

Why 'Doing Business' with the World Bank May Be Bad for You

Professor Gerard McCormack



Key findings

- The World Bank Doing Business (DB) project is not fit for purpose and should be replaced.
- The DB project stresses the importance of a well-functioning legal and regulatory system in creating an effective market economy.
- The rankings have sparked the attention of politicians and policy makers across the globe.
- The project has focused attention on law and development issues; its methodology is fairly transparent and it has produced data sets that are of great benefit to researchers.
- But the rankings embody ideological and technical preferences whose relationship with economic development is at best uncertain.

This paper arises out of the ESRC funded project 'Boosting growth through strengthening investor and creditor protection in China: How China can learn from the UK experience'.

In one of the papers for this research project I critically examine the role of law in promoting economic development and argue that the very influential World Bank Doing Business (DB) project – is not fit for purpose and should be replaced. The latest World Bank Doing Business rankings were published on 24 October 2019 in the form of the Doing Business 2020 report – see www.doingbusiness.org/en/rankings and www.doingbusiness.org/en/doingbusiness. In it, the position of the UK in the global rankings has somewhat remarkably improved from 9th to 8th position (nothing to do with Brexit!) whereas China's position has improved even more dramatically from 46th to 31st place.

Doing Business – Background

The DB project and associated rankings embody a set of ideological and technical preferences whose relationship with economic development is at best uncertain. Context and cultural sensitivity are all important in the 'real' world and reducing complicated matters to a single ranking is not compatible with bringing about genuine improvements in the legal framework for doing business.

The role of law in promoting economic development has long been a controversial one. Certain legal systems may be conducive to higher rates of economic

development but the necessary causal link between the two is difficult to establish. Nevertheless, the DB project and associated rankings has sparked the attention of politicians and policy makers across the globe. For example, the UK government has committed itself to being among the global top five in the rankings and the European Commission has used the relatively poor ranking of some EU countries as part of its justification for building a Capital Markets Union.

The DB project stresses the importance of a well-functioning legal and regulatory system in creating an effective market economy and, as a corollary, the deleterious effects that a poor regulatory environment can have on output, employment, investment, productivity, and living standards. The DB project has focused attention on law and development issues; its methodology is fairly transparent and it has produced data sets that are of great benefit to researchers.

Nevertheless, the way in which the rankings are compiled encourages countries to 'game' the system. Moreover, the DB project largely, if not entirely, mirrors the law on the books which may not necessarily reflect what happens in practice in a particular country. I suggest that the DB project should not survive, at least in its present form, because of the theoretical and methodological deficiencies inherent in its conception and implementation.

The Doing Business (DB) project purports to measure the regulations affecting business in countries throughout the world — regulations that affect business formation and operation. The rankings are premised on the assumption that everyday economic activity in countries is fashioned by laws, regulations and institutional arrangements.

The DB rankings have been issued annually since 2004 in the form of a report published by the World Bank Group. Originally, the DB report contained five sets of indicators for 145 economies whereas the most recent 2020 report includes 12 sets of indicators for 190 economies. Each economy is ranked on the individual indicators and also in an overall table based on its score across 10 of the 12 indicators. The rankings are grounded on the notion that smarter business regulation promotes economic growth.

The rankings however, do not directly measure more general factors that might facilitate doing business such as country's geographical location including proximity to large markets; the quality of the physical infrastructure and the incidence of crime, corruption and internal unrest. The focus is deliberately narrow even within the relatively small set of indicators that make up the rankings.

In terms of basic approach, the DB reports and rankings are based on a more sophisticated version of the 'legal origins' / 'law and finance' or 'law matters' thesis developed by a leading group of financial economists in the 1990s. Many of the leading lights in the legal origins movement shaping the commissioning and content of the Doing Business reports¹. One of these 'leading lights' Simeon Djankov, has stated²:

*The inspiration behind Doing Business was two-fold. First, ... I had previously researched the experience of centrally planned economies and documented the waste of entrepreneurial talent and resources as a result of overregulation. With the collapse of communism, research on the benefits of simpler regulation would be of use to reformers in Eastern Europe. Second, in his book *The Other Path*, Hernando de Soto (1989) showed that the prohibitively high cost of establishing a business in Peru denies economic opportunity to the poor.*

The DB methodology is subject to many of the same criticisms as the legal origins literature including a common law bias, a US-centric approach and an underlying deregulation and free market agenda.

Nevertheless, the Doing Business project is one of the most prominent knowledge products emanating from the World Bank. The reports have considerable success in persuading countries to institute reforms that are consistent with their recommendations. When Narendra Modi was elected Prime Minister of India, he explicitly set out the target of achieving 50th place in the ranking as a benchmark for his administration. This would mean an improvement of almost 100 places compared to India's then position and it is now in 63rd position. In 2012, Russian President Vladimir Putin suggested that Russia should get into the top 20 in the DB rankings by 2018 – it is now in 28th position.

Developing countries may be particularly receptive to ideas advanced by the World Bank because of the scale of its 'legal technical assistance' operations. Donor countries may also use the DB rankings in gauging whether a particular destination is safe for investment. Smaller developing countries may try to use the rankings to show foreign investors that they have improved their business environment.

Nevertheless, countries may have made 'strategic' use of the rankings by amending formal regulations in a way that has not much bearing with the substance or the reality on the ground.

Clearly, one's position in the DB rankings is not a neat proxy for per capita GDP, whether on an absolute or purchasing power basis.

Doing Business — Criticisms

The rankings may be criticised for an actual or perceived common law bias, a preference for deregulation and free market solutions, lack of correlation between the DB rankings and the empirical realities on the ground and also methodological flaws in the way in which the rankings are drawn up.

The first DB report in 2004 did not hide its deregulation and free market perspectives as well as its preference for the common law over the civil law which, to a certain extent, was a hangover from the earlier legal origins' literature. The report argued that a 'heavy' regulatory regime brought about the worst results in terms of economic outcomes since it was usually associated with inefficiency within public institutions, long delays in reaching decisions, high costs of administrative formalities, lengthy judicial proceedings, higher unemployment and more corruption, less productivity, and lower investment.

The rankings involve a process of aggregation across topics including a value judgment about what is 'better'

for doing business and how much better it is. Aggregation relies on strong built-in assumptions and this makes it an inherently value laden practice. The act of ranking countries may appear devoid of value judgement, but, in reality, it is an arbitrary method of summarising vast amounts of complex information as a single number.

While the DB reports address important topics, they are weak on execution and technique. The reports have something of a missionary or proselytising tone and make the case for the DB indicators but without expressing appropriate scepticism and taking a balanced view of the evidence. There are many problems and technical flaws which becomes apparent when one considers in detail how the 'Getting Credit' indicator is drawn up.

Firstly, this indicator is inappropriately named for, despite the name, it does not really measure 'getting credit' at all. In reality, it measures whether a country has a credit bureau system that collects and distributes fundamental information about credit and a secured transactions legal regime that allows entrepreneurs access to credit using movable property. The indicator does not measure directly what it purports to address.

The DB reports in their methodology section explain in detail how the 'Getting Credit' indicator is composed with the indicator including both 'legal rights' and 'sharing of credit information' features. The 'legal rights' feature purport to ascertain the extent to which certain elements are present within the secured credit/secured transactions/collateral laws and the corporate insolvency (bankruptcy) laws of a particular country. A second aspect considers the coverage, scope and accessibility of credit information that is available through credit bureaus or credit registries. 60 per cent of the overall ranking is made up of the 'legal rights' element and the remaining 40 per cent is attributed to the 'sharing of credit information element'.

In determining a country's overall ranking, scores on the individual sub-indicators are aggregated with the higher scores signifying that the collateral and insolvency laws in a particular economy are, in the words of the World Bank, 'better designed to expand access to credit'. The 'Getting Credit' indicators has been a feature of the DB reports and rankings from the very beginning though there have been some changes to the list of sub-indicators and adjustments to the detailed methodology over the years. One might argue that these changes provides evidence of learning from experience and demonstrates the project's capacity for self-development. This seems however, to be far too

sanguine an assessment. It is submitted that the 'Getting Credit' indicator has three main imperfections: (a) glitches in methodology and related data inaccuracies; (b) unblinking alignment with a highly contestable model, and (c) formalistic rule following.

Some DB defenders may brush such criticisms aside on the basis that the DB data is incapable of capturing the complexities of the legal system or on the basis of a culture clash between economists and lawyers. But while short-cuts may be acceptable in certain circumstances, crude (and inaccurate) measurements are not.

DB defenders also argue that the rankings play a vital role in promoting economic inclusion: success on the basis of rules and not on connections or corruption. But the 'Getting Credit' indicators seem highly prescriptive and overly committed to a particular view of secured transactions law that may not be best for a particular economy. Absolute commitment to a DB 'Getting Credit' blueprint ignores history and tradition in individual economies. It also risks countries simply copying the DB indicators and making formalistic rules changes to their respective laws that either have little or no impact, or may be counter-productive, in practice.

Law also behaves differently in different contexts and legal changes may not have the effects they have in the 'host' country when transplanted into a different implementing environment. The DB project appears to ignore the rich literature on legal transplants and the practical insights gained from decades of experience in law and development work.

The DB project has a universalist, quasi-imperialist vision in that it puts legal rules and legal systems at the fulcrum of the development equation but a variety of non-legal factors clearly impact on a country's economic performance. While these factors may be difficult to quantify and measure scientifically, the same is also true of legal factors.

Given the interaction between the different factors, the best we can hope for in terms of law and development is probably a pragmatic multifaceted set of indicators structuring and guiding inquiries rather than a bold and all-encompassing vision. In this connection, one might refer to the notion of reflexive law thereby acknowledging that the influence exerted by the export of legal norms is most likely to be effective when it seeks to achieve its ends not by direct prescription but by inducing second order effects on the part of social actors in the receiving State.

Legal systems perform a number of different functions and there are choices, or a set of choices, to be made between means and ends. The relationship between means and ends is also contingent and uncertain. The DB project appears to embody a top-down formalistic logic assuming that if certain reforms are enacted the intended consequences will more or less automatically follow. Assessing 'success' also becomes a self-referential process which is judged in terms of how the legal system is changed instead of on how social realities have been affected. The DB project has a formalist tendency that appears to overestimate the closeness of the link between legal rules and structures and economic outputs in the 'real' world.

There are more advantages of providing options that are based upon experience rather than setting out answers. The question becomes not whether legal rules have been transplanted from one country to another but whether the legal institutions in a particular country as a whole function in such a way as to support rather than to obstruct economic growth. Addressing this question calls more for a process of continuous adjustment and learning from experience rather than a simple 'big bang' solution which the Doing Business set of indicators appears implicitly to endorse.

The DB project should be stripped of its preoccupation with rankings — the process of simplifying complex matters of policy execution and design into a simple, single ranking. Such reductionism pays scant regard to subtlety and nuance and disrespects the reality that various functions might be carried out under the framework of a legal rule in one country but through an extra-legal procedure in another country. Context and cultural sensitivity are all important in the 'real' world and reducing all sorts of complicated matters to a single ranking hardly seems compatible with bringing about genuine improvements in the legal architecture for doing business.

References

¹ See the 2004 Doing Business report, p. vii: 'Doing Business in 2004 was prepared by a team led by Simeon Djankov [...] Andrei Shleifer co-authored the main background studies and provided valuable suggestions throughout the writing of the report. Florencio Lopez-de-Silanes and Rafael La Porta co-authored the background studies'

² See also p. iv of the foreword to the 2017 Doing Business report.

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