

Towards the Economics of Comparative Law: the ‘*Doing Business*’ Debate

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The centrality of institutional determinants for economic performance has recently flourished in the economic policy debate. ‘Doing Business’ is a project launched in 2004 by the World Bank with the aim of providing objective measures of business regulation and enforcement across the world. Several legal and economic scholars have questioned the reliability of Doing Business indicators, the methodology and the theoretical background. We discuss the main critics raised and the potential of the World Bank project towards the economic analysis of comparative law.

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I. INTRODUCTION

The centrality of institutional determinants for economic performance has recently flourished in the economic policy debate. This is testified, among other things by several initiatives launched either by intergovernmental organizations or foundations, focused on measuring the impact of institutional framework on growth or competitiveness. The “Doing Business” report published annually by the World Bank is just one of the prominent examples in this respect. Recent debates over global financial crises have further renewed the role of institutional setting and legal standards as

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“genetic” features of well-performing markets, which is now acknowledged even by one of the Chicago School’s most eminent scholars.

The idea that designing appropriate institutional frameworks should be the new frontier of policy-making in the hands of governments¹ is now central in comparative law and economics studies. Structural reforms are, indeed, the new horizon of most governments both in developing/transition countries and in the most advanced. To assign a quantity measure to the quality of institutions is crucial in policy evaluation analysis. On the one hand, indeed, to express institutional entities through quantitative values is essential in order for an empirical evaluation of institutions to be feasible; on the other, an ambiguous measuring might lead to wrong normative recommendations.

Policymakers increasingly refer to “quality” as a useful benchmark according to which evaluate institutions. While “quality” sounds as a sufficiently general and acceptable benchmark, it remains also an empty concept. Indeed, the quality of an institution is nothing else that the capacity of the institution to achieve a certain objective, which can be any. A common and rather widespread claim is that better institutions are those that leave market agents to behave as much freely as possible. In 2004 the World Bank launched the *'Doing Business'* program with the aim of assessing the extent to which, across the world, the regulation affecting small – medium sized firms represents an “inefficient” constraint on business activity and therefore, on a country’s competitiveness.

The project, which owes most part of its fulfillment to the economist Simeon Djankov and the team he led to this purpose, has been conceived as toolkit to: (i) measure the ongoing regulatory reforms through countries’ benchmarking; (ii) induce changes in those areas of the business regulation which adversely affect a country’s competitiveness; (iii) improve the effectiveness of money-aids by helping donors to monitor the quality of the institutional environment of a country; (iv) provide quantitative measures of the actual rate of regulation, in order to test the impact of existing theories².

Precisely, the project consists of a set of ten indicators, each one measuring the extensiveness of the regulation applying to a particular moment of the business life-cycle, i.e. from the starting up of a business to the payment of taxes, from the employment of workers to the resolution of commercial disputes, etc., for a sample covering today one hundred and eighty-three economies.

Every year, since 2004, these indicators are published by the World Bank in reports discussing, for each index, a country-ranking aimed at ordering

¹ R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The Economic Consequences of Legal Origins*, 46 *Journal of Economic Literature* 285, 332 (2008).

² World Bank, *Doing Business in Report 2004: Understanding Regulation*, ix – x (2004).

countries from those which regulate the least to those which regulate the most; the number and the type of reforms which have been implemented by countries; the economies which should reform but still have to do it; how and to what extent these countries should adopt reforms in given areas; and a review of the established and emerging theories of regulation³.

At a first glance, one could argue that *'Doing Business'* shows nothing new with respect to other research programs assessing the business environment from a legal point of view, like e.g. the *'Global Competitiveness Report'* of the World Economic Forum⁴, the *'Index of Economic Freedom'* of the Heritage Foundation⁵, the Business Environment and Enterprise Performance Survey (BEEPS)⁶ which are devoted as well to assess countries' business institutions through quantitative indicators.

To this purpose, *'Doing Business'* emphasizes that its distinguishing feature is the “approach to measurement” adopted. Specifically, the methodology has two main advantages: firstly, it focuses to a broader extent on poorest countries and domestic small firms; and secondly, it relies on objective information concerning the implementation of both the regulation and the legal system. Thus, it is a rather improvement relative to survey data which merely capture the perceptions economic agents have of the business institutions.⁷

Indeed, one of the aspects *'Doing Business'* stresses the most about its measurement methodology concerns the involvement of the so called “*local partners*” (i.e. lawyers, accountants, government officials, judges, and international private law firms) who are deemed to provide a reliable ‘objective’ assessment of the actual implementation of the country's business regulation.

All in all, the main distinguishing feature of the *'Doing Business'* indicators has to be found, in our view, neither in the approach to measurement it pursues, nor in the objectives it intends to achieve. Differently, we argue that the specificity of the *'Doing Business'* project mainly consists in the emphasis

³ For an insight on *Doing Business* reports, see the publications ‘Doing Business in 2004’, ‘Doing Business in 2005’, ‘Doing Business in 2006’, ‘Doing Business 2007’, ‘Doing Business 2008’, and ‘Doing Business 2009’, ‘Doing Business 2010’ available at: <http://www.doingbusiness.org/Downloads/>.

⁴ For more details see: <http://www.weforum.org/en/initiatives/gcp/index.htm> .

⁵ For more details see: <http://www.heritage.org/Index/>

⁶ For more details see: <http://www.ebrd.com/country/sector/econo/surveys/beeps.htm> or www.worldbank.org.

⁷ World Bank, *Doing Business in Report 2004*, cit. viii – ix.

attributed to the goal of promoting and addressing the nature of institutional reforms needed to improved a country's competitiveness.

In fact, since the publication of the first report, the '*Doing Business*' program has largely influenced the reform agenda of many developing countries by addressing reforms as well as by advertising in the internet and on the media the successful reformatory initiatives adopted world-wide⁸.

The ambition of becoming an active part of the countries' reform policies is, indeed, the main focus of legal scholars' critics about the '*Doing Business*' indicators. Actually, in the light of the proclaimed intent of addressing countries' reforms, many have been the seminal works devoted at investigating the reliability of the conceptual framework and the methodology underlying the '*Doing Business*' indicators.

The present work aims at presenting a short review of the several papers dealing with the supposed methodological and conceptual weaknesses of the '*Doing Business*' indicators. Despite the permanent and unprecedented debate raised by the '*Doing Business*' program, this is the first attempt, to our knowledge, to provide a preliminary assessment of the legal and economic literature on the meaning and extent of '*Doing Business*' indicators.

The paper is organized as follows. Section 2 illustrates how the '*Doing Business*' program works. Section 3 presents the theoretical background of the '*Doing Business*' indicators. Section 4 discusses the critics raised to '*Doing Business*' with reference to the measurement methodology, its theoretical framework, and the reform recommendations it provides. Section 5 concludes.

II. MEASURING AND COMPARING THE REGULATORY ENVIRONMENT

The '*Doing Business*' project consists in a set of ten indicators, each one measuring the extensiveness of the regulatory environment, firms have to face in the most relevant moments of their business life. Precisely, these indicators - which cover a sample of one hundred and eighty-three economies and are yearly updated since 2004 - are the following: (i) the *Starting a Business* index: concerning the regulation applying to the process of formally starting up and operating of a firm; (ii) the *Employing Workers* index: measuring the rigidity of the employment regulation; (iii) the *Getting Credit* index: assessing the quality of the credit information system, and the strength of the bankruptcy and collateral laws in protecting the creditors' rights; (iv) the *Closing a Business* index: concerning the efficiency of the bankruptcy procedures; (v) the *Enforcing Contracts* index: evaluating the efficiency of the judicial system in settling

⁸ See for example <http://www.doingbusiness.org/Reformers/>, and specifically the link *Who reformed (and who did not) between 2004 and 2009?*, and the book "*Celebrating Reform 2007: Doing Business Case Studies*", edited in 2007 by the World Bank.

commercial disputes; (v) the *Protecting Investors* index: assessing the extensiveness of the protection the law provides to minority shareholders against the directors' misuse of corporate assets; (vi) the *Registering Property* index: measuring the efficiency of the system of transfer of property titles; (vii) the *Paying Taxes* index: evaluating the country's fiscal system applying to firms; (viii) the *Dealing with Construction Permits* index: assessing the extensiveness of the bureaucracy requirements needed to construct a firm's buildings; and (ix) the *Trading Across Borders* index: evaluating the regulation applying to the export and import of goods via ocean transport⁹.

In turn, every measure consists of a set of sub-components measuring, alternatively: (i) whether the administrative procedures represent a constraint for business activities, thus measuring the number of required official procedures, the time, and the costs involved by these mandatory administrative requirements. This is the case, in particular, of the indexes *Starting a Business*, *Enforcing Contracts*, *Registering Property*, *Trading Across Borders*, *Paying Taxes*, and *Dealing with Construction Permits*; (ii) the existence of some specific provisions concerning a given area of the business regulation. This is the case, precisely, of the measures *Getting Credit*, *Investor Protection*, and to a lesser extent, of *Employing Workers*.

The central idea behind the theoretical framework underlying the '*Doing Business*' is that a cumbersome regulation is not beneficial, ultimately for economic growth, being related to several adverse socio-economic outcomes. Actually, given a certain theoretical framework defining what business regulation is, what should be its objectives, and what are the main interests it should satisfy, it follows that a definition of what should be measured (i.e. the unit of measurement) and of the coding to be used to transform a qualitative matter in a quantitative indicator automatically derives.

In the following Section we illustrate this conceptual background.

III. "HEAVIER REGULATION BRINGS BAD OUTCOME"

'*Doing Business*' has been inspired by the pioneering works of the Peruvian economist Hernando de Soto.¹⁰ During the 90's, de Soto and his team of researchers realized a field experiment consisting in starting up and formally operate a small business in Lima (precisely a garment workshop). The procedure of filling up with all the required certificates, to obtain the legal status for the business, took 289 days and costed \$1,231 (i.e. thirty-one times

⁹ Indicators (i) – (v), (vi) – (vii), (viii) – (x) have been computed, respectively, since 2004, 2005, 2006.

¹⁰ H. de Soto, *The Other Path: The Invisible Revolution in the Third World* and *Id., The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Every Else* (2000).

the monthly minimum Peruvian wage). Similarly, to obtain an authorization to build a building in a state-owned land took almost seven years and eight hundreds procedures. The experiment was conducted also in other countries like the Philippines, Egypt, and Mexico revealing a situation very similar to that of Peru.¹¹

In the light of his field experiments, de Soto claims that one of the most important obstacles to economic development is represented by the complex and costly legal rules governing property rights. According to de Soto economic growth of developing countries is not hindered by the scarcity of economic or financial resources, but rather by cumbersome and complex legal rules which prevent resources to flow into productive uses by discouraging business activities to become formal. Precisely, de Soto argues that the heavier is the regulatory intervention in a country, the more costly and unaffordable is for the poors to set up a legal productive activity. This, in turn, make them prefer to remain informal consequently raising the amount of dead capital of the economy. Looking, for example, to the regulation of property rights on real assets, de Soto observes that in Peru people find many way out as much as “there are legal obstacles to circumvent” in order to avoid to deal with such a costly and complex legal framework. “The result is that most people' s resources are commercially and financially invisible. Nobody really knows who owns what and where, who is accountable for the performance of obligations, who is responsible for loss and fraud, and what mechanisms are available to enforce payment for services and good delivery. Consequently, most potential assets in these countries have been not identified or realized: there is little accessible capital, and the exchange economy is constrained and sluggish“.¹²

Djankov¹³ - one of the most influential works delineating the theoretical framework and the methodology of the '*Doing Business*' program – builds, actually, on the idea of de Soto.¹⁴ In particular, Djankov illustrates the methodology underlying the construction of the first '*Doing Business*' measure, i.e. the *Starting a Business* indicator. Precisely, these scholars developed, for a sample of eighty-five countries, a set of three indicators capturing, respectively, the number of procedure, the number of days, and the costs - as a percentage of GNI per capita - to formally start up and operate a business. These measure are then employed by Djankov to test two different theories of

¹¹ H. de Soto, *The Mystery of Capital*, cit. 18 – 23.

¹² H. de Soto, *The Mystery of Capital*, cit. 29.

¹³ S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The Regulation of Entry*, 118 *Quarterly Journal of Economics* 1, 37 (2002).

¹⁴ H. de Soto, *The Other Path*, cit., *Id.*, *The Mystery of Capitalism*, cit.

regulation: the public interest¹⁵ and the so called tollbooth theory of regulation¹⁶, that is a particular case of the public choice approach.

The main finding of the empirical analysis of Djankov is that the extent of the business regulation is not correlated to the degree of the market failures, but rather it is significantly correlated with a set of socio-economic characteristics of a country, like the level of corruption and democracy, legal origins, and the stage of economic development. Specifically, they claim that a heavier regulation, i.e. a greater number of permits, certificates, and documents the law forces to comply with in order to legally constitute a firm, does not help to solve market failures (i.e. there is not a statistically significant relationship). Rather it turns out to be positively correlated with the level of corruption and autocracy of a country, as well as negatively related to its level of economic development. In particular, the direction of the causality relationship goes is the following way: the higher is the extent of the regulatory intervention, the more a country is corrupted, poorly democratic, and economically underdeveloped. Therefore, it may be argued that an extensive regulatory intervention is mainly a tool through which politicians collect bribes and votes, rather than a channel through which it fixes market failures.

What then originally shapes the extensiveness of the entry regulation is found to be the type of legal family from which the legal system derives. Precisely, it appears that Socialist legal origin countries, as well as French, and German Civil Law countries regulate the most, while Nordic and English Common Law countries regulate the least. These results go hand in hand with the findings of La Porta¹⁷ which have been pioneering in evidencing the role of the legal origins in explaining differences in the features of the legal environment and, consequently, in the level of economic and financial development of a country.

The article by Djankov *et al.*¹⁸ can be considered one of the most influential paper defining the theoretical framework of the '*Doing Business*' program. Not only because it is the first contribution on the topic, but also because it addresses the existence of a link between the extent of the regulatory intervention and a broad set of institutional and economic variables. Actually, it is on this link, i.e. that cumbersome regulation brings to bad outcomes, that '*Doing Business*' builds its policy reform recommendations and the subsequent

¹⁵ A. C. Pigou, *The Economics of Welfare* (1938).

¹⁶ E.g. F. S. McChesney, *Rent extraction and rent creation in the economic theory of regulation*, 16 *Journal of Legal Studies* 101, 118 (1987).

¹⁷ R. La Porta, F. Lopez-de-Silanes, A. Shleifer, R. Vishny, *Law and Finance*, NBER Working Paper No. 5661 (1996), *Id.*, *Legal Determinants of External Finance*, 52 *Journal of Finance* 1131, 1150 (1997).

¹⁸ S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The regulation*, cit..

papers illustrating the methodology behind other 'Doing Business' indicators draw on.

Indeed, in another work by Djankov *et al.*¹⁹ - which defines the methodological and conceptual framework of the *Enforcing Contracts* index – it is shown that more formalized judicial systems are associated with higher level of corruption, less honesty and fairness of the judicial decisions, higher duration of the judicial proceedings, and with the condition of being a Civil law instead of a Common law country.

Common law countries appear to regulate the least also with reference to market labor. Botero *et al.*²⁰ which illustrates the methodological background of the *Employing Workers* index, shows that Socialist, French, German, and Scandinavian legal origin countries have “sharply higher levels of labor regulation than do Common law countries”. This in turn determines a better performance of the former countries with reference several outcomes related to market labor like unemployment and labor force participation. Indeed, Botero *et al.* find that the stricter is the regulation of labor - e.g. fixed term contracts are prohibited for permanent tasks, weekend work is restricted, night work is restricted, etc. - the lower the labor force participation and the higher the level of unemployment is, especially of the young.

The relationship between legal origins and the extent of the regulatory intervention arises to be strong also with reference to the regulation applying in the case of insolvency of a firm. Indeed, Djankov *et al.*²¹ which presents the background of the index *Closing a Business*, argues that the efficiency of the debt enforcement (proxied by “the present value of the terminal value of the firm after bankruptcy”) affects the development of credit markets, and it is also “strongly correlated with per capita income and legal origin”. Once again, Common law countries appear to have more efficient bankruptcy procedures than Civil law countries, which consequently are also characterized by less developed credit markets.

The role of legal origins in predicting the effectiveness of the legal framework applying to small domestic firms is also strongly emphasized in the papers

¹⁹ S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *Courts*, cit.

²⁰ J. C. Botero, S. Djankov, R. La Porta, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The Regulation of Labor*, 119 *Quarterly Journal of Economics*, 1339, 1382 (2004).

²¹ S. Djankov, O. Hart, C. Mc Liesh, A. Shleifer, *Debt enforcement around the World*, 116 *Journal of Political Economy* 1105, 1149 (2008).

related to the *Getting Credit*²² and *Investor Protection* index²³ which, to some extent, represent an updating of the previous La Porta *et al.*²⁴.

Djankov *et al.*²⁵ find that, respectively, the legal protection of creditors and shareholders' rights varies systematically across legal origins. Specifically, Common law countries protect investors' rights more than Civil law countries and especially more than the French Civil law economies that appear to provide the weakest protection to the investors' property rights and thus to have also less developed financial markets.

That Civil law countries, especially the French Civil law ones, are characterized by a less market friendly regulation - according to the '*Doing Business*' view - is also highlighted by Djankov *et al.*²⁶ This paper, which illustrates the methodology of the index *Paying Taxes*, shows that "French legal origin countries exhibit sharply higher numbers of tax payments and time to comply with taxes than other legal traditions (particularly common law)". In addition, it is claimed that the heavier is the tax rate, the lower is the size of investments (measured by the fixed capital formation to GDP), of FDI (measured by inflows of investment to acquire a lasting management interest to GDP), and of the level of a country's entrepreneurial activity (measured by number of business and by the rate of new business registration). Conversely, the more dramatic the regulatory intervention is, the higher is the size of the informal economy as well as the dimension of the debt market compared with that of the equity market (as measured by the debt to equity ratio).

Finally, the relationship between the extensiveness of the regulatory framework and macroeconomic performance is emphasized also by Djankov *et al.*²⁷ which draws the methodology of the *Trading Across Border* index. Actually, the authors show that the higher is the time a firm must spend in filling the required procedures relate to the import – export of a cargo, the lower is the volume of trade.

²² S. Djankov, C. Mc Liesh, A. Shleifer, *Private credit in 129 countries*, 84 *Journal of Financial Economics* 299, 329 (2007).

²³ S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The law and economics of self-dealing*, 88 *Journal of Financial Economics* 430, 465 (2008).

²⁴ R. La Porta, F. Lopez-de-Silanes, A. Shleifer, R. Vishny, *Legal Determinants of External Finance*, 52 *Journal of Finance* 1131, 1150 (1997).

²⁵ S. Djankov, C. Mc Liesh, A. Shleifer, *Private credit*, cit.; S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The law and economics*, cit.

²⁶ S. Djankov, T. Ganser, C. Mc Liesh, R. Ramalho, A. Shleifer, *The effect of corporate taxes on investment and entrepreneurship*, NBER Working Papers No. 13756 (2008).

²⁷ S. Djankov, C. Freund, C.S. Pham, *Trading on Time*, 92 *Review of Economics and Statistics* 166, 173 (2010).

What clearly emerges from the papers illustrating the 'Doing Business' methodology²⁸ is that "*heavier regulation brings bad outcomes*".²⁹

First of all, the regulation appears to be a tool through which non benevolent politicians persecute their own personal interests by collecting bribes and vote, rather than a device through which counterbalancing market failures. This evidence seems to be particularly strong for developing, poorly democratic, and high corrupted countries, as it emerges by some of the empirical analyses discussed above³⁰ which show a high correlation between the extent of the regulation, level of corruption and democracy, and income per capita.

In addition, countries characterized by heavier regulatory intervention and by weaker protection of property rights are also characterized by worst performances in financial, labor, and international markets as well as in other socio-economic variables, as it appear from the higher levels of unemployment, lower levels of trade, the higher size of the informal sector, and less developed financial markets.

Is on the evidence that cumbersome and rigid legal environments ultimately prevent economic growth - and thus on the identification of a 'right' model of regulation toward which countries should converge - that '*Doing Business*' develops its policy reform recommendations, especially in developing countries. Precisely, a reduction of the pervasiveness and rigidity of the business regulation and an increase in the protection of outside investors' property rights are the pillars characterizing '*Doing Business*' reformatory receipts.

The conceptual background and the policy implication of these pillars of the regulatory reforms builds one of the main concerns of the legal and economic literature criticizing the '*Doing Business*' program.

The next Section will present these specific concerns and the critics relative to the supposed weakness of the measurement methodology and of the theoretical framework of '*Doing Business*'.

IV. The debate on '*Doing Business*' Indexes

In reviewing the literature criticizing '*Doing Business*' we summarize the following areas: (i) the measurement methodology; (ii) the econometric analyses of the background papers of '*Doing Business*'; (iii) the active attitude of '*Doing Business*' in addressing countries' reform policies.

²⁸ See <http://www.doingbusiness.org/MethodologySurveys/> for further details on the methodology behind the indicators.

²⁹ World Bank, *Doing Business in 2004*, cit. 87.

³⁰ For example S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The Regulation*, cit., S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *Courts*, cit.

The works discussing these concerns are essentially characterized by a considerable contribution of the French legal and economic scholars and by a broad focus on the measurement issues.

Actually, since the first papers published by R. La Porta, F. Lopez-de-Silanes, A. Shleifer and R. W. Vishny on 'Law and Finance', and their mention in the World Bank reports 'Doing Business', the debate about the effects of Law over economic growth has been evolving significantly (*Economic Attractiveness of Law*).³¹ In 2004 French scholars promoted a research program aimed at studying, from a comparative perspective, the links between law and economic performances.

The French project, named '*Economic Attractiveness of Law*',³² has thus provided many contributions about the methodological and the conceptual framework of the indicators measuring the efficiency of the law.³³

A first general critique relates to methodological issues and it is essentially due to the consequences that eventual flaws in the design of the measurement procedure might have on rankings and consequently on policy implications. To appropriately measure institutions is important, among other reasons, because it affects the reliability of the econometric evidence, and thus of the consequent policy implications, of those papers arguing that "institutions matter", i.e. for economic development.³⁴ The methodological issues the literature criticizing '*Doing Business*' discusses the most are: (i) the ability of effectively measuring the costs of doing business in a given country; (ii) the employment of a standardized case study, "to ensure comparability across countries and over time" (*Doing Business Report 2004*, p. 3), in the questionnaires submitted to the so called 'local partners'; (iii) issues related to the employment of surveys to collect information from the mentioned 'local partners'; (iv) the coding and the aggregation procedure of the data collected through these questionnaire; (v) the adoption of the legal origin criterion to discriminate between countries characterized by different extents of the regulatory intervention.

A second, more pervasive, critique refers to countries' 'regulatory moral hazard' in introducing opportunistically short-term reforms to climb the

³¹ See http://www.gip-recherche-justice.fr/aed_va.htm .

³² See http://www.gip-recherche-justice.fr/aed/presentation_va.htm for further details on the research program '*Economic Attractiveness of Law*'.

³³ Indeed, two of the topics the French research project is aimed at investigating are: "the robustness of composite indexes related to the efficiency of Law", and "the methodology of aggregation of composite indexes related to the efficiency of Law" (http://www.gip-recherche-justice.fr/aed/presentation_va.htm).

³⁴ C. M. Woodruff, *Measuring Institutions*, International Handbook on the Economics of Corruption (2006).

Doing Business ranking. Country-rankings may indeed provide incentives to governments to manipulate the indicators³⁵ and to promote window-dressing reforms aimed essentially at altering the position in the rankings which has become an end itself.³⁶ This eventuality appears to be particularly concrete for “developing countries, where it is widely believed that a higher position in the ranking will attract foreign investment”³⁷ especially “once it becomes clear that donors and investors are using the *Doing Business*’ indicators to allocate material benefits across countries”.³⁸

Actually, the *Doing Business*’ indicators are used both to provide money-aids, for example by the Millennium Challenge Account program,³⁹ and to construct several diagnostic tools, like the *Index of Economic Freedom* of the Heritage Foundation, the *Global Competitiveness Report* of the World Economic Forum, and the *Country Policy and Institutional Assessment* of the World Bank, which are usually used by investors to monitor the conduct of the economies toward which they intend to channel their resources.⁴⁰

In addition, some scholars argue that in the case of the *Doing Business*’ indicators the risk of a competition between countries, in order to achieve higher ranks, is amplified by the great coverage received by the media and the Internet⁴¹ and by the pressures *Doing Business*’ itself put on the necessity to reform.⁴²

³⁵ K.E. Davis, M.B. Kruse, *Taking the measures of Law: The Case of the Doing Business Project 2007*, 32 *Law & Social Inquiry*, 1095, 1119 (2007).

³⁶ B. Arruñada, *Pitfalls to avoid when measuring institutions: Is ‘Doing Business’ damaging business?*, 35 *Journal of Comparative Economics*, 729, 747 (2007); *Id.*, *How Doing Business Jeopardizes Institutional Reform*, Working Paper No. 1088, Universitat Pompeu Fabra (May 2008).

³⁷ B. Arruñada, *Pitfalls*, cit. 734.

³⁸ K.E. Davis, M.B. Kruse, *Taking measures*, cit. 1116.

³⁹ B. Arruñada, *Pitfalls*, cit., 2007; K.E. Davis, M.B. Kruse, *Taking*, cit.; S. Djankov, *The Regulation*, cit..

⁴⁰ K. E. Davis, M.B. Kruse, *Taking measures*, cit.; S. Djankov, *The Regulation*, cit.

⁴¹ See <http://www.doingbusiness.org/Media/> and <http://www.doingbusiness.org/Media/db.aspx> in order to have an idea of the extent to which *‘Doing Business’* indicators have been advertised on the media. B. Arruñada, *Pitfalls*, cit.; V. Bath, *The World Bank doing Business Reports – Regulation and Change in China and Australia*, Working Paper AED – Attractivité Economique du Droit, Programme international de recherches (April 2007).

⁴² See, for example, the link *Simulate reforms: See the impact of reforms by using the ranking simulator (Excel, 420KB) to change indicator values* at <http://www.doingbusiness.org/> or the stress given to those countries who have reformed more at <http://www.doingbusiness.org/Reformers/> as well as the link *Top Reformers* in which they post “a video produced by the Government of Azerbaijan to celebrate its top reformer status in Doing Business 2009. See also B. Arruñada, *Pitfalls*, cit.. “Lawmakers in many countries, and in particular in developing and transition economies, face considerable pressure from multiple sources to implement the DB [*Doing Business*] project’s recommendations and improve their performance as

If countries become aware of the fact that improvements in country-rankings will receive great visibility and that foreign investors use the indicators to allocate resources, they probably will face the incentives to promote short-term reforms aimed essentially to receive a better rank⁴³ and to favor vested interests⁴⁴ rather than to really improve their institutional framework.

To this purpose, Arruñada⁴⁵ argues that the simplification of the business formalization procedures encouraged by *'Doing Business'* is a typical example of reforms fostering rent-seeking and vested interests. According to Arruñada to simplify the formalization process allows politicians to obtain short term results, international recognition, and to give to the government they represent an impression of modernity and speed. In addition, when the simplification brings to the implementation of a completely different system of formalization, this allows the creation of new job opportunities, to hire new personnel, and to create new professional figures, that "being only human, may well succumb to rent-seeking, just as their predecessors did before them".⁴⁶

However, rent-seeking and myopic reforms are only two of the criticisms the literature makes with reference to the reform recommendations of *'Doing Business'*. Indeed, according to Arruñada the reforms advocated by *'Doing Business'* with regard to the starting up procedures, also disregard a typical tradeoff of the institutional design, namely that between the *ex-ante* and the *ex-post* costs, respectively, of more and less business formalization. Actually, reforms like the standardization of the start-up documents, the elimination of the minimum capital requirement, and the reduction of the involvement of the courts in the registration procedure, undoubtedly help to improve the efficiency of the business formalization but at the same time can increase future transaction costs by lowering the quality of the provided information.⁴⁷

Moreover, scholars argue that the reform policies encouraged by *'Doing Business'* have little chances to work because they exclusively draw on the principle "one size can fit all", which often do not work, at least for some countries⁴⁸ and which is such to completely disregard the local circumstances

measured by the DB project's benchmarks. To begin with, the World Bank has chosen to treat the DB project's findings as a suitable basis for legal reforms and has begun to promote reform by documenting examples of reforms consistent with their recommendations and providing annual awards for the most outstanding reformers" (K.E. Davis, M.B. Kruse, *Taking measures*, cit. 1115).

⁴³ B. Arruñada, *Pitfalls*, cit.; K. E. Davis, M. B. Kruse, *Taking measures*, cit.

⁴⁴ B. Arruñada, *Pitfalls*, cit.; *Id.*, *How Doing Business Jeopardizes*, cit.

⁴⁵ B. Arruñada, *Pitfalls*, cit., *Id.*, *How Doing Business Jeopardizes*, cit.

⁴⁶ B. Arruñada, *Pitfalls*, cit. 734.

⁴⁷ B. Arruñada, *How Doing*, cit.

⁴⁸ See for example V. Bath, *The World Bank Doing Business Reports*, cit., T. C. G. Fisher, M. Melatos, *The Economics of Doing Business in China, Indonesia and Thailand*, Working Paper AED

in which such reforms should have been implemented. The expression “*one size can fit all*” represent an effective way of summarizing that link between the legal framework and several socio-economic performances that the literature presenting the ‘*Doing Business*’ methodology has strongly emphasized since the beginning of the project. Specifically, this claim refers to the evidence that those countries that appear to perform better with reference to many socio – economic aspects, i.e. financial markets, labor markets, corruption etc., all present similar features with reference to their business regulation. In other words, it captures the idea of the existence of a *best practice* of regulation which if implemented by other countries may lead at the achievement of successful improvements in their respective economic as well as social performances.

V. CONCLUSIONS

A large body of research literature suggests with increasing confidence that institutions matter for the economic performance of both micro- and macro-level actors⁴⁹. Nonetheless, once one moves beyond general statements such as “institutions matter”, there is still much that remains unclear. In particular: what are the institutions that matter, and how institutions can be measured?

In the last two decades, a great effort has been made by agencies and scholars in order to identify those institutions that are relevant for economic performance, and in order to assess empirically their effects on economic variables in practice. This growing effort has been motivated mainly by the idea that to improve the efficiency of institutions is ultimately beneficial for economic growth.⁵⁰ The most crucial component of this research activity has been devoted to measuring institutions, i.e. to assign a quantity to a qualitative matter. On the one hand, indeed, to associate a quantitative value to institutional entities is essential in order for an empirical evaluation of institutions to be feasible; on the other, however, an ambiguous or misleading measuring can lead to wrong normative recommendations and unwanted outcomes.

Of course, different policy needs and – more generally – different research objectives drive who is attempting to measure institutions to rather different strategies. This is the very reason why a proliferation of indicators has recently

– Attractivite Economique du Droit, Programme international de recherches (April 2007), R. H. McLeod, *Doing Business in Indonesia: Legal and Bureaucratic Constraints*, Working Paper AED – Attractivite Economique du Droit, Programme international de recherches (April 2007) for country-insights.

⁴⁹ E. Brousseau, A. Nicita, *How to Design Institutional Frameworks for Markets*, Revue d'Economie Industrielle, n. 129 (2010).

⁵⁰ E.g. H. de Soto, *The Other Path*, cit. and *Id.*, *The Mystery of Capital*, cit., S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The Regulation*, cit.

taken place. Among such a large amount of measures, we devote our attention to the indicators of the “quality” of those institutions that affect the business environment. Such indicators may be roughly classified in: (i) those regarding the socio and political institutional framework; (ii) those concerning directly the business life-cycle; and (iii) those specifically related to markets’ regulation *stricto sensu*, with particular reference to the reform processes of network industries.

Among the several projects devoted to measure the “quality” of business-cycle regulation, Doing Business is the most recent. Doing Business is a program launched in 2004 by the World Bank consisting in a set of eleven indicators each one measuring the extensiveness of the regulation applying to a particular moment of the firms’ life. Specifically, these indicators cover the regulation of: starting a business, employing workers, getting credit, closing a business, enforcing contracts, protecting investors, registering property, paying taxes, dealing with licenses, trading across borders, and dealing with construction permits.

Underlying this approach, there is an idea of market efficiency, according to which the more a market is left free from institutional constraints, the more it is able to lead to an efficient resources allocation.⁵¹ While this approach underlies some important aspects (lower institutional burden and simpler procedures, indeed, reduce the costs of gathering information about the regulatory framework and increase the capabilities of the economic agents to choose their optimal private strategies), it is also partial inasmuch as it overlooks several other relevant dimensions.

First of all, as it is increasingly recognized, markets forces alone are not able to lead to an efficient resources allocation. Furthermore, minimal regulation is associated to large transaction costs in the market place, since economic parties need to rely more often on entangled contractual structures in order to undertake economic relationships. Also, the predictability of what counterparts in economic relationships will do may result strongly reduced in a context in which agents’ behaviors are not really regulated; and this can depress the willingness of entering in economic relationships at all.⁵²

More in general, the number of the regulatory constraints and their pervasiveness are likely to be a misleading proxy for institutional quality (whatever the reference objective of quality is), if one does not consider the substantial content and final outcome of such regulatory prescriptions.

Therefore, a comprehensive discussion on the concept of quality of institutions cannot abstract from (i) how the regulatory tools actually operate

⁵¹ See e.g. S. Djankov, R. La Porta, F. Lopez-de-Silanes, A. Shleifer, *The Regulation*, cit.

⁵² O.E. Williamson, *Market and Hierarchies: Some Elementary Considerations*, *American Economic Review* 63 (2), 316 – 325 (1973).

and how they affect eventually agents' behavior, (ii) from the amount of resource allocated to the regulatory activities and their utilization, (iii) from the skills of those who define the regulatory tools and adapt them as new socio-economic needs arise and new information become available, (iv) from the presence of authorities that monitor the implementation of the regulatory framework and enforce it, (v) from the transparency and consistency of such authorities' decisions and actions, (vi) from the absence (or the presence) of conflicts of interests that may affect – even strongly – how the regulatory framework is set at its various levels, (vii) from the stakeholders involvement in the definition of regulatory prescriptions, and, finally, (viii) from a comprehensive evaluation of all the relevant effects of regulation on the spheres of a society's macro-economy (such as aggregate production, consumption, prices' level and employment).

Once a description of the possible dimensions of institutional quality is provided, a measurement strategy, however, does not follow automatically.

First, by looking only to the costs deriving from the administrative procedures imposed by a certain regulation (e.g. as it happens in part for the Doing Business project) – rather than the law *stricto sensu*⁵³ – means to neglect the fundamental trade-off between ex-ante costs and ex-post benefits of institutions, where institutions are conceived as rules shaping human interactions. Indeed, institutions, and in particular business regulation, have the important function of reducing future transaction costs by reducing the informative asymmetry between agents.⁵⁴

However, even when an agreement on the concept of institution is achieved, this is not sufficient for having a comprehensive measurement of institutions themselves. Actually, *de jure* and *de facto*, i.e. the law on the books and its enforcement, are often worlds apart. The effects of institutions are due both to their formal content and their factual implementation. Thus, both *de jure* and *de facto* institutions should be measured. To consider the law on the books and its enforcement as substitute matters is equivalent to assume that they are identical everywhere.⁵⁵

The Doing Business's methodology consists in the definition of a standardized unit of measure (e.g. a particular type of business activity), so as to allow a valid comparisons across different socio-economic environments.

⁵³ B. Du Marais, *Methodological limits of 'Doing Business' reports* (May 2009), available at SSRN: <http://ssrn.com/abstract=1408605> (last visited May 21, 2010), C. Ménard, B. du Marais, *Can we rank legal systems according to their economic efficiency?*, 26 Washington Journal of Law & Policy 72, 75 (2008).

⁵⁴ B. Arruñada, *Pitfalls*, cit.

⁵⁵ S. Voigt, *How (Not) to Measure Institutions* (2009), available at SSRN: <http://ssrn.com/abstract=1336272>.

Nevertheless, if the adoption of a stylized case study allows to reach a compromise between the benefits and the limits of surveys (namely capturing the de facto implementation of the law and reducing its subjectivity), it also shows several concerns. It may imply: (i) overlooking countries' specific characteristics; (ii) unrealistic or too restrictive assumptions about how institutions really work; (iii) to disregard the actual implementation of the law, by assuming that countries adopt the same legal solutions for the same problem; (iv) a "right" institutional system to which countries should converge.

The employment of standardized case studies is also questionable because: (i) it neglects the legal solutions most frequently implemented in practice (i.e. the modal cases); and (ii) it ignores the functional equivalents that a legal system may have developed at a local level. The two pitfalls mentioned above, named 'legal parallax errors' reflect the belief that the "same legal instruments are used to resolve identical problems".⁵⁶

Also, one of the most basic issues for coding legal variables is whether only mandatory rules, default rules, or optional rules should be counted. To use default or optional rules may not allow to validly compare regulatory provisions across countries. Indeed, the default and optional rules' substantive content does not matter very much in the presence of low transaction costs, which in turn substantially vary across countries.⁵⁷

To conclude, high-quality regulation is one of the most challenging tasks for governments. The *Doing Business* project aims to identify a synthetic and comprehensive benchmark of regulation's quality, to provide a methodological strategy in order to measure the quality of institutions, and to employ such methodological strategy to assess a country's regulatory framework and its impact on competitiveness. In the last two decades, the *Doing Business* report has induced several economic scholars to focus on measuring institutional quality as a determinant of a country's competitiveness. This effort produced a large amount of indicators on the issue. Nonetheless, a well-established and universally acceptable index is still missing, as a unique and coherent framework defining institutional quality. It emerges that different ideas about what institutional quality is can drive economic and law scholars (and so the methodological strategies) to very different, and even contrasting, measurements.

⁵⁶ B. Du Marais, *Methodological limits*, cit.

⁵⁷ H. Spamann, *The 'Antidirector Rights Index' Revisited*, 23 *Review of Financial Studies* 467, 486 (2010).