

AED Newsletter n°3- September 2006

« Indicators to measure Law? Methodological limitations of “Doing Business” reports »

September 2006: Publication of the 1st AED book.

Translated Summary

1st Part: Methodological limitations of « Doing Business » reports »

Bertrand du MARAIS, member of the French Conseil d’Etat.

- From correlations to causality: the Doing Business methodology and the development of the “ease of Doing Business Index”.
- The results and poor explanatory aspects of Doing Business indicators.
- How to measure? Technical criticisms of Doing Business method.
- What to measure ?

2nd part: Exploratory analysis of the indicators proposed by 2005 and 2006 Doing Business Reports from the World Bank.

Didier Blanchet, National Institute for Statistics and Economic Studies. (INSEE)

- Analysis of results in the 2005 DB report.
- Analysis of results in the 2006 DB report.

3rd part: Information systems on creditworthiness: theoretical and comparative analysis.

Anna Dorbec, Researcher in Economics, Université Paris X Nanterre

- Theoretical debate: what is the necessity of the information sharing on the borrowers?
- Which configuration of the information sharing system of the borrowers?
- Problems related to the assessment of the information system on the creditworthiness or private credit bureaus?
- Analysis of the French situation within the perspective of the theoretical outcomes and the criticisms evoked
- General conclusion.

To order a copy of the book, currently available in French :

réf. 9782110062444, 158 p., 21 €

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The stakes of the Doing Business reports

The first publication of the international research program on “the Economic Attractiveness of Law” is a critical analysis of the methodological limitations of “Doing Business» reports (see IFC (World Bank) 2004, 2005 and 2006.)

The first Doing Business report of 2004 irritated French lawyers. Indeed, it formulated three distinct judgements: that there exists one universal legal model supporting the economic growth (« *One size can fit all* » - *Doing Business in 2004*, p. XVI); that the French Civil Law tradition would be an obstacle to the economic growth and finally, that French Civil Law is intrinsically conducive to corruption. The next three Doing Business reports, although not taking into consideration the debate on the relative superiority of the two major Legal traditions, are based on the same methodology and pursue the same goal: to comparatively assess the effect of Law on economic growth and the development businesses according to a new Doing Business index called (« *The ease of doing business index* »).

The stakes of debating with the authors of the Doing Business reports transcend the differences between legal traditions and are crucial.

The first dimension of this debate is Scientific.

Economists have shown how Institutions and Law influence economic growth of a country. Consequently, creating a synthetic index on the economic effect of legal systems should lead to a great improvement in the knowledge of social behaviours. Unlike the attempts of some private institutions, the good thing about Doing Business reports is to have brought this debate on an international level. However, it remains to be examined whether this measure is sound and robust enough, especially to justify recommendations in public policies.

Working Papers available in their English
version at : www.gip-recherche-justice.fr/aed.htm

The first publication by the research program on “the Economic Attractiveness of Law” (EAL), based on the works of experts from Civil Law as well as from Common Law backgrounds, demonstrates that, *ad minima*, the questionnaires used in drawing up the Doing Business reports should be drastically revised in order to build a more robust index “the ease of doing business”. However, the core of the DB methodology suffers two major limitations.

Firstly, the technique of encoding Law into binary variables is not adapted to the effective function of the legal system. Law helps qualifying concrete factual situations in order to insert them in a pre-defined legal category. Moreover, the result of such subsumption depends on the appreciation a Judge will make on a specific case subjected to him. Secondly, the fact that Doing Business uses hypothetical case studies in order to set up comparisons between legal systems adds several bias to the data.

To conclude on this point, the Doing Business reports analyzes *the divergence between National legal systems and a pre-established theoretically created “ideal” legal model* which is geographically not identifiable and completely abstract. Moreover, the economic efficiency of this “ideal” model was never scientifically demonstrated, which is what econometric tests highlight in the second part of the EAL program’s publication.

The second stake of the debate is operational and economic. The Doing Business rankings published from 2006 on *clearly* indicate the direction to be followed by investors and lawyers. The authors of the Doing Business reports thereby did more than merely operating a change of intensity in the study of « Measuring Law ». They changed the nature of the debate.

Finally, the **third stake of this discussion with the supervisors of the Doing Business team concerns politics.** The authors of the reports draft public policy recommendations from their conclusions. The latter are also used to adjust the loan policy of the World Bank (also see Bakvis, 2006).

The third part of EAL program’s publication analyses in depth the “Getting credit” indicator, one of the ten indicators which compose the “ease of doing business” index. This confirms that the scientific approach, as well as the data collection, of Doing Business, is incorrect.

the 10 indicators which composed the « ease of Doing Business index »

- « Starting a Business »
- « Dealing with licenses »
- “Hiring and firing workers”
- “Registering property”
- « Getting credit »
- « Protecting investors »
- « Paying taxes »
- « Trading across borders »
- “Enforcing Contracts”
- « Closing a Business »

According to Doing Business 2006: Investors should decide to build their installations and hire people in Koror (capital city of Palau, 1st for these two indicators), register our (titres de propriété immobilière) in Palikir (Micronesia, 5^{ème}), paying taxes in Male (Maldives, 1st), and create a company in Kingston (Jamaica, 10^{ème}) or Kabul (Afghanistan, 16^{ème}), rather than in Helsinki, Oslo, Stockholm or Bern, 18th, 19th, 20th and 28th.

Source : SFI (Groupe Banque mondiale), Doing Business 2006

Given these methodological flaws, it seems rather unlikely that the Doing Business report recommendations may be justified. On the contrary, these recommendations – as well as the ranking of « good reformers », also published since the Doing Business 2005 – are likely to lead to failures.

In developed countries, reforms based on Doing Business recommendations would appear to be difficult since they would be wrongly focused. Similarly, in developing countries, the money spent for technical assistance for legal reforms risk to be rather useless. In all cases, tremendous human damage could be done.

With regard to these three stakes, experts (legal practitioners and academics) participating in the international research program on « the Economic attractiveness of Law » have decided to adopt a constructive approach and face this debate.

Ranking by Doing Business 2006 according to the « ease of Doing Business index »	
Pays	Ease of Doing Business
New Zealand	1
Singapore	2
United States	3
Canada	4
Norway	5
Australia	6
Hong Kong, China	7
Denmark	8
United Kingdom	9
Japan	10
Ireland	11
Iceland	12
Finland	13
Sweden	14
Lithuania	15
Estonia	16
Switzerland	17
Belgium	18
Germany	19
Thailand	20
Malaysia	21
Puerto Rico	22
Mauritius	23
Netherlands	24
Chile	25
Latvia	26
Korea	27
South Africa	28
Israel	29
Spain	30
Maldives	31
Austria	32
Namibia	33
Fiji	34
Taiwan, China	35
Tonga	36
Slovak Republic	37
Saudi Arabia	38
Samoa	39
Botswana	40
Czech Republic	41
Portugal	42
Jamaica	43
France	44
Kiribati	45
Armenia	46
Kuwait	47
Marshall Islands	48
Vanuatu	49
Palau	50

The international research program on « the Economic Attractiveness of Law » analyzes two key issues:

- Can comparative efficiency of legal instruments be brought about by synthetic, standardized indicators or would it be more appropriate and enriching to analyze and compare local legal characteristics and then evaluate their economic effect ?
- Is the diversity of legal systems an obstacle for business transactions or, on the contrary, a ground for legal certainty? Does successful business making require necessarily uniform legal systems?

The current publication by the EAL research program discusses the first issue. It critically analyzes the methodology used to construct « the ease of Doing Business index » published in the Doing Business reports.

It thus invites to a broader debate – which the EAL program will continue over the years to come – on the concept of measuring the efficiency of legal systems, on possible methodologies, requirements on official statistics, etc.

This program's intention is not only to contribute to the emergence of a "new comparative economics" research approach (to refer to the project of some of the authors or inspirers of the reports Doing Business (Djankov *et alii*, 2003)) but also to help creating *really* comparative economics.

Bertrand du MARAIS

References:

Bakvis P., 2006, *How the World Bank & IMF use the Doing Business Report to promote labour market deregulation in developing countries*, Mimeo, ICFTU/Global Unions, www.icftu.org

Djankov Simeon, Glaeser E., La Porta R., Lopez-de-Silanes F. & Shleifer A., (2003), « The new comparative economics », *Journal of Comparative Economics*, n° 31, p. 595 - 610

Edward L. Glaeser & Andrei Shleifer, (2002) *Legal Origins*, Quarterly Journal of Economics, 117, p 1193.

IFC & World Bank:
Doing Business 2004 « Understanding regulation » ;
Doing Business 2005 « Obstacles to growth »
Doing Business 2006 « Creating jobs »

Kaufmann, Daniel, Kraay A., Zoido P., « Governance matters », World Bank Policy Research Working Paper n° 2196, august 99, <http://www.worldbank.org/wbi>

La Porta, Rafael, F. Lopez-de-Silanes, A. Shleifer and R. Vishny, (1998), "Law and Finance", *Journal of Political Economy*, 106, 1998, p. 1113-1155.

The research program on « the Economic Attractiveness of Law »

The international research program on « the Economic Attractiveness of Law » is a Think Tank launched in 2004 in order:

- To assess the comparative efficiency of some legal instruments stemming from the Civil Law tradition and thus, to compare and to evaluate these instruments with regard to the development of economic transactions.
- To prove that legal diversity in financial and business transactions is a key element of economic efficiency since diversity brings legal certainty. On the contrary, a hurried standardization of Law brings a lot of adverse effects to international investments.

This program Institutions makes a comparative analysis of the relationships between Law and Economics.

The program is financially supported by: the French ministries of Justice, Finance and Foreign Affairs, by the Caisse des depots et consignations; the International Organisation of Francophonie; the associations representing all French Legal professions (the notaries, the attorneys, the bailiffs, the liquidators), and the French Central Bank.

This program is overseen by a Scientific Council composed 30 International Scientists and practitioners, Jurists as well as Economists, presided over by Jean du Bois de Gaudusson, Professor of Law, Université Montesquieu, Bordeaux.

The international program is based at the University of Paris X – Nanterre. The public Interest Grouping “Mission de Recherche Droit et Justice” is in charge of the financial management of the program.

The scientific Director and project manager is Bertrand du Marais, member of the French Conseil d'Etat.

On July 1st 2006, it represented :

- 10 international teams
- A network of more than 100 academics and practitioners.

EAL's PUBLICATION : Executive Summary

The first part of the book shows the methodological limits of Doing Business. It is based on an exhaustive analysis of the questionnaires used in drawing up the 2006 Doing Business report.

The Doing Business results give rise to a series of questions: they contradict official statistics; they do not consider initiatives of harmonization of law. As an example, *for the “cross border trading” indicator, which should capture the efficiency of customs law, the rank of the EU members varied from the 1st rank to the 90th.*

This is due to the limits of the methodology in data-collecting. Out of the ten questionnaires leading to the **10 indicators which composed the “ease of Doing Business index” none can be considered totally reliable.**

Above all and from a general point of view, the binary coding of law and the use of hypothetical case studies, without regard to national legal specificities, lead to **unacceptable econometrical results concerning the quality of the measure.**

The 2nd part of the book carries on econometrical test of the aggregation methodology used in Doing Business. Didier Blanchet's estimates demonstrate that, in contrast to what it was supposed to do according to the recommendations of the Report, the “ease of doing business” index explains very little the variations of macroeconomic variables.

In the 3rd part of the book, Ana Dorbec makes a thorough assessment of the « Getting Credit » indicator. She argues that, in today's scientific community, there is no clear judgement as to the relative efficiency of monitoring systems on creditworthiness, contrary to what is suggested by Doing Business authors.

Dorbec conducts a very detailed analysis of the information system on creditworthiness available in France. She concludes that it is not possible, **contrary to the Doing Business report, to rank France among the worst countries in the world (115th/155)** in terms of information facilitating the access to credit.

[Attractivité Economique du Droit](#)

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