by specific goals. Malaysia aims to be a fully developed economy by 2020. Colombian President Alvaro Uribe envisions a new Colombia in which, rather than 60% of the population living in poverty, most would be counted as middle class. Rwanda aims to become a technology and trade hub in the region. The Kyrgyz Republic wants to become the center for regional regulatory excellence in Central Asia, Azerbaijan the gateway to the region.

Setting long-term goals and keeping a steady course of reform might help economies recover from shocks, including the current global financial and economic crisis. In the words of Egyptian Minister of Investment Mahmoud Mohieldin,

It is not just a crisis of the economy. It is a crisis of economic thinking. It is a crisis that is confusing many reformers . . . [but] whatever crisis you are facing, you need to make life easier for those who are endeavoring and working hard to create opportunities for jobs, and this is the least that we can be doing.

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