Economic Research Forum
ERF POLICY BRIEF

ERF Policy Brief No. 7 | April 2016

Going beyond Doing Business to Foster Job Creation in Arab Countries

Jamal Ibrahim Haidar and Hedi Larbi

About the authors

Jamal Ibrahim Haidar is a postdoctoral research fellow at Harvard University. He holds a PhD in economics from the Paris School of Economics, Université Paris 1 Panthéon-Sorbonne.

Hedi Larbi, a former director for the Middle East and North Africa region at the World Bank and former Minister of Economic Infrastructure and Sustainable Development in Tunisia, is currently a Visiting Scholar at the Middle East Initiative at Harvard University.

In a nutshell

- *Creating enough jobs is a key development challenge for Arab countries.*
- *To address this challenge, many Arab policy makers sought to enhance the positions of their countries in the World Bank's Doing Business ranking.*
- *A better Doing Business ranking is thought to attract job-creating investments. This policy brief argues that such a policy goal is not sufficient to foster investment and job creation in Arab countries.*
- *Arab policy makers need to embrace a broader approach, which include structural reforms, to reduce business-government transaction costs, enhance competitiveness and increase investment returns.*

Arab policy makers should implement reforms that contribute to creating highly-needed productive jobs. Improving the business environment to attract job-creating investments is an important policy option to achieve this. The *Doing Business* rank-improvement approach provides a useful tool to benchmark countries along several business indicators and identify areas where relevant reforms are needed. However, this approach is not sufficient for Arab countries where the reform agenda of the business environment needs to be wide-ranging. Arab policy makers would gain from adopting a reform approach that goes beyond the *Doing Business* indicators. The challenge lies in designing and implementing a comprehensive policy reform framework that substantially improves relevant institutions. International benchmarks may be useful for getting an idea of achievable performance in a particular area. Nevertheless, the key is to improve on the areas that matter, regardless of whether existing global indicators cover them or not.

Why did Doing Business indicators attract the attention of Arab policy makers and beyond?

The World Bank has been publishing annual *Doing Business* reports for the past 13 years. These reports provide tools to measure regulations that affect business activity. The tools include statistics about the time and cost required to start a business, import and export, register property, enforce contracts, pay taxes, access electricity, and get construction permits. While the *Doing Business* report is built on the methodology of other reports of development organizations, it pushed the frontier by establishing indicators and rankings of ease of *Doing Business* in different countries and on an annual basis.

In terms of indicators, *Doing Business* offers investors and policy makers a framework to help make decisions. Before *Doing Business*, researchers trying to study the importance and effectiveness of business regulations were mostly limited to survey-based broad measures (i.e., from Business Environmental Risk Intelligence (BERI)). By focusing on specific institutions (i.e., credit registries), *Doing Business* provides a benchmark for cross-country analysis of specific business environment angles. In addition, *Doing Business* indicators are measurable, regularly monitored and are based on a methodology that is continuously improved to better assess the business environment and its evolution over time. They also reflect the impact of specific policy actions implemented by countries.

Moreover, *Doing Business* went a step further by publishing rankings, both for individual indicators as well as an aggregate indicator of the ease of *Doing Business* in each country. By doing so, *Doing Business* highlights countries that improved their rankings as a result of reforms undertaken and those that lagged behind. As such, it creates an incentive for policy makers to emulate each other, to better position their countries in the race for domestic and foreign investments. For example, the case of Georgia, which used the 'Reformer of the Year' award to attract foreign direct investment, illustrates the emulative power of *Doing Business* rankings.

The move from data collection to rankings and their use in policy debates and reforms at the country level has given the *Doing Business* project more attention. Advocates appreciate the clarity of the indicators measured, the relative rankings of the countries, and the policy reforms countries should focus on to improve their positions. These factors helped the *Doing Business* indicators become more popular too. For example, the *Doing Business* 2015 report generated about 1700 media hits within the first three days of release. This year (*Doing Business* 2016), there were over 3,000 media reactions, responses, and shares within that same time frame. Given the considerable attention it attracted, it is not surprising that it has also become an authoritative resource for Arab policy makers. For instance, Saudi Arabia, Lebanon, Egypt, Qatar, and other Arab countries have set goals to improve their relevant *Doing Business* rankings.[1]

Why should policy makers not solely rely on Doing Business rankings to improve business environment and foster investments and job creation in Arab countries?

As an analytical instrument, informative as it is, *Doing Business* is not enough to capture the complexities and actual difficulties at the ground level of most Arab countries. The key issues with the *Doing Business* rankings are about what they do (and do not) measure as well as about how they should be interpreted and used by policy makers.

First, *Doing Business* treats all indicators as if they were equally important to all sectors or types of investments. *Doing Business* indicators neither cover all aspects of the cost of *Doing Business* nor factor in issues unique or specific to individual countries. Moreover, most of the indicators considered by *Doing Business* are one-time or infrequent occurrences (construction permit, business registration, etc.,) and do not capture the daily hurdles and associated costs faced by the businesses.

[1] Other countries have similar goals too – see Haidar and Hoshi (2015) for an example from Japan.

Second, *Doing Business* does not look into the reasons behind the low performance of a country on a given indicator. As such, low performance may be due to policies or regulations and can stem from low capacities and deficient practices of implementing agencies. In the latter case, *Doing Business* fails to capture the administrative practices and complex procedures applied on the ground. For instance, rampant corruption and lack of accountability increase the cost of *Doing Business* even when business regulations are streamlined and theoretically easy to comply with. Therefore, *Doing Business* indicators provide a good assessment of certain regulatory frameworks for businesses but not how they function in practice or why if they are dysfunctional.

Third, *Doing Business* does not capture many relevant dimensions of the business environment in Arab countries. For example, if enterprises do not have access to formal credit, the efficiency of the credit registry might not be relevant. And, if the majority of enterprises are not formal, they do not have access to finance or to the formal court system for contract enforcement. It is worth noting that the informal sector represents an important (30% to 50%) share of most Arab economies.

Fourth, the *Doing Business* indicators do not take into account major institutional factors, such as political stability, social tension, and rule of law. Likewise, macroeconomic and monetary policies are very important factors for the business environment but are not factored in the *Doing Business* indicators.

Fifth, the *Doing Business* rankings are relative. If a country enhances its business environment, it will only move up the ranking if it improves more than other countries. Similarly, a country can keep its rank or even improve it if other countries fall behind in terms of certain business regulatory aspects.

Therefore, policy makers should go beyond *Doing Business* rankings to better inform their job creation policy debates. They need to formulate more comprehensive structural reforms in support of *Doing Business* not only at the entry level, but also throughout the life cycle. *Doing Business* rankings work well as a catalyst for competition among countries and policy debates in support of enhancing private sector development. However, such rankings should be used with caution. Indeed, it is common – but almost never wise – to think that the goal of policy should be to improve countries' *Doing Business* rankings. For example, to measure the difficulty of dealing with licenses, *Doing Business* indicators examine the burden of obtaining a construction permit to build a warehouse. But, the operation of the warehouse may require (depending on type of business) several other licenses and permits that may be more or less easy to obtain but not covered by *Doing Business* indicators. Typically, countries that regard raising their ranking as an important key policy goal may not see the need to improve licensing procedures in other areas not covered by the *Doing Business*.

Toward a more practical and effective approach to creating investment-attracting and job-creating business environments in Arab countries

Arab policy makers should use the *Doing Business* indicators after understanding what they do and do not measure. One way to productively use the *Doing Business* approach is to call on complementary analytical work. Such work would include investment climate assessments (more comprehensive firm surveys), country policy reviews (carried out by countries and/or development agencies), and country diagnostic assessments (a recently-developed product by the World Bank). The goal would be to identify constraints to investment, firm growth, and job creation.

In other words, *Doing Business* rankings should be considered complementary, helping either target or guide some of the reforms aiming at improving the business environment of the country. For example, a long bureaucratic delay to register a new business is an important indicator to improve the business entry process. But, the policy reform should go beyond reducing the registration paper work or administrative process. Access to finance, availability of ready space to occupy or developed land for new construction, as well as institutional support to new start-ups and other incentives should be considered if policy makers want to improve the business environment in a sustainable manner.

Therefore, the *Doing Business* rank-improvement approach would be best treated as part of a broader set of tools that policy makers in Arab countries can use to reform public institutions. The soundness of this approach is supported by recent literature on the effects of improving the business environment and institutional frameworks. Also, there is a growing consensus that the quality of business regulation and the institutions that enforce it are major determinants of economic prosperity.[2]

That said, a full assessment of the business environment faced by enterprises in a specific country would go beyond cross-country comparisons of *Doing Business* indicators and firm-level assessments. Precisely, it needs to be more inclusive in terms of policy areas that directly or indirectly affect the quality of the business environment and over time — not only at inception of new businesses. For example, the following areas are also important for investment decisions and thus for the business environment: quality of human capital and skills, access to finance (especially for SMEs), quality of infrastructure services, and logistics and cross-border trade facilitation.

Last but not least, another important policy concern, which is relevant for Arab countries, is the growth obstacles facing firms, especially SMEs. It has been noted that in Arab countries, most new firms either disappear after a few years of operation or remain small with one or two employees at most. Only a tiny proportion of firms move up the scale to become medium or large firms. Looking into the root causes behind lack of growth of existing and new SMEs should constitute another priority reform although it is not covered by *Doing Business*.

References

Alesina, A., Ardagna, S., Nicoletti, G., and Schiantarelli, F., (2005). Regulation and Investment. *Journal of the European Economic Association*, 3: 791-825.

Allen, F., Qian, J., and Qian, M., (2005). Law, Finance and Economic Growth in China. *Journal of Financial Economics* 77: 57-116.

Besley, T., and Burgess, R., (2004). Can Labor Regulation Hinder Economic Performance: Evidence from India. *Quarterly Journal of Economics* 119: 91-134.

Ciccone, A. and Papaioannou, E., (2007). Red Tape and Delayed Entry. *Journal of the European Economic Association*, 5: 444-58.

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

Haidar, J. I. (2009). Investor Protections and Economic Growth. *Economics Letters*, 103:1-4.

Haidar, J. I. (2012). The Impact of Business Regulatory Reforms on Economic Growth. *Journal of the Japanese and International Economies*, 26: 285-307.

Haidar, J.I. and Hoshi, T., (2015). Implementing Structural Reforms in Abenomics: How to Reduce the Cost of *Doing Business* in Japan. National Bureau of Economics Research, NBER Working Paper 21507.

Klapper, L., Laeven, L., and Rajan, R., (2006). Entry Regulation as a Barrier to Entrepreneurship. *Journal of Financial Economics*, 82: 591-629.

[2] See, among others, Besley and Burgess 2004, Alesina et al 2005, Allen et al 2005, Klapper et al 2006, Ciccone and Papaionnou 2007, Haidar 2009, 2012, and Djankov et al 2010.

Recent Policy Briefs

"The Quality of Educational Performance of Students in The Middle East And North Africa Much Remains to Be Done" *by Donia Smaali Bouhlila, ERF Policy Briefs No. 6, December 2015.*

"Untapping Low Female Labor Force Participation In Egypt: Ending The Marriage Mismatch" *by Rana Hendy, ERF Policy Briefs No. 5, September 2015.*

"Improving Health Status in Turkey: Combating Pollution" *by Oznur Ozdamar and Eleftherios Giovanis, ERF Policy Briefs No. 4, September 2015.*

"Farmer Access to Formal Credit Institutions in Kassala, East Sudan: Determinants and Possible Ways Forward" *by Ebaidalla Mahjoub Ebaidalla and Eltyeb Mohamdain Abdalla, ERF Policy Briefs No. 3, September 2015.*

"Pension Reform: Securing Morocco's Elderly" *by Najat El Mekkaoui de Freitas, ERF Policy Briefs No. 2, June 2015.*

"Transforming Egypt: Innovation and Diversification as Drivers of Growth" *by Markus Loewe, ERF Policy Briefs No. 1, June 2015.*

ERF Contact Information

Address: 21 Al-Sad Al-Aaly St., Dokki, Giza, Egypt
Telephone: 00 202 333 18 600 - 603 | **Fax:** 00 202 333 18 604
Email: erf@erf.org.eg | **Website:** http://www.erf.org.eg

ECONOMIC RESEARCH FORUM

منتدى البحوث الاقتصادية