Doing business in 2006

Creating Jobs

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A copublication of the World Bank and the International Finance Corporation.

Additional copies of *Doing Business in 2006: Creating Jobs, Doing Business in 2005: Removing Obstacles to Growth,* and *Doing Business in 2004: Understanding Regulation* may be purchased at http://www.worldbank.org/publications

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Creating jobs: an overview

Who reformed most?

Where is doing business easy?

Less costly does not mean less protection

More reform is needed in Africa

Success requires new jobs in the formal economy

If you were opening a new business in Lao PDR, the start-up procedures would take 198 days. If you were opening one in Syria, you would have to put up $61,000 in minimum capital—51 times average annual income. If you were building a warehouse in Bosnia and Herzegovina, the fees for utility hook-up and compliance with building regulations would amount to 87 times average income. And if you ran a business in Guatemala, it would take you 1,459 days to resolve a simple dispute in the courts. If you were paying all business taxes in Sierra Leone, they would take 164% of your company's gross profit.[1]

Starting a business is a leap of faith even in the best of circumstances. Governments should encourage the daring. And many do. In 2004, 99 countries—two-thirds of the *Doing Business* sample—introduced 185 reforms to make it easier to do business. They simplified some aspect of business regulations, strengthened property rights, reduced exporting and importing costs, eased tax burdens and increased access to credit.

Such reforms allow firms to grow faster and create more jobs. An increasing number of those jobs will be in the formal economy because the benefits of being formal (such as easier access to credit and better utility services) often outweigh the costs (such as taxes). And more formal jobs will mean that more workers are protected by pensions, safety regulations and health benefits.

Women, who now make up three-quarters of workers in the informal sector, will be big beneficiaries. So will young and inexperienced workers looking for their first job.

Jobs are a priority for countries emerging from conflict, to absorb former soldiers into the workforce and quickly enable families to rebuild their lives. Without jobs there is a high risk that these countries will return to conflict. And jobs in the formal economy are a priority for countries in Africa—which have the most obstacles to doing business and are reforming more slowly than anywhere else.

Who reformed most?

In 2004 Serbia and Montenegro led in making the kinds of reforms that can spur growth in firms and jobs, improving in 8 of the 10 areas studied by *Doing Business* (table 1.1). The capital requirement for starting a new business was cut from 5,000 euros to 500. The time to start a new business was reduced from 51 days to 15. A new labor law made it easier to hire workers by allowing firms to offer term contracts rather than having to hire under indefinite contracts even when addressing temporary needs. The time to resolve commercial disputes fell from 1,028 days to 635, thanks to a new code of civil procedure. Payroll and sales tax were replaced by a value added tax, which is easier to collect. The number of new registered (formal) firms in 2004 jumped by 42% over the previous year.

Georgia was the runner-up reformer. A new licensing law cut from 909 to 159 the number of licensed activities. A one-stop shop was created for license applications, so that now businesses can submit all documents there, with no verification by other agencies required. A simplified tax code eliminated 12 of 21 taxes. And the time to register property fell by 75%, and the cost by 70%.

Regionally, the most reform took place in Eastern Europe and Central Asia, where every country took at least one step to make things easier for business (figure 1.1). Many of these reforms were driven by integration with the European Union. Three Eastern European countries—Slovakia, Romania and Latvia—were among the top 12 reformers in 2004 (see table 1.1), and Slovakia was the leading reformer in 2003. All 3 have made it easier for new businesses to open. These efforts appear to be paying off: in 2004 the number of new start-ups jumped by 8% in Latvia, 13% in Slovakia and 22% in Romania. The most common reforms in the region, occurring in half the countries, involved simplifying tax administration and reducing tax burdens. Earlier reforms in Estonia, Russia and Slovakia led the way.

Some of the boldest reforms, driving the biggest improvements in the *Doing Business* indicators, were:

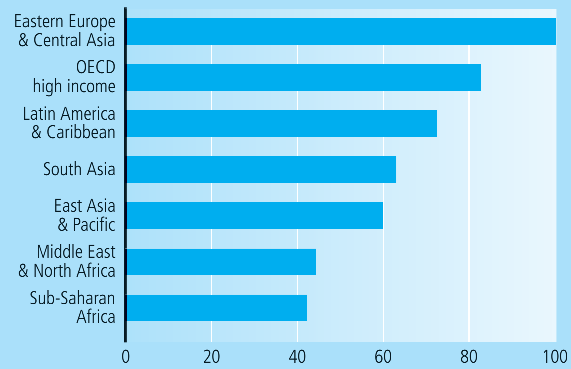
- Serbia and Montenegro's simplification of business start-up.
- Egypt's streamlining of customs procedures and trade documents.
- Brazil's improvements to bankruptcy law.

Serbia and Montenegro moved start-up registrations from its courts to a new administrative registry. Entrepreneurs can register online, and a "silence is consent" rule ensures rapid approval. In addition, a new unified electronic database links the commercial courts, statistics bureau, customs office, national bank and municipalities. With these reforms, a company can start operating in 15 days rather than 51 (figure 1.2).

FIGURE 1.1

Every country in Eastern Europe and Central Asia reformed

Countries that made at least one reform in 2004 (%)



Source: Doing Business database.

Egypt established a single window for trade documentation and merged 26 approvals into 5. A time limit of 2 days for passing through customs now applies. Improvements at customs were part of a broader reform to cut the number of tariff bands from 27 to 6 and simplify inspection procedures at the border.

Brazil's new bankruptcy law gives insolvent companies the option of remaining open while undergoing restructuring. Creditors have more power to direct reorganization proceedings by establishing creditors' committees that vote on restructuring plans. Secured creditors now get preference over tax claims when assets are sold.

TABLE 1.1

The top reformers in 2004

Country	Starting a business	Dealing with licenses	Hiring and firing	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business
Serbia and Montenegro	✓	✓	✓	✓	✓		✓		✓	✓
Georgia	✓	✓	✓	✓			✓			
Vietnam	✓			✓		✓			✓	✓
Slovakia	✓		✓	✓	✓					
Germany	✓		✓					✓	✓	
Egypt	✓			✓	✓			✓		
Finland		✓	✓				✓			✓
Romania	✓				✓		✓		✓	
Latvia	✓			✓			✓		✓	
Pakistan	✓			✓		✓		✓		
Rwanda					✓			✓	✓	
Netherlands		✓		✓			✓			

Note: Countries are ranked on the number of reforms. When countries have the same number of reforms, they are ranked on the impact of the reforms on the *Doing Business* indicators. The larger the improvement in ranking on each set of indicators, the higher the country ranks as a reformer.

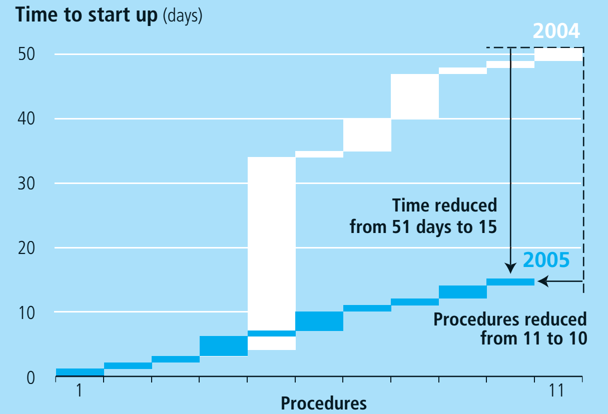
Source: Doing Business database.

The new law halved the average time for going through bankruptcy from 10 years to 5 and is expected to raise the recovery rate from 0% of company assets to 7.5%.

But not all changes in *Doing Business* indicators were for the better. In 2004, 20 countries—18 of them poor—made it harder to do business. Among them:

- Madagascar raised its minimum capital requirement for starting a business to $6,500—22 times annual income per capita.
- Chad raised transfer taxes and notary fees for registering property. Taxes and fees to buy land or buildings equal 21% of their value—among the highest levels in the world.
- Mauritania raised its corporate income tax rate from 20% to 25%—the only country to increase this tax in 2004.

FIGURE 1.2
Making entry easier in Serbia and Montenegro



Source: Doing Business database.

Where is doing business easy?

New Zealand has the most business-friendly regulation in the world, as measured by the *Doing Business* indicators (table 1.2). Singapore is the runner-up. The United States is third. Five other East Asian countries—Hong Kong (China), Japan, Thailand, Malaysia and Korea—are among the top 30. So are the Baltic countries—Lithuania, Estonia and Latvia. Their ranking is a remarkable achievement, as only a decade has passed since they first began reforms.

But the rankings on the ease of doing business also show that many reformers still have a long way to go. Although Eastern Europe was the top reforming region, some of its countries still rank poorly on the ease of doing business. For example, Serbia and Montenegro's rank is 92, Croatia's is 118 and Ukraine's 124. Egypt, another top reformer in 2004, ranks 141. And India, though making big gains on collateral recovery and ease of registering property, ranks 116—25 places behind China.

Rankings on the ease of doing business do not tell the whole story. The indicator is limited in scope. It does not account for a country's proximity to large markets, quality of infrastructure services (other than services related to trading across borders), the security of property from theft and looting, macroeconomic conditions or the underlying strength of institutions. Thus while Jamaica ranks close (at 43) on the ease of doing business to France (at 44), this does not mean that businesses are better off operating in Kingston rather than in Paris. Crime and macroeconomic imbalances—2 issues not directly studied in *Doing Business*—make Jamaica a less attractive destination for investment.

But a high ranking on the ease of doing business does mean that the government has created a regulatory environment conducive to the operation of business. Often, improvements on the *Doing Business* indicators proxy for broader reforms to laws and institutions, which affect more than the administrative procedures and the time and cost to comply with business regulation.

TABLE 1.2
Top 30 economies on the ease of doing business

1	New Zealand	16	Estonia
2	Singapore	17	Switzerland
3	United States	18	Belgium
4	Canada	19	Germany
5	Norway	20	Thailand
6	Australia	21	Malaysia
7	Hong Kong, China	22	Puerto Rico
8	Denmark	23	Mauritius
9	United Kingdom	24	Netherlands
10	Japan	25	Chile
11	Ireland	26	Latvia
12	Iceland	27	Korea
13	Finland	28	South Africa
14	Sweden	29	Israel
15	Lithuania	30	Spain

Note: The rankings for all economies are benchmarked to January 2005 and reported in the Country tables. The ease of doing business averages country rankings across the 10 topics covered in *Doing Business in 2006*. This year's rankings are not comparable to last year's as three new sets of indicators—on dealing with licenses, paying taxes and trading across borders—have been included. See the Data notes for details.

Source: Doing Business database.

Less costly does not mean less protection

Having a high ranking on the ease of doing business does not mean that a country has no regulation. Few would argue that it is every business for itself in New Zealand, that workers are abused in Canada or that creditors seize debtors' assets without a fair process in the Netherlands. And to protect the rights of creditors and investors, as well as establish or upgrade credit registries, more regulation rather than less is needed to make the top 30 list.

All the top ranking countries regulate businesses, but they do so in less costly and burdensome ways. Consider the 5 Nordic countries, all of which are on the top 30 list: Norway (5), Denmark (8), Iceland (12), Finland (13) and Sweden (14). These countries do not regulate too little. Instead, they have simple regulations that allow businesses to be productive, and focus intervention where it counts—protecting property rights and providing social services.

The Nordic countries have moderate to high business taxes—52% of gross profit in Finland and Iceland, 53% in Sweden and 60% in Norway. Yet just 8% of economic activity occurs in unregistered (informal sector) businesses. The reason is that businesses receive excellent public services for what they pay. For example, Denmark has the world's best infrastructure.[2] Norway ranks highest on the human development index produced by the United Nations Development Programme, with Sweden right behind it.[3] In these countries, as well as the rest of the top 30, reformers do not have to choose between making it easy to do business and providing social protection. They have found a way to do both.

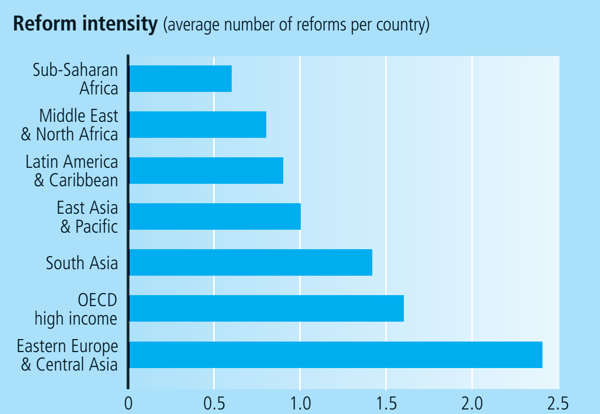
More reform is needed in Africa

If reformers of business regulation in Africa are seeking an example, they should look nearby—to Rwanda. In 2001 new company and labor laws made it easier to start businesses and hire workers. The next year the government began land titling reform. And in 2004 Rwanda was among the top 12 reformers (see table 1.1). Customs procedures were streamlined and the credit registry improved. Judicial procedures were also simplified, expediting contract enforcement. The country's president has explained the importance of court reform: "As the saying goes, justice delayed is justice denied. Our courts are clogged with an ever-increasing backlog of cases, some of which date back 10 years or more. The rich, powerful and well connected get preferential treatment . . . One of the bottlenecks that our program of national reconstruction faces is a malfunctioning legal system."[4] Since initiating reform, Rwanda has had economic growth averaging 3.6% a year—among the highest levels in Africa.

There are other Sub-Saharan success stories. In 2004 Nigeria introduced 3 reforms, involving business entry, labor practices and credit information. Mauritius, with a rank of 23 among the easiest places to do business, made 2 reforms. South Africa ranks 28 on the ease of doing business—and Namibia, 33. These countries can inspire others in the region, just as Japan's success motivated reformers elsewhere in East Asia and Chile's success has energized its Latin American neighbors. Some African governments are responding, with ambitious reforms planned in Burkina Faso, Lesotho and Malawi, among others.

Reform is sorely needed. Entrepreneurs face more regulatory obstacles in Africa than in any other region. Yet in 2004 reform was slower there than in other regions (figure 1.3). The 16 West African countries managed just 2 reforms: Cameroon imposed a 7-day limit on customs clearance, and Côte d'Ivoire enabled employers to register workers with the social security fund in 1 day, down from 2 weeks. Across the region, for every 3 countries that improved regulation, 1 made it more burdensome.

FIGURE 1.3
Africa had the lowest reform intensity in 2004



Source: Doing Business database.

Success requires new jobs in the formal economy

"First, I would like to have work of any kind," says an 18-year-old Ecuadoran in *Voices of the Poor,* a World Bank survey capturing the perspectives of poor people around the world. People know how to escape poverty (figure 1.4). What they need is to find a decent job. Studies confirm this—the vast majority of people who escape from poverty do so by starting their own business or finding work in an existing one.[5]

Better performance on the ease of doing business is associated with more jobs (figure 1.5). New Zealand, the global leader on the ease of doing business, has 4.7% unemployment. In Greece, the OECD country with the worst ranking (80) on *Doing Business* indicators, unemployment is 10.9%.

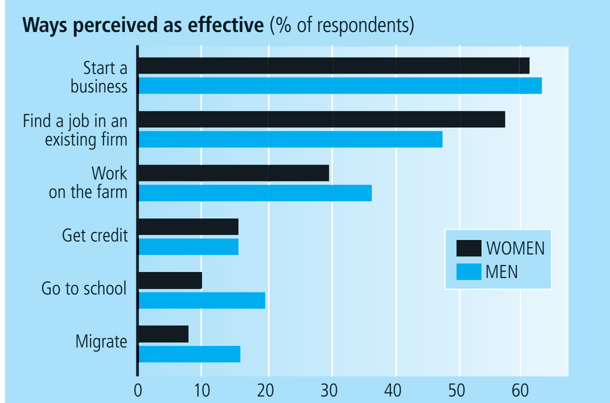
Earlier studies confirm this pattern. Quarterly job creation in Portugal, one of the most heavily regulated labor markets, is 59% of that in the United States on a per capita basis. A Portuguese business is 40% less likely than a U.S. one to create jobs during an economic upturn.[6] Such jobless recoveries are common to heavily regulated markets—and mean that some people remain without work for long periods.[7]

Enormous opportunities exist for creating jobs. If Croatia adopted the business environment of Denmark, all else being equal, analysis suggests that unemployment could fall by up to 4 percentage points (see figure 1.5). If Argentina adopted Danish-style business regulation and property rights protection, analysis suggests that unemployment could fall by up to 3.3 percentage points.[8]

But where regulations are costly and burdensome, businesses often operate in the informal economy—and remain small, creating few jobs. Consider an example from Burkina Faso. There, Oumarou runs a food supply business. He would like to move into the formal economy so that he can serve larger customers, who demand value added tax receipts. But registering a business requires minimum capital equal to nearly 5 times annual income per capita. Fees alone cost 1.5 times income per capita. To get a bank loan Oumarou would have to put up a large amount of collateral. But he has never registered his property, because doing so would require fees equal to 16% of its value. In the face of such obstacles, Oumarou keeps his business informal—and small. He is not alone: in a country of more than 12 million people, only 50,000 work in the formal sector.

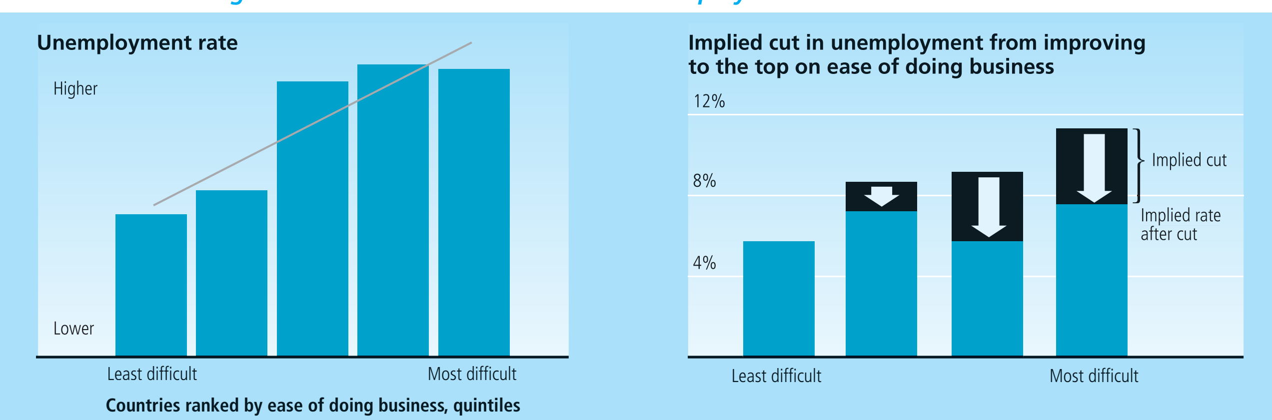
Reform can change this. Improving a country's *Doing Business* indicators to the level of the top quartile is associated with a 9 percentage point fall in the share of GDP accounted for by informal activity (figure 1.6). In

FIGURE 1.4
Starting a business is the main way out of poverty



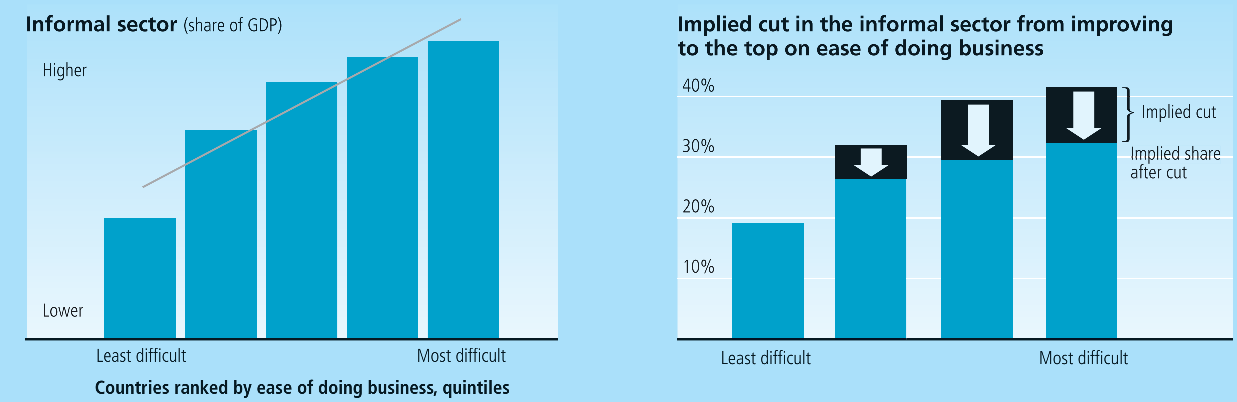
Note: Based on interviews with 60,000 poor people in more than 50 countries.
Source: Narayan and others (2000).

FIGURE 1.5
Greater ease of doing business is associated with fewer unemployed



Note: Relationships are significant at 1% level and remain significant when controlling for income per capita.
Source: Doing Business database, ILO (2005).

FIGURE 1.6
Greater ease of doing business is associated with less informality



Note: Relationships are significant at 1% level and remain significant when controlling for income per capita.
Source: Doing Business database, Schneider (2005), WEF (2004).

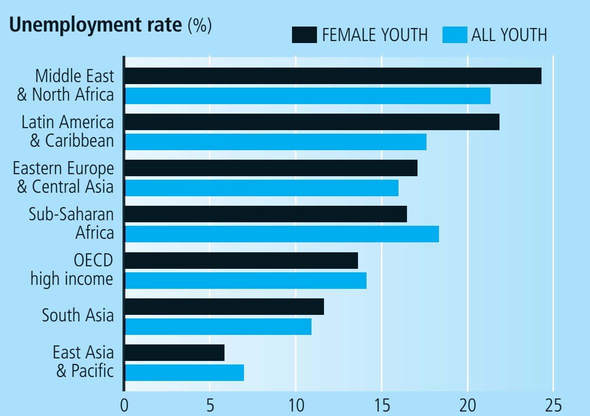
other words, reform expands the reach of regulation by bringing businesses and employees into the formal sector.

Female and young workers would benefit the most from these changes. Both groups account for a large share of the unemployed (figure 1.7), and burdensome regulations significantly affect their job opportunities. In Iran, for example, an employer cannot write a term contract unless the job is seasonal. And women are not allowed to work more than 8 hours a day. Not coincidentally, only 28% of women in the labor force are formally employed.

Governments in conflict-affected countries are especially hard-pressed to create jobs. Continued peace depends on demobilizing rebel armies and finding livelihoods for thousands of refugees and former combatants. This year *Doing Business* studies 5 conflict-affected countries: Afghanistan, Eritrea, Iraq, Sudan and Timor-Leste. Among these, Afghanistan was the top reformer in 2004. The number of entry procedures for new businesses was cut from 28 to 1, and the time to complete the process from 90 days to 7. Transport infrastructure on major Afghan trading routes was improved. Property records are being compiled and digitized—providing the base for a new property registry (even though the records cover only a quarter of the country). There are also plans to establish a credit registry, owned by the central bank and private commercial banks. Property and credit registries will make it easier for creditors to provide loans.

Successful regulatory reforms abound, with payoffs for job creation. Since 2002 Slovakia's reforms have helped cut the number of unemployed by 43,000.[9] In Colombia reforms of employment and business start-up regulations have created 300,000 jobs in the formal economy.[10] Another success story comes from Peru, where in the past decade the government has issued property titles to 1.3 million urban households. Secure property rights have enabled parents to find jobs rather than staying home to protect their property. Similarly, children can now attend school. As a result, the incidence of child labor has fallen by nearly 30%.[11]

FIGURE 1.7
Youth unemployment highest in the Middle East



Source: ILO (2005).

Notes

1. Defined as sales less material and labor cost.
2. WEF (2004).
3. UNDP (2004).
4. Kagame (2002, p. 8).
5. See also Fields and others (2002).
6. Blanchard and Portugal (1998).
7. Holmes (1998).
8. Analysis based on cross-country regression controlling for the standard variables used in the labor literature.
9. Slovak Statistical Office (2005).
10. Echeverry and Maria (2004).
11. Field (2002).