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INDEPENDENT EVALUATION GROUP

FAST TRACK BRIEF

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IEG's Evaluation of the World Bank/IFC "Doing Business" Indicators was discussed by the Board of Directors on May 23, 2008

An Independent Evaluation of the World Bank/IFC Doing Business Indicators

- **The Doing Business Indicators (DBI) exercise, anchored in research that links characteristics of a country's business environment to firm performance, measures the regulatory framework faced by businesses in more than 170 countries.**
- **The DBI notes the burdens of regulation without aiming to capture their benefits for safety, environmental protection, or other public goods. DBI assesses regulations as they are written, not the extent or way in which they are applied. Investment decisions may depend on factors the DBI does not measure, like the cost of finance, infrastructure, labor skills, and corruption. Because of these limitations, the DBI needs to be complemented by other information to form an overall assessment of a country's investment climate.**
- **The DBI is based on information collected from a global network of expert informants, mostly lawyers. The ratings would be more reliable if more informants, with more diverse expertise, were recruited. More transparency is needed about how the data are adjusted and corrected.**
- **By providing a basis for international comparisons, DBI has spurred policy discussion of business regulation issues in many countries. Since it is not intended to capture country nuances, it has been less useful in designing specific policy reforms.**

The *Doing Business Indicators*, an annual World Bank-IFC publication launched in 2004, has become one of the Bank Group's flagship knowledge products. It measures the burden of business regulations in 178 countries and ranks the countries on 10 dimensions. The program's stated objective is to advance the World Bank Group's private sector development agenda in four ways: motivate reforms through country benchmarking; inform the design of reforms; enrich international initiatives on development effectiveness; and inform theory.

This independent evaluation of the Doing Business Indicators assesses the methods and processes underlying the construction of the indicators, the relevance of the indicators to desired intermediate outcomes, and their use by World Bank Group staff, policy makers, and other stakeholders. It finds that the indicators have been highly effective in drawing attention to the burdens of business regulation, but cannot by themselves capture other key dimensions of a country's business climate, the benefits of regulation, or key related aspects of development effectiveness. Thus, the Bank Group and stakeholders need to consider the

DBI in a country context and interpret them accordingly.

The Underlying Framework of the DBI

The DBI exercise is anchored in research that links characteristics of a country's business environment to firm performance, and thence to macroeconomic outcomes. The regulatory framework—the part of the business environment that Doing Business measures—has been shown to be associated with firm performance, but its association with macroeconomic outcomes is less clear. Many other factors affect macroeconomic outcomes, and the direction of causality between regulation and economic outcomes is difficult to isolate. Since regulations generate social benefits as well as private costs, what is good for an individual firm is not necessarily good for the economy or society as a whole. Therefore, the policy implications are not always clear-cut. The right level and type of regulation is a matter of policy choice in each country.

The DBI exercise reflects the limitations inherent in the underlying research. As an exercise in cross-country comparison, DB is not intended to, and cannot, capture country nuances. Firms' investment decisions also depend on variables not measured by the DBI, such as the cost and access to finance and infrastructure, labor skills, and corruption. Different aspects of regulation have varying degrees of economic importance depending on countries' income levels, legal regimes and other characteristics. Seven of DB's 10 indicators presume that lessening regulation is always desirable whether a country starts with a little or a lot of regulation. Reform, as measured by the DBI, typically means reducing regulations and their burden, irrespective of their potential benefits.

The evaluation confirmed that the Doing Business Indicators primarily measure laws and regulations as they are written. But the relevance of each indicator in any particular country depends on the extent to which the law is actually applied, which DB does not aim to measure. Likewise, the payoff of a particular regulatory reform will depend on how significant a burden the regulation posed in practice. These limitations underscore the need for DB to be interpreted cautiously and used in conjunction with complementary tools such as investment climate assessments.

The indicators objectively and reliably measure what they set out to measure, with a few qualifications. The controversial 'employing workers' indicator is consistent with the letter of relevant ILO conventions, if not always their spirit, insofar as it gives lower scores to countries that have chosen policies for greater job protection. Systematic differences in the country rankings for a few indicators are associated with countries' legal origins, but these patterns have little impact on the overall rankings or the validity of the exercise. The 'paying taxes' indicator includes an anomalous subindicator—the 'total tax rate'—which does not simply measure administrative burden to firms, but rather reflects a country's overall fiscal policy. Finally, inaccurate nomenclature and overstated claims of the indicators' explanatory power have provoked considerable criticism from stakeholders.

Methodology and Data Reliability

The DB has created a unique process for collecting information. It has created a global network of expert informants who provide information free of charge. This process is capable of generating reliable data, but three areas of vulnerability need to be addressed.

First, the data are provided by few informants, with some data points for a country generated by just one or two firms. Of particular concern is the 'paying taxes' indicator, for which DB relies on a single firm to provide both the underlying methodology and data for 142 countries. The number and diversity of informants for all indicators needs to be increased and their information validated more systematically. An increase in the informant base will require a systematic vetting process to eliminate self-selection bias. Simplifying the questionnaire may also help to encourage more informants to contribute.

Second, although DB makes available a great deal of information about its data and methodology, it remains insufficiently transparent about the number and types of informants for each indicator, the adjustments its staff make to the data received from informants, and the changes made to previously published data and their effects on the rankings. DBI needs to adequately explain to users the possibilities for errors and biases.

Third, DB reports make much of annual changes in the country rankings. The rankings entail three weaknesses. First, because most DB indicators presume that less regulation is better, it is difficult to tell whether DBI's highly-ranked countries have good and efficient regulations, or simply inadequate regulation. Second, the small informant base makes it difficult to measure confidence in the accuracy of the individual indicator values and thus in the aggregate rankings. Third, changes in a country's ranking depend on where it sits on the distribution; small changes can produce large ranking jumps, and vice versa. These factors contribute to anomalies in the rankings.

These issues do not, in and of themselves, jeopardize DB's reliability. But the lack of transparency about them undermines DB's credibility and goodwill. DB's documents and presentations should include full explanations and cautions on these points.

Motivating and Designing Reforms

The Doing Business Indicators have motivated policy makers to discuss and consider business regulation issues. Its active dissemination in easy-to-understand language permits widespread press coverage and generates interest from businesses, NGOs, and senior policy makers.

DBI has had less influence on the choice, scope, and design of reforms. Most Bank Group staff and country stakeholders interviewed for this evaluation report that they draw on a range of analytical material to determine the nature, sequence, and direction of reforms; the DBI has limited use in this regard. As a cross-country benchmarking exercise, it cannot be expected to capture the country-specific considerations involved in prioritizing, sequencing and designing policy reforms. Each year DB spotlights countries that have demonstrated the largest gain in the overall rankings and an improvement on at least three indicators. Such an approach, while transparent, does not capture the reforms' relevance and potential impact on the binding constraints to investment climate in the country.

IEG did not find evidence that the DBI has distorted policy priorities in the countries nor in the Bank Group's programs, nor that countries have made superficial changes for the sole purpose of improving their rankings.

In summary, the DB measures the costs but not the benefits of regulation. Despite its methodological limitations, it has provided countries with a basis for making international comparisons on business climate issues. It has helped to catalyze debates and dialogue about investment climate issues in developing countries. For the Bank Group, it is a key global knowledge product. Most of the DB's methodological limitations can and should be addressed promptly. Inaccurate nomenclature should be rectified and DB reports should not overstate claims of causality and the indicators' explanatory power.

Implications for the Bank Group

This evaluation has generated two implications for the Bank Group.

First, by prominently recognizing DBI's highly ranked countries the Bank Group may be inadvertently signaling that it values reduced regulatory burdens more than other development goals. The Bank Group's approach entails helping countries achieve a wide range of objectives, yet it has no comparable way of celebrating improvements in other important development outcomes.

Second, the DB exercise has demonstrated that cross-country ranking can be effective in spurring dialogue and motivating interest and action. It could potentially be applied to certain other development issues—those for which actionable indicators can serve as proxies for the target outcomes and for which the direction of improvement is uniform for all countries. The lessons from the DBI's experience are listed in the box below.

Lessons for the Bank Group

Should the Bank Group wish to build on the DB's experience to create actionable indicators in other areas of development, this evaluation offers five lessons:

Choose what to measure and start small: Use existing or new research to identify a few issues within a sector/theme that can serve at least as partial proxies for development. Then specify some quantitative variables that can be measured relatively easily, have an intuitive appeal, and are easily understood. This implies accepting that the indicators will be limited in scope, not comprehensive.

Look for efficiency in data collection and processing: Data collection methods need to be simple. Use an appropriately diverse range of expert informants and provide informants with a common reference point such as a hypothetical scenario.

Identify target audience: Country benchmarking can be an effective door-opener and motivate a wider dialogue. Consider in advance who the indicators should aim to influence and who could participate in the dialogue.

Create and maintain competitive pressure: Any indicator can be effective only to the extent it is widely communicated and understood by the target audience, and can generate competition among countries and pressure to reform. The DB's assertive marketing and communication strategy combined with its use of rankings helped to generate and maintain country interest.

Don't overstate the implications of the rankings: Cross-country rankings inherently miss country-specific issues nuances. They have to be used in conjunction with other analyses to help countries determine the direction, nature and sequence of reforms.

Recommendations

1. **To improve the credibility and quality of the rankings,** the DB team should:

   (a) Take a strategic approach to selecting and increasing the number of informants by:

   - Establishing and disclosing selection criteria for informants
   - Focusing particular effort on the indicators with fewest informants and countries with the least reliable information
   - Formalizing the contributions of the supplemental informants by having them fill out the questionnaire
   - Involving Bank Group staff more actively to help identify informants

   (b) Be more transparent about the following aspects of the process:

   - *Informant base*: Disclose the number of informants for each indicator at the country level, differentiating between those who complete questionnaires and those who provide "supplemental" information.
   - *Changes in data*: Disclose all data corrections and changes as they are made, explaining their effect on the rankings, and, to facilitate research, make available all previously published datasets.
   - *Use of the indicators:* Be clear about the limitations in the use of the indicators for a broader policy dialogue on a country's development priorities.

   (c) Revise the paying taxes indicator to include only measures of administrative burden. Since the tax rate is an important part of the business climate, DB should continue to collect and present simple information on corporate tax rates, but exclude it from the rankings (as it does for the information it collects on non-wage labor costs in the employing workers indicator). A wider range of informants should be engaged for the paying taxes indicator.

2. **To make its reform analysis more meaningful,** the DB team should:

   (a) Make clear that DB measures improvements to regulatory costs and aspects of efficiency, which is only one dimension of any overall reform of the investment climate.

   (b) Trace the impact of DB reforms at the country level: The DB team should work with country units to analyze the effects of implementing the reforms measured by the DBI (such as revised legislation or streamlined processes) on: (i) firm performance, (ii) perceptions of business managers on related regulatory burdens, and (iii) the efficiency of the regulatory environment in the country.

3. **To plan future additions to or modification of the indicators,** the DB team should:

   (a) Use Bank analyses to drive the choice of DB indicators: Business Enterprise Surveys, Investment Climate Assessments, and other work can help determine stakeholders' priorities for domestic private sector growth. The DBI team should use such analyses to determine the choice of new indicators and periodically reassess its current set of indicators.

   (b) Pilot and stabilize methodology before including new indicators in rankings: Frequent changes in methodology make comparison across time less meaningful. New indicators should be piloted—that is, data collected and published for comment, but not factored into rankings—until the methodology is validated and stabilized.

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