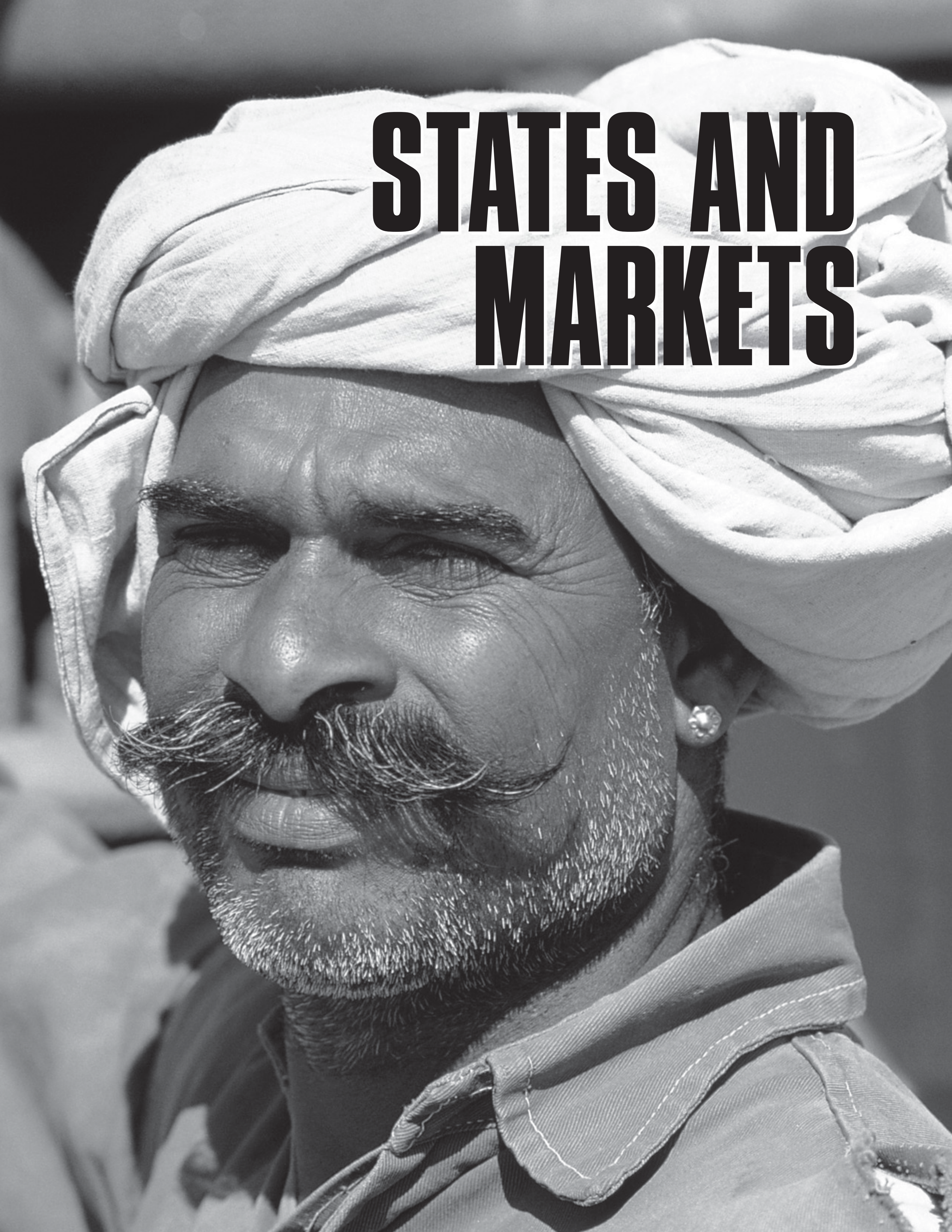
STATES AND MARKETS



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New firm creation recently declined sharply in most countries, according to the 2010 World Bank Group Entrepreneurial Snapshots. The economic and financial crisis that began in 2008 increased unemployment in many countries, and the fight against poverty could be hampered as spending for human and productive capital is strained. Governments around the world face fiscal deficits and pressure to improve public spending and accelerate business reforms. Partnership between the private sector, which employs people and makes investments, and a capable public sector, which creates a stable regulatory environment, is a key ingredient to successful development.

This section includes a range of indicators showing how effective and accountable government, together with a vibrant private sector, produces employment opportunities and services that empower poor people. Its 13 tables cover cross-cutting themes: private sector development, public sector policies, infrastructure, information, communications, telecommunications, and science and technology. New data show that business reforms are making it easier to do business and create new firms and that more-inclusive financial systems are removing barriers to economic growth and development.

Businesses are created faster in a good business environment

The World Bank Group Entrepreneurship Snapshots (www.enterprisesurveys.org), which cover 112 countries, show that new businesses are created faster in countries with good governance, low corporate taxes, minimal red tape, and a strong legal and regulatory environment. Countries with well developed financial markets also have higher new firm creation than countries with less developed financial markets. The downside is that countries with well developed financial markets also had steeper declines in new firm creation during the recent financial and economic crisis, probably due to the credit crunch. High-income countries created more new limited liability firms—more than 4 per 1,000 working-age people, compared with only about 0.3 in low-income countries. Data on business entry and density are in table 5.1.

The Doing Business database (www.doingbusiness.org) shows that between June 2009 and May 2010, 117 countries adopted 216 business regulation reforms, making it easier to start and operate businesses, strengthening property rights, and improving commercial dispute resolution and bankruptcy procedures. Using data from the Enterprise Snapshots and Doing Business to analyze whether some reforms are more important than others, Klapper and Love (2010a) find that small reforms that reduce costs, time, or number of procedures to register a business by less than 40 percent do not have a significant impact on new firm registration. This suggests that "token" reforms do not boost private sector activity and that countries with weak business environments require larger reforms to increase new firm registration. They find that two reforms occurring simultaneously tend to have more impact than two reforms occuring sequentially over a longer period.

Forty countries made it easier to pay taxes between 2009 and 2010

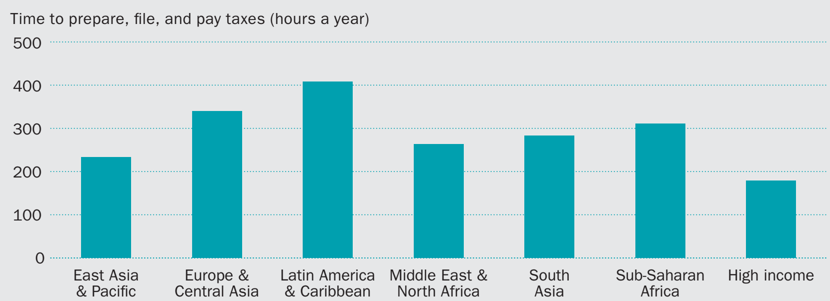
The World Bank's Doing Business project collects information for 183 countries on tax payments, time spent paying taxes, and the total tax rate borne by a standard firm. In cooperation with PricewaterhouseCoopers, the project collects information on business tax systems around the world, allowing governments to benchmark their tax system with others to identify good practices, and researchers to analyze the impact of higher corporate tax rates on business start-ups and investments.

Over June 2009–May 2010, 40 countries made tax compliance easier, reducing costs for firms and encouraging job creation. Higher tax compliance costs are associated with larger informal sectors and more corruption, ultimately limiting employment, investment, and growth. Keeping rules simple and clear improves compliance and reduces tax evasion. And better compliance keeps the system working and supports government programs and services.

In the past six years more than 60 percent of the countries covered by the Doing Business project made paying taxes easier or lowered the tax burden for local enterprises. Countries that make paying taxes easy for domestic firms usually offer electronic systems for tax filing and payment, have one tax per tax base, and use a filing system based on self-assessment. In high-income countries the average business spends about 180 hours a year preparing, filing, and paying taxes; in Latin America and the Caribbean, more than 400 hours a year (figure 5a).

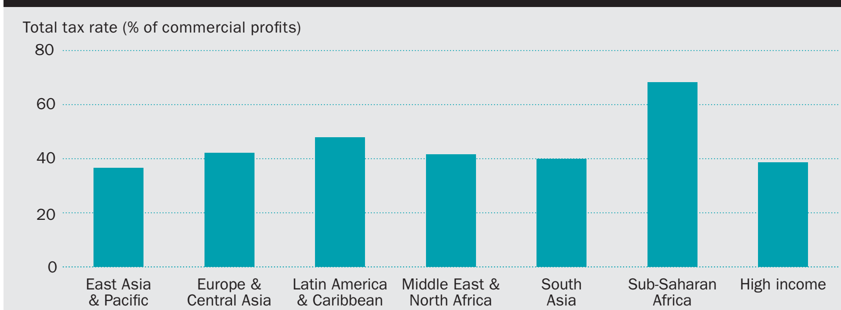
Previous editions of *World Development Indicators* included data on the highest marginal corporate tax rate (the statutory rate of corporate income tax). It is not a comprehensive indicator of the amount of tax a company pays, however, because it is only one of the many taxes businesses pay. Generous tax allowances in some countries significantly reduce the corporate income tax paid, while disallowances in others can increase the effective rate.

The average business in Latin America and the Caribbean spends about 400 hours a year in preparing, filing, and paying business taxes, 2009 **5a**



Source: Doing Business 2011.

Firms in East Asia and the Pacific have the lowest business tax rate, 2010 **5b**



Source: Doing Business 2011.

In this year's edition table 5.6 on tax policies includes the total business tax rate as a percent of commercial profit, with details on corporate taxes, labor taxes paid by the employer, social contributions, and other taxes. The total tax rate is a comprehensive measure of the cost of all the taxes a business bears. It differs from the statutory tax rate, which merely provides the factor to be applied to the tax base. In computing the total tax rate, tax payable is divided by commercial profit. The total tax rate is lowest in East Asia and Pacific and is highest in Sub-Saharan Africa (figure 5b). Note that these tax rates are "de jure" tax rates based on case studies of a "standardized business" as defined by the Doing Business project.

Benchmarking the quality of the business environment—Doing Business and Enterprise Surveys are complementary

The World Bank's Enterprise Surveys are based on firm-level surveys of a representative sample of the nonagricultural private sector in a country. The surveys cover a broad range of business environment topics including corruption, infrastructure, crime, competition, performance measures, and access to finance. Data from Enterprise Surveys are presented in table 5.2.

The Doing Business project uses indicator sets and rankings to measure business regulations and quantify the ease of doing business across countries. The indicators cover common transactions such as starting a business or registering property based on standardized case studies. Data are collected through surveys of local experts on business transactions and reflect the country's laws and regulations. Data on Doing Business indicators are in tables 5.3 and 5.6.

Box 5c compares the data sources, coverage, and information collected by Enterprise Surveys and the Doing Business project.

About half the world's households do not have deposit accounts in formal financial institutions

Financial exclusion is a barrier to economic development. Evidence from household surveys indicates that access to basic financial services such as savings, payments, and credit can make an important difference in poor people's lives. For firms, lack of access to finance is often the main obstacle to growth. In an increasingly digitized and globalized world many countries are promoting access to financial services—from establishing a credit facility for indigenous farmers in rural areas to introducing broad consumer protection legislation.

Although financial inclusion mandates, from consumer protection to rural finance promotion, are on the agenda of many financial regulators, insufficient authority and resources to provide broad financial access limit implementation capacity in many developing countries. Nevertheless, more than 70 percent of financial regulators in developing countries have programs to protect consumers, and almost 60 percent promote financial literacy.

Five new financial indicators from *Financial Access 2010* (www.cgap.org/financialindicators) are included in table 5.5 this year: commercial bank deposits, commercial bank loans, commercial bank branches, automated teller machines (ATMs), and point-of-sale terminals.

Although many nonbank institutions (cooperatives, specialized state financial institutions, and microfinance institutions) provide financial services, the most complete information available to central banks and financial regulators is on commercial banks, which account for 85 percent of deposits and 96 percent of accounts. Although financial inclusion, measured as people with commercial bank accounts, is high in some developing country regions such as East Asia and Pacific, it remains low in Sub-Saharan Africa (figure 5d).

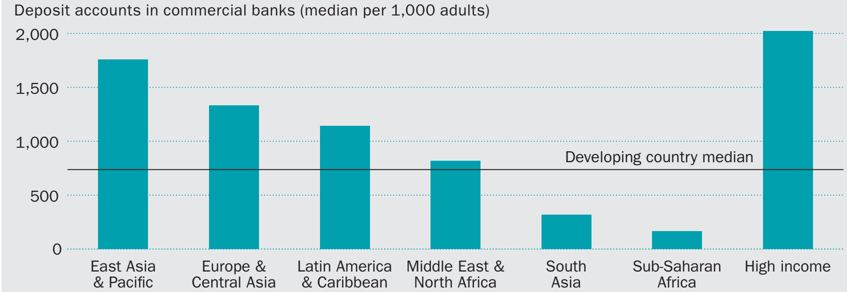
Access to deposit and credit services varies by region. Access is greater in countries with higher incomes, better infrastructure, and a well functioning legal environment. People without access to bank accounts and credit from regulated institutions have to rely on informal nonregulated financial services, often more costly and less reliable. Low- and middle-income countries lag behind high-income countries in the number of bank branches, ATMs, and point-of-sale terminals, but the number of ATMs exceeds the number of bank branches in low-income countries. And new technology, including the expansion of electronic payments through mobile and Internet banking, offer hope for bringing financial services to the unbanked.

Two approaches to collecting business environment data: Doing Business and Enterprise Surveys **5c**

Topic	Enterprise Surveys	Doing Business
Global coverage	125 countries	183 countries
Data source	Collects firm-level data; face-to-face interview with owner or top manager. Businesses surveyed include manufacturing, retail, construction, transport, communications, and other services	Collects information through surveys administered by local experts (lawyers, accountants, and architects). The information is confirmed through the underlying laws and regulations
Number of observations	150–360 observations in smaller countries; 1,200–1,800 interviews in larger countries	Underlying laws and regulations in addition to an average of 39 surveys per country
Geographical coverage within a country	Main cities or regions of economic activity	Main (most populous) business city and subnational studies in other cities
Information gathered	Objective data on the business environment as experienced by firms, performance measures, firm characteristics, and perceptions regarding obstacles to growth	Time and cost to complete common business transactions based on standardized case studies; underlying laws and regulations
	Business characteristics; approximately 20 Investment climate topics	Standardized business; 10 business regulation topics
Examples of data	Hard data: number of days to obtain a construction permit. Soft data: opinion on whether access to land is an obstacle faced by the establishment	Hard data: laws and regulations, number of procedures, and costs to build a warehouse. Soft data: experts' estimates on the number of days required for each procedure
Inference from the data	Stratified random sampling design of the surveys, which ensures that data are representative of the universe of formal firms (with five or more employees)	Standardized case studies that relate to a common business situation, which makes comparisons and benchmarks valid across countries
	Measures what happens to existing firms—their actual experiences with investment climate issues such as payment of taxes. Also surveys obstacles to business growth	Expectations of a standardized firm following official legal requirements and costs. For instance, "paying taxes" measures the number of payments, time to file, and tax rates
	Measures what happens in practice in the normal course of business; for instance, whether a firm pays a bribe when obtaining an import license and the actual time it takes to obtain the license	Assumes that firms comply with all formal regulations and minimize information gathering time and that all regulations are enforced. Measures what would happen if the firm complied with all regulatory requirements in a lawful manner.
	Can be used to identify potential areas of reform in the business environment as well as assess the impact of reforms on businesses.	Can be used to identify areas for reform based on bottlenecks or weaknesses in specific areas of private sector regulation and learn from practices in other countries.

Source: Summary of www.enterprisesurveys.org/Methodology/Compare.aspx.

People living in developing countries of East Asia and Pacific have more commercial bank accounts than those in other developing country regions, 2009 **5d**



Source: Financial Access 2010, CGAP and World Bank.