

Voices of the Firms 2000:
**Investment Climate and Governance Findings
of the World Business Environment Survey (WBES)**

Geeta Batra

Daniel Kaufmann

Andrew H. W. Stone

The World Bank Group

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Abstract

A set of enterprise data are presented, based on a survey of more than 10,000 firms in 80 countries that was carried out between late 1999 and mid 2000. In addition to the data, detailed explanations and the core questionnaire are provided in this paper, as well as a presentation of key findings across regions and firm characteristics. The specificity of the questions posed to firms permits an empirical unbundling of the types of constraints faced by enterprises. Basic econometric analysis of these data suggests that taxes and regulations, financing, governance and other business constraints matter significantly in explaining a firm's performance and behavior. Further, there is a large variance in the extent of business and governance constraints across countries, regions, and type of firms, suggesting the need for caution when averaging across broad categories. Listening to firms contributes significantly to assessing the climate for business, investment, and governance in a country, and warrants institutionalization of periodic worldwide enterprise survey efforts.

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Disclaimer

The data and views presented do not necessarily reflect official views of the entire institution or its Board of Executive Directors. Given inherent error margins associated with any single survey results, it is inappropriate to use the results from this survey for precise country rankings in any particular dimension of the investment climate or governance.

Executive Summary

Background: Listening to Firms Matters

How can one assess and compare the environment for doing business and investing in countries around the world? The World Business Environment Survey (WBES), administered in roughly parallel fashion to enterprises in 80 countries and one territory throughout the world, provides a basis for making regional comparisons of investment climate and business environment conditions, as well as comparisons of the severity of constraints affecting enterprise depending on their characteristics—such as size or ownership, and to perform country-specific evaluations. It captures firm perceptions of key constraints in the business environment—perceptions that shape operational and investment decisions—as well as several quantitative indices of firm experience.

This paper provides the first comprehensive summary of the major patterns and findings of the global WBES results. Most constraints are presented by region and many by firm size, focusing in particular on the findings regarding reported constraints imposed by 1) policy instability and uncertainty; 2) taxes and regulations; 3) inflation/price instability and the exchange rate; 4) finance; 5) governance, the legal system and corruption, and 6) the quality of public services, including infrastructure. The analysis in this paper are based on a sample of 10,090 enterprises that responded to the core questionnaire.

Furthermore, based on this rich enterprise data set, we also provide a selective analysis of key determinants of firm performance and their behavior. Based on this empirical analysis, we suggest which constraints affect firm-level outcomes the most. In addition, we explore what types of firms are affected in particular by different business constraints. The close nexus between the investment climate for business development and governance constraints is a significant theme throughout this paper.

Considerable effort has gone into an analysis of the survey data, both by the authors of this paper and by others.¹ We present some key findings and provide a bibliography of papers that have used this data set for further reference. Yet, arguably, the more valuable contribution of this work may reside simply in presenting, explaining, and making accessible to analysts, academics, and students this worldwide enterprise dataset. The main text of the report includes detailed explanations of the data, which are summarized graphically in many of its dimensions. Detailed tables in the extensive annex to this paper feature the data for each country and region and most key variables, as well as the survey instrument. Complementing this paper, we have also developed an interactive web tool to access the data in a manner tailored to each user's needs.² Through the interactive web tools, the dataset can be downloaded and used in analyses that can go far beyond what is presented in this report.³ The data set reflects an ambitious multipartner effort that has gone into implementing this survey of firms in all continents, as well as into the data processing and integration into a unified dataset.

Main Findings on Overall Constraints to Enterprise

¹ Known works based on the WBES are included in the bibliography appearing at the end of this paper.

² <http://info.worldbank.org/governance/wbes/>

³ <http://www1.worldbank.org/beext/resources/assess-wbessurvey-alt.htm>

Focusing on a simple average for the overall world sample, the following constraints stand out: taxes and regulations, financing, policy uncertainty/instability, and inflation. Yet such worldwide average results mask crucial differences across regions, and particularly between industrialized and developing countries. For OECD, newly industrialized East Asian countries, and transition economies, the leading obstacles identified by the firms were indeed taxes and regulations, financing, policy instability, and inflation. However, for developing countries (Africa; Latin America and the Caribbean, LAC; Middle East/North Africa, MENA; South Asia; and East Asia) the leading constraint is corruption, followed by inflation, financing, policy instability, and infrastructure. Indeed, in four developing regions, South Asia, Africa, developing East Asia and MENA, corruption figures as one of the three leading constraints. Salient regional differences emerge. For example, in South Asia, street crime imposes the leading constraint, whereas in Africa, infrastructure is identified as the second leading problem after financing. In Central and Eastern Europe (CEE), inflation ties with taxes and regulations as the leading constraints. The large variance across regions (and countries) in the severity assigned by responding firms to the various constraints points to the importance of assessing the results by region and country, rather than relying on worldwide averages.

Size Matters, in Complex Ways

The data also indicate that for most categories of obstacles, small and medium enterprises identify themselves as more constrained than larger firms. Indeed, in reviewing the many key potential obstacles to business development, the econometric evidence suggests that firms that are private, smaller, newer, devoid of foreign direct investment (FDI), and that cater to the domestic market generally tend to report more acute business constraints than firms that are older, larger, exporting, have FDI, or are state-owned. There are some notable exceptions vis-à-vis some business constraints, however: older firms report being more constrained by macro-instability and by anticompetitive practices than smaller firms, and obvious reasons, exporters are hit harder by an inadequate exchange rate regime than nonexporters, for instance. On a global scale, on average, large firms report being more constrained than small and medium sized enterprises (SMEs) only by infrastructure quality.

The statistical results suggest a complex relationship between firm characteristics and the severity of the investment constraint reported by a business. As other research has pointed out, the evidence presented here also indicates that, in general, large enterprises report facing less severe constraints, either because their objective conditions are better or because they can better cope with them. At the same time, the empirical exploration presented here advances the notion of the forgotten middle, challenging the orthodoxy that claims that invariably the smaller the firm, the more severe the constraint. Indeed, while smaller firms are specially afflicted by some constraints, medium sized firms face more daunting constraints in terms of taxes and regulations as well as property rights protection, and mid-sized firms are more affected by an inadequate exchange rate regime than smaller firms. These more subtle results suggest that efforts to level the playing field, which unduly target microenterprises and small enterprises may overlook important constraints to medium-sized enterprises.

Specific Business and Investment Climate Constraints

Taxes and regulations impose a severe constraint. The category for taxes and regulations is found to top the constraint list in OECD, Latin America, and transition economies (Central and Eastern Europe, CEE; and the Commonwealth of Independent States, CIS). By contrast, taxes and regulations were rated as a much lower constraint in Africa, East Asian developing and newly independent countries, and MENA. The survey asked firms to evaluate the severity of a list of potential regulatory constraints. In every region, high taxes topped this regulatory list. Independent of the direct cost of tax payments, **tax administration** imposes a major or moderate constraint for more than 70% of firms in Central and Eastern Europe, 65% of firms in CIS countries, and 63% of firms in Latin America. **Customs procedures and trade regulations** impose serious constraints for more than half of all firms in Latin America and South Asia, while less so in other regions. The degree of constraint imposed by **labor regulations** varies sharply by region, with about 60% of South Asian firms and more than 50% of Latin American firms finding labor regulations to be a major or moderate constraint, while this figure is lower in other regions.

Finance. The second leading general constraint for the global sample is financing. Firms in Central and Eastern Europe are most likely to identify it as seriously constraining, followed by those in CIS countries, and then those in Africa, South Asia, and Latin America. Globally, while financing is identified as the second-leading constraint by small and medium enterprises, it ranks as fourth for large enterprises. Consistent with surveys of this nature, within finance, high interest rates are reported to be a leading financial constraint across all regions, followed by access to long-term credit. **Sources of finance** vary markedly by region and firm size. While internal funds and retained earnings provided the leading source of financing across regions, in South Asia and Latin America, domestic commercial banks provide 20% of investment finance, and in developing East Asia and OECD nations, banks provide around 15%. In Africa, which was measured differently, self-finance and internal funds appeared as the most common source of finance, followed by the firm's own capital or equity. By size, SMEs in the sample rely less on commercial and foreign banks for investment finance than do large firms, and depend more on internal funds and retained earnings.

Policy uncertainty and instability. At one extreme, more than 70% of firms in South Asia, Central and Eastern Europe, and developing East Asia report policy instability as seriously constraining, with firms in Latin America, MENA, and CIS close behind. By contrast, only 26% of firms in newly industrialized East Asia and China identified this constraint as major or moderate, and also only 37% of firms in OECD countries did so. Firms differed by region in the particular dimension of policy instability that troubled them. More than 70% of firms in CEE, more than 60% of firms in CIS countries and developing East Asia, and about half the firms in LAC find **economic and financial policies** to be unpredictable. In CEE and Africa, nearly three-quarters of firms rated **changes in rules, laws, and regulations** affecting them as being unpredictable, while two-thirds of firms did so in CIS. For **advance notification of changes in laws and policies** affecting them, 68% of firms in CEE, 60% of CIS firms, and 57% Latin American firms responding reported that they were seldom or never notified in advance of changes affecting them. Finally, to the question of whether **government considers businesses' views** in the formulation of legal and policy changes, in the transition economies of Europe, MENA, and Latin America, the majority of firms respond that this is relatively rare.

Corruption and governance. Corruption is identified as a serious constraint by more than 70% of firms in South Asia and by nearly as many in developing East Asia and MENA. Sixty-four percent of firms in Africa, almost 60% of those in Latin America, and about half in the CIS and

Central and Eastern Europe report it as a serious impediment. This contrasts with the much lower share (about 20%) of firms in newly industrialized East Asia and China,⁴ and in OECD countries that rate it as a major or moderate obstacle. Further, in much of the developing countries the majority of firms reported that it was common “in their line of business to have to pay some irregular ‘additional payments’ to get things done.” The data on the reported percentage of total revenue that firms pay every year in bribes clearly and positively correlates with the data on the degree to which firms find corruption constraining. An important manifestation of weak governance is the extent to which registered firms operate unofficially, and related, the degree to which firms comply with tax laws. While there are variations from region to region, about one-half of the firms indicated reporting no more than 80% of their revenues.

Quality of public services. About two-thirds of firms in Central Europe, Latin America, and CIS countries, and nearly 60% in South Asia, report that the government is inefficient in delivering services. The rate of dissatisfaction is particularly marked among smaller firms. There is variation

State capture in transition economies: a major manifestation of misgovernance. Traditional measures of corruption derived from enterprise survey questions are useful to assess the extent to which administrative bribery is present in a particular country, and thereby it provides an indicator of the extent to which corruption exists in the *implementation* of laws and regulations. However, the transition economy version of the WBES (the “BEEPS” survey) went further and assessed the extent to which countries may have experienced good or poor governance in the formation and shaping of the policies, laws, and regulations. Such research highlighted that in about half the countries in transition (particularly in the CIS, but also some in CEE) a very high extent of state capture by the corrupt interests of the enterprise elite had taken place. In those countries, the policies, laws, and regulations of the state are reported to have been shaped to a large extent by some firms’ corrupt payments. The empirical work further indicates that the effect of such grand form of misgovernance characterized as state capture on the business and investment climate is very large: firms in countries that avoided the state capture grow much faster and invest significantly more than those subject to state capture.* Further, the implications of this work goes beyond the need to further monitor and measure this important manifestation of ‘grand corruption’ (typically not measured), but it has a fundamental policy implication: if indeed some firms are not only merely investment climate “takers,” but investment climate “makers,” conventional advice to government officials as to what rules and regulations to reform will continue to have limited impact in those settings subject to state capture by the vested interests of the elite.

* For background research and interactive access to the data: <http://info.worldbank.org/governance/beeps/>

in the evaluation of different types of public services and institutions: on average, the majority of firms give a negative evaluation for public health, parliament, and public works/roads, while more than 40% negatively evaluate the courts, police, education services, and central government leadership. By contrast, the postal, telephone, and electric power services are the most positively rated services.

Business Environment, Investment Climate, Governance, and Enterprise Performance

Direct reporting on the main constraints to enterprise development perceived by firms is now recognized as an increasingly valuable tool for assessing the business climate in a country. The information given directly by firms, notwithstanding the element of subjectivity and margins of

⁴ The subcontractor carrying out the survey in China could ask only this general constraint question about corruption; therefore, no further data from detailed questions on this topic were obtained.

errors, is generally found to be highly correlated with other measures and a sound basis for assessing the business and governance climate.⁵ At the same time, additional insights emerge when such direct reporting of constraints is complemented by econometric analysis that evaluates whether and how the various business environment variables matter for a firm's performance. Based on the indicators from the WBES, a basic econometric exploration suggests that, controlling for other factors, countries with inadequate conditions in the areas of finance, high taxes, corruption, and policy predictability experienced an average growth rate of 10.5 percentage points less than those with positive ratings in all of these categories over a 3-year period. We also find that the extent of "unofficialdom" (as represented by the extent to which firms underreport their revenues) is significantly associated with macroeconomic instability, tax and regulatory burden, corruption, and inadequate protection of property rights.

Implications

The cross-country enterprise-based data gathered through the WBES and its analysis suggest that survey-based indicators of the business environment can serve as an important input to a country specific business and investment climate assessment. Key variables measured by the WBES significantly relate to firm-level outcomes point to the importance of assessing the constraints to business, which matter for identifying different priorities for reform in different countries. Furthermore, policy analysis can be enhanced by understanding firms' behavioral response to different constraints—and its implications. Thus, the findings on firms' greater tendency to underreport revenue when key policy and institutional conditions are weak has important implications for government efforts to mobilize revenue and improve governance. Indeed, constraints to business are found to have a significant macroeconomic cost, over and above their direct effect on lower enterprise growth.

Furthermore, this type of business survey paves the way toward a deeper understanding of a firm's behavior in shaping the business environment and investment climate. For example, a major finding of the related research on the transition economy version of the WBES (the Business Environment and Enterprise Performance Survey -- BEEPS) is that, contrary to convention, the firm ought not be seen merely as a passive business climate "taker," traditionally viewing government as the primary source of all business constraints. Instead, the in-depth analysis of the forces of "state capture" highlights the extent to which powerful firms play a key role in shaping the policies, laws, and regulations that form the business environment and investment climate—thus transforming them into business climate "makers"—in countries where state capture is prevalent. This finding underscores how important it is to view both governance and the investment climate within an integrated framework, and is suggestive of further issues that cross-country survey instruments might further investigate in the future.

The complex interaction between firm size and severity of reported constraints by enterprise found in this work poses a challenge for policy makers. If indeed the relationship between firm size and the severity of a constraint instead of being linear and declining (with the smallest firms facing the most daunting constraints) is nonlinear for many business constraints, with mid-sized enterprises facing these most severely, orthodoxy is challenged. First, it would then be prudent to focus in depth on each particular constraint and explore the manner it affects differently sized

⁵ See "Governance Matters II: Updated Indicators for 2000/01" by Kaufmann, Kraay and Zoido, World Bank Policy Research Working Paper 2772, February 2002.
<http://www.worldbank.org/wbi/governance/pubs/govmatters2001.htm>

firms, because depending on which constraint the firm faces, whether the enterprise is small, medium, or large, it will be affected differently. Second, given the prevalence of constraints for which mid-sized firms are worst afflicted, it is warranted to probe further on the obstacles to growth for mid-sized enterprises, given their importance as potential or actual engines of growth in many countries. And third, these nonlinear results between firm size and business constraints argue against targeted policies to small enterprises based on the notion that they are needed to level the playing field.

Another key finding of this work lies in the enormous variance in the nature and severity of different types of constraints across countries and regions. This points to the limited value of engaging in global generalizations regarding the severity of a particular constraints. It also suggests the importance of the need to unbundle generic clusters of constraints; for example, regulatory or governance constraints will always exhibit different manifestations and components, whose severity and effect will vary across countries—even where, on average, the generic constraint is rated similarly across such countries.

Furthermore, the country specific data, initial analysis, and findings emerging the WBES in this paper and other empirical work points to the value of monitoring the business environment indicators over time. The relationship shown between key WBES indicators and firm-level outcomes suggests that progress in these indicators should be associated with real improvements in enterprise performance over time. Thus, akin to this survey exercise implemented on a large international basis over a limited period of time, it would be highly advisable to repeat such initiative periodically, say every three years or so.

Implementation of the WBES suggests a few lessons. First, given that WBES was a multipartner venture, the need for optimal coordination by all partners on the core instrument and uniform implementation across countries would ensure reliability and comparability across many variables. Second, as the extensive use of country control variables and “perception-bias control” (or “kvetch,” see Section IV) suggest, it is important to account for inherent biases and measurement errors in any enterprise survey of this type, necessitating care in interpretation, use of control variables, and in assessing the investment climate, points to the need to complement survey results with other information as well. Experience with WBES also points to the value of complementing perceptual data with greater use of quantitative questions that evaluate constraints in terms of dollar equivalent amounts, time costs, percentages, etc., which would facilitate cross-country comparisons and provide a check on more ordinal values and perceptual responses.

Finally, in the next such survey of firms (starting in 2002 for some regions), it will be important to aim at a larger firm sample size in each country (to lower the measurement error, although the caveats regarding margins of error will always apply), and to maintain comparability with the approach taken during the implementation of the WBES 2000. This is particularly true for economy-wide sampling, replication of key core questions, and using a similar interview methodology to gather information on a firm’s response to the institutional and policy framework, as well as its potential influence on its environment. The WBES experience suggests the high value of parallel international enterprise surveys in generating insights into which policies and institutions contribute most to firm-level growth, investment, and employment; all key elements of a strategy for reducing poverty.

Voices of the Firms 2000:

Investment Climate and Governance Findings of the World Business Environment Survey (WBES)

Section 1: Background, Approach, and Sampling

A. Background

How can one assess and compare the environment for doing business in countries around the world? This is a challenge confronted by the World Bank Group and other international financial institutions and investors in their private sector development work and efforts to assess the investment climate. To encourage economic growth and poverty alleviation, it is important to assist countries in diagnosing where constraints to investment and business operation lie. Surveys provide not only a diagnostic tool, but also an important means of generating consensus around a credible, locally derived information source—that of entrepreneurs and managers who daily deal with the institutions, policies, and practices of the local business environment. Surveys also stimulate analysis and action by providing a comparative basis for examining local conditions and costs.

The World Business Environment Survey (WBES) represents a large-scale effort by the World Bank with partner institutions to implement a standard core enterprise survey using a uniform methodology and parallel parameters for sample structure to evaluate business conditions in a large, cross-regional set of member countries. It represents an important step toward unifying fragmented work to assess conditions for private investment as shaped by local economic policy; governance; regulatory, infrastructure, and financial impediments and services to businesses.

WBES is a World Bank initiative, which in partnership with other institutions, has sought to assess the state of the enabling environment for private enterprise in a large number of countries, by surveying a minimum of 100 firms per country. In the context of economic globalization, member countries are increasingly concerned with how conducive their business environment is to private investment (both foreign and domestic) and business development, the priorities for reform, and their relative standing in their region or globally. Unfortunately, few indicators allow objective measurement and comparison of the business environment, its binding constraints, the quality and integrity of supportive and regulatory public services, as well as benchmarking of the relative change in constraint severity and service quality over time.

The WBES team, beginning with substantial seed capital from the Innovations Marketplace, hoped to accomplish the following objectives:

- To provide feedback from enterprises on the state of the private sector in client countries;
- To measure the quality of governance and public services including the extent of corruption;
- To provide the Bank with better information on constraints to private sector growth, from the enterprise perspective;

- To sensitize client governments and Bank staff to the importance of listening to firms and using this information to critically assess policies;
- To establish the basis for internationally comparable indicators that can track changes in the business environment over time thus allowing both for competitive assessment and impact assessments of market-oriented reforms; and
- To stimulate systematic public-private dialogue on business perceptions and the agenda for reform.

WBES builds on a start made in the enterprise survey conducted for the *1997 World Development Report*. That survey effort, with varying sample sizes (as low as 15 enterprises in one country) and methodology (e.g., mail, phone and in-person), implemented a standard set of 25 questions in 67 countries. The WBES uses a number of those questions, but substantially broadens coverage on a number of issues, expands the sample and the number of countries covered, and harmonizes methodology across countries (using only direct interviews, except in Africa, where mail surveys predominated).⁶

B. Survey Approach

Before this exercise, consistent firm level data to analyze business constraints to efficient operation and growth were not available for a large number of countries. The WBES steering committee led an effort to generate the desired data from a representative sample of firms in the manufacturing and services sectors, beginning by developing a common core survey instrument for the WBES to be used in every region. The team worked in collaboration with its partners in different regions and countries to implement the survey and to develop regional modules that would capture in detail issues judged to be important to those regions. This paper, however, focuses on the findings from the common core questionnaire.

The survey instrument is broad in its coverage and includes a wealth of information on firm and business environment attributes (Annex 1). Firm-level attributes include information on firm size (employees, sales, and assets); years of operation; sales, debt and growth performance (trends); sources of finance; and a mix of qualitative and quantitative evaluations of such business environment features as corruption and governance, the regulatory regime, economic policy predictability, the nature of competition, public service delivery, the judicial system, financing, and general constraints to business operations.

The design of the sampling frame reflected several considerations. In general, the sample aimed to represent the relative importance of manufacturing vs. service and commercial firms in the economy. To ensure representative findings across countries, a sample frame was developed for most countries to reflect the distribution of privately owned companies in each country by sector, size (measured by number of employees), and location. In most developing and transition countries, commercially available databases are poor.⁷ Desk research was used by each consulting

⁶ For more information on the WDR 1997 survey, see Aymo Brunetti, Gregory Kisunko, and Beatrice Weder. *Institutional Obstacles to Doing Business: Region-by-Region Results from a Worldwide Survey of the Private Sector* (World Bank Research Working Paper 1759; 1997).

⁷ For example, Dun and Bradstreet and Kompass, which are very widely used for business survey sample in Western Europe and North America, have much poorer coverage in terms of both proportion of businesses they include and the level of information on each company.

firm to generate a suitable sample frame, the primary source being the government registers of enterprises, which are maintained by most of the countries under review.

To ensure adequate representation of firms by industry, size, ownership, export orientation, and location, the following targets were agreed upon across all regions for sampling.

- **Sectoral composition.** The number of manufacturing versus service companies were allocated according to their contribution to GDP, with a 15% minimum for each.
- **Size.** At least 15% of the sample was in the small category (fewer than 50 employees) and at least 15% in the large category (more than 500 employees).
- **Ownership.** At least 15% of the companies in the sample would be firms with foreign control (or where the law prohibits this, will have substantial foreign ownership).
- **Exporters.** At least 15% of firms would export at least 20% of their output.
- **Location.** At least 15% of firms would be located in small towns (with a working definition of a population of less than 50,000), or in the countrys ide.

The survey was implemented by the Gallup Organization in East Asia, Pakistan, Latin America, and OECD countries; by AC Nielsen in Eastern Europe and Turkey; by the Confederation of Indian Industries in India; by the Harvard Center for International Development in Africa; by the Egyptian Center for Economic Studies in Egypt; by Lidee Khmer in Cambodia; by the University of the Chamber of Commerce in Thailand; and by the Bangladesh export development project in Bangladesh.

Table 1.1: WBES Completed Surveys by Country

OECD W. Europe/N. America		Latin America & Caribbean		Eastern Europe & Central Asia		Middle East & Africa	
UK	100	Argentina	100	Albania	100	W. Bank Ghaza	93
France	100	Brazil	201	Armenia	125	Botswana	101
Germany	100	Chile	100	Azerbaijan	128	Cameroon	57
Spain	100	Belice	50	Belarus	125	CDI	97
Portugal	100	Bolivia	100	Bosnia-Herzegovina	110	Egypt	101
Italy	100	Colombia	101	Bulgaria	125	Etiopia	105
Sweden	100	Costa Rica	100	Croatia	127	Ghana	119
Canada	100	Dominican Rep.	111	Czech Republic	137	Kenya	113
USA	100	Ecuador	100	Estonia	132	Madagascar	116
		El Salvador	104	Georgia	129	Malawi	55
		Guatemala	106	Hungary	129	Namibia	95
East Asia		Haiti	103	Kazakhstan	127	Nigeria	93
China	101	Honduras	100	Kyrgyzstan	125	Senegal	124
Malaysia	100	Mexico	100	Lithuania	112	South Africa	121
Indonesia	100	Nicaragua	100	Moldova	125	Tanzania	83
Singapore	100	Panama	100	Poland	225	Tunisia	52
Philippines	100	Peru	100	Romania	125	Uganda	137
Thailand	422	Trinidad & Tobago	108	Russia	525	Zambia	84
Cambodia	326	Uruguay	101	Slovakia	129	Zimbabwe	129
		Venezuela	100	Slovenia	125		
South Asia				Turkey	100		
India	210			Ukraine	225		
Bangladesh	50			Uzbekistan	125		
Pakistan	103						

<i>Low Income</i>	<i>Middle Income</i>	<i>High Income</i>
Armenia	Albania	Bosnia
Azerbaijan	Argentina	Canada
Bangladesh	Belarus	France
Cambodia	Belize	Germany
Cameroon	Bolivia	Italy
China	Botswana	Portugal
Cote d'Ivoire	Brazil	Singapore
Ethiopia	Bulgaria	Slovenia
Ghana	Chile	Spain
Haiti	Colombia	Sweden
Honduras	Costa Rica	United Kingdom
India	Croatia	United States
Indonesia	Czech Republic	
	Dominican Republic	
Kenya	Ecuador	
Kyrgyzstan	Egypt	
Madagascar	El Salvador	
Malawi	Estonia	
Moldova	Georgia	
Nicaragua	Guatemala	
Nigeria	Hungary	
Pakistan	Kazakhstan	
Senegal	Lithuania	
Tanzania	Malaysia	
Uganda	Mexico	
Zambia	Namibia	
Zimbabwe	Panama	
	Peru	
	Phillipines	
	Poland	
	Romania	
	Russia	
	Slovakia	
	South Africa	
	Thailand	
	Trinidad	
	Tunisia	
	Turkey	
	Ukraine	
	Uruguay	
	Uzbekistan	
	Venezuela	
	West Bank/Ghaza	

with an almost equal proportion of small and medium enterprises. Large firms accounted for about 20% of the sample.

Survey enumeration was carried out over a period of roughly 1.5 years between the end of 1998 and the middle of 2000. Data were collected through personal interviews conducted with managers in enterprises in most regions, with the exception of Africa, where surveys by mail predominated. Response rates were generally high, with the exception being responses to questions on corruption. By region, response rates were among the lowest in Africa. All the analyses in this report are based on a sample of 10,090 enterprises that responded to the core questionnaire. The sample distribution, by country, generally met the minimum goal of 100 firms (see table 1.1).

C. Sample Characteristics as Realized

Table 1.2 presents the sample by country income. Using the classifications of *World Development Report 2000*, a third of the countries are categorized as low-income (per capita income of \$760 or less); half are middle-income countries (with per capita income of \$761–\$9,360), and a fifth of the sample are high-income countries with a per capita income of more than \$9,360. These differences across the economies are an important source of variation in the business environment in which these firms operate and influence firm performance. Another important source of variation is the differences that exist within each country; and across firms of different sizes, activities, and other characteristics. Both sources of variation are exploited in this report to highlight the key constraints facing businesses and their potential impact on growth and performance.

Table 1.3 presents the regional breakdown of firms by size and sector. Both small and medium enterprises (SMEs—those with 500 or fewer workers) and large firms (those with 501 or more employees), were sampled in the WBES, although as shown in table 1.3, SMEs comprised the clear majority of samples (80%),

Table 1.3: Distribution of Firms by Region, Size and Sector

	<i>Manufacturing</i>	<i>Services/ Commerce</i>	<i>Agriculture</i>	<i>Construction</i>	<i>Other</i>	<i>Total Firms</i>
Africa						
Small	16.7%	28.9%	5.7%	24.2%	24.4%	508
Medium	30.1%	26.8%	8.0%	16.3%	18.8%	485
Large	36.6%	25.4%	8.7%	14.0%	15.4%	358
Total	26.8%	27.2%	7.3%	18.7%	20.0%	1351
MENA						
Small	60.0%	20.0%	0.0%	8.9%	11.1%	45
Medium	31.6%	35.5%	6.6%	7.9%	18.4%	76
Large	31.0%	41.4%	8.6%	8.6%	10.3%	58
Total	38.5%	33.5%	5.6%	8.4%	14.0%	179
East Asia/NIC China						
Small	41.0%	49.3%	1.5%	8.2%	0.0%	134
Medium	55.1%	37.1%	1.1%	6.7%	0.0%	89
Large	53.8%	38.5%	0.0%	7.7%	0.0%	78
Total	48.5%	42.9%	1.0%	7.6%	0.0%	301
East Asia Dev						
Small	36.4%	54.5%	3.5%	5.6%	0.0%	536
Medium	48.7%	45.5%	1.1%	4.7%	0.0%	279
Large	68.8%	28.1%	3.1%	0.0%	0.0%	128
Total	44.4%	48.3%	2.8%	4.6%	0.0%	943
South Asia						
Small	50.0%	40.6%	0.9%	8.5%	0.0%	106
Medium	63.4%	22.6%	2.7%	11.3%	0.0%	186
Large	79.2%	12.3%	1.9%	6.6%	0.0%	106
Total	64.1%	24.6%	2.0%	9.3%	0.0%	398
Latin America						
Small	36.4%	53.6%	2.0%	8.1%	0.0%	459
Medium	45.1%	47.1%	1.5%	6.3%	0.0%	669
Large	53.4%	38.5%	3.5%	4.6%	0.0%	481
Total	45.1%	46.4%	2.2%	6.3%	0.0%	1609
OECD						
Small	21.7%	64.5%	1.3%	12.6%	0.0%	318
Medium	30.3%	60.2%	1.0%	8.2%	0.3%	389
Large	33.5%	63.5%	0.6%	2.4%	0.0%	167
Total	27.8%	62.4%	1.0%	8.7%	0.1%	874
CIS						
Small	20.8%	63.5%	4.4%	8.2%	3.1%	903
Medium	49.3%	34.7%	5.7%	6.6%	3.7%	683
Large	60.3%	27.0%	6.3%	5.2%	1.1%	174
Total	35.8%	48.7%	5.1%	7.3%	3.1%	1760
CEE						
Small	21.9%	60.6%	7.2%	9.9%	0.4%	718
Medium	29.2%	27.7%	30.2%	12.9%	0.1%	902
Large	54.3%	12.4%	28.7%	4.7%	0.0%	129
Total	28.0%	40.1%	20.6%	11.0%	0.2%	1749

Notes: 1. Eastern Europe: 1.72% of firms in the "Other" category are not included in the table. 2. Manufacturing includes electricity/gas/water and mining/quarrying. 3. Differences in administration of the survey in sub-Saharan and North Africa led to a large number of firms that could not be identified in the four main sector groups.

The differences in industry categories in the sample generally reflects the variations in national economies. Most common overall was the commerce/services category, which accounted for 43% of firms interviewed, followed by manufacturing (36% of firms), construction (9% of firms), agriculture (7% of firms),⁸ and “other” (3.87% of firms).

Consistent with regional sector contributions to GDP, Eastern Europe and OECD had a higher proportion of firms in the services sector, whereas South Asia had the highest proportion of firms in manufacturing. SMEs are also consistently less involved in manufacturing than large firms, and more involved in services and commerce. Differences in administration of the survey in sub-Saharan and North Africa led to a large category of firms that could not be identified in the four main sector groups.

One important caveat on all results reported in this paper is that they are unweighted. This has two implications. First, the views of enterprises in small countries in each region carry the same importance as those of the major countries in the region (unless the sample size in those countries happened to be larger). Second, the findings are skewed toward the larger enterprises in each country. Nevertheless, the findings are an accurate representation of the study sample in the light of the objectives of the WBES. However, the caution at the outset of this paper remains: given inherent error margins arising from small samples that are drawn in a targeted manner, individual indicators should not be used for precise country rankings in any particular dimension of the investment climate or governance.

Table 1.4 shows the main attributes of firms surveyed by region. On average, roughly a third of the firms are export-oriented, with an average export:sales ratio among exporters of 38%. Firms in Africa, MENA, and South Asia have a higher percentage of exporting firms, which account for almost half of the sample; in sharp contrast, the percentage of exporting firms is lowest in CEE countries, at 15%. However, the intensity of exports is highest in East Asian (developing) nations, where the average export:sales ratio is 64% and sharply higher than the other regions.

Firm ownership is mainly domestic and private. Twelve percent of firms reported having some state ownership. By region, this ranges from 20% in CIS and CEE countries (this was part of the sample design agreed with EBRD), to 2% in East Asia (developing), and 3% in Latin America. By region, 17.5% of firms in agriculture, 23% in manufacturing, but only 5% in commerce reported a degree of state ownership. In firms reporting some degree of state ownership, the extent of state ownership was, on average, about 70%. Twenty percent of firms in the sample reported having any foreign ownership. Among this subset, the average foreign share of capital is 67%. The samples in sub-Saharan Africa and developing East Asia have the highest percentage of firms with foreign ownership (30%), and the highest share of foreign capital among foreign-owned firms. South Asian firms had the lowest percentage of foreign ownership with foreign capital, at 33%.

On average, the youngest average sample age of firms was for those in Central and Eastern Europe (9.5 years). The oldest was in OECD nations (34.1 years).

⁸ Because, by design, farmers were not included in the sample, agriculture would include either agro-industry or commercial aspects of the industry. Many more agriculture firms appear in the Africa sample, where firms normally self-identified the sector rather than being guided by a trained surveyor.

Table 1.4: Trade, Ownership, and Age Characteristics

	<i>% Exporting Firms</i>	<i>If Export, % of Total Sales Exported</i>	<i>% of Firms with Foreign Ownership</i>	<i>If foreign owned, % of foreign ownership</i>	<i>% of Firms with State Ownership</i>	<i>If state owned, % of state ownership</i>	<i>Average Age</i>
Africa	52%	34.0	30%	80.8	10%	91.2	*
MENA	51%	42.5	13%	60.5	11%	72.9	*
East Asia/NIC China	40%	49.8	30%	67.1	11%	76.4	16.2
East Asia Dev	32%	64.3	25%	70.3	2%	60.1	12.7
South Asia (***)	57%	34.2	21%	33.1	15%	47.9	22.5
Latin America	33%	37.9	23%	69.8	3%	56.0	24.9
OECD	37%	28.8	23%	61.0	8%	55.3	34.1
CIS	42%	36.3	11%	58.2	24%	67.5	15.4
CEE	15%	29.1	5%	48.1	22%	67.7	9.5
Total	36%	37.9	19%	66.8	12%	68.2	18.7

*Exact age of firms in Africa and MENA not available. Instead, firms were grouped in three age categories.

*** India not included in category for % of firms with sales to public sector and % of sales to public sector.

<i>(% of Firms in Each Age Category)</i>	<i><5 years</i>	<i>5-15 years</i>	<i>>15 years</i>
Africa	20%	29%	51%
MENA	13%	39%	48%

Table 1.5: Legal Form

<i>(% of Firms in Each Category)</i>	<i>Single Proprietorship</i>	<i>Partnership</i>	<i>Cooperative</i>	<i>Corporation, privately-held</i>	<i>Corporation, listed on stock exchange</i>	<i>Other</i>
Africa	10%	11%	1%	45%	12%	21%
MENA	12%	28%	5%	41%	9%	5%
East Asia/NIC China	12%	11%	5%	48%	7%	16%
East Asia Dev	36%	18%	1%	39%	4%	1%
South Asia	17%	14%	3%	32%	25%	10%
Latin America	15%	23%	1%	17%	4%	40%
OECD	12%	12%	2%	36%	14%	24%
CIS	33%	24%	2%	27%	7%	6%
CEE	23%	20%	11%	26%	19%	1%
Total	20%	19%	3%	31%	10%	17%

The most common legal organization of firms interviewed was the privately held corporation, which accounts for an average of almost a third of all enterprises in each region (Table 1.5). This form was especially prevalent in the samples in MENA, MENA, China, and the newly industrialized nations of East Asia. In Latin America, other (unspecified) forms of organization and partnerships predominate. Single proprietorships were the second most common form of organization, representing a fifth of the enterprises surveyed, accounting for a third of the enterprises in East Asia, but only 10% of enterprises in Africa. Partnerships accounted for 19% of enterprises in total, including 28% of interviewed firms in MENA. Cooperatives were relatively uncommon, accounting for only 3% of those interviewed, and were most prevalent in CEE countries (11%).⁹

⁹ Cooperatives were most common in Belarus (40% of firms interviewed), Kyrgyzstan (24%), and Moldova (22%).

Table 1.6: Operations in Other Countries and Sales to the Public Sector

Region	% of Firms with Operations in Other Countries	% of Firms With Sales to Public Sector	% of Sales to Public Sector, if sell to Public Sector
Africa	32%	60%	.
MENA(**)	19%	53%	13%
East Asia/NIC China	28%	27%	41%
East Asia Dev	15%	38%	24%
South Asia (***)	23%	62%	25%
Latin America	25%	47%	18%
OECD	25%	42%	23%
CIS	12%	52%	27%
CEE	3%	55%	37%
Total	18%	50%	24%

As shown in Table 1.6, by region, an average of 18% of firms surveyed have holdings or operations in other countries. The highest incidence is found in Africa (32%)¹⁰; by contrast, developing countries in East Asia (15%), CIS (12%), and CEE (3%) are well below the sample average, with a higher proportion of firms operating almost exclusively within the country.

About half of all firms surveyed trade with the state sector. There is substantial variation by region and country, reflecting the varying economic power of the state and the nature of the firms surveyed within countries in a region. The proportion is highest in South Asia (62%) and Africa (60%). Although the lowest incidence is in East Asian newly industrialized countries (27%), the proportion of sales to the state sector is highest in this region (41%). On average, the state sector represents 24% of sales to those firms trading with it. The proportion is lowest in MENA (13%) and Latin America (18%).

¹⁰ Since much of the Africa sample was based on a mail response, this may in part reflect self-selection bias in responses.

Section II: Business Environment Constraints

A. Leading Constraints to Business Operation and Growth

Table 2.1 presents the responses for the world and by region to the question, “Please judge on a four-point scale how problematic the following factors are for the operation and growth of your firm.” Focusing on a simple average for the overall world sample, the following constraints stand out: taxes and regulations, financing, policy uncertainty/instability, and inflation. Yet such worldwide average results mask crucial differences across regions, and particularly between industrialized and developing countries. Although the main obstacles identified in OECD and newly industrialized Asian nations were indeed financing, policy instability, and inflation—and taxes and regulations in OECD nations—for developing countries, clearly the largest constraint is corruption, followed by inflation, financing, policy instability and infrastructure.

Table 2.1: General Constraints to Enterprises

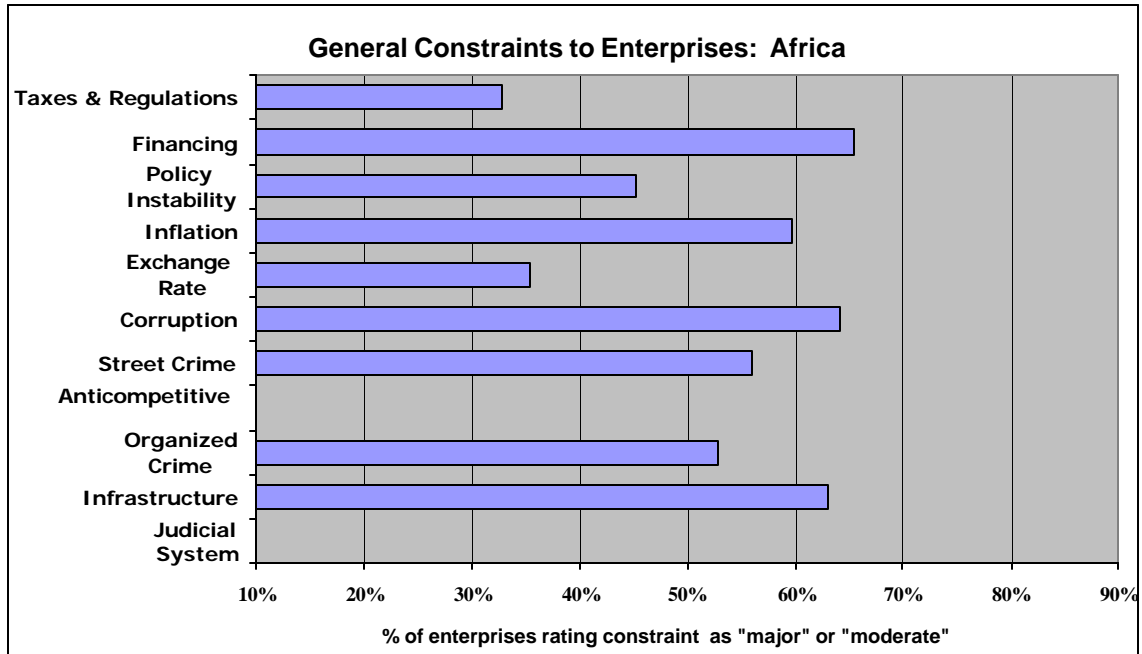
	Africa	MENA	East Asia NIC/China	East Asia Developing	South Asia	Latin America	OECD	CIS	CEE	Total	OECD & NIC	CEE & CIS	Developing countries
Taxes and regulation	33%	54%	20%	58%	56%	73%	62%	77%	85%	70%	53%	81%	51%
Financing	66%	50%	51%	53%	62%	64%	39%	68%	78%	64%	43%	73%	60%
Policy Instability	45%	69%	26%	72%	72%	70%	37%	64%	73%	62%	37%	69%	58%
Inflation	60%	56%	31%	67%	68%	63%	33%	58%	85%	62%	37%	72%	61%
Exchange Rate	35%	55%	25%	67%	55%	63%	25%	43%	70%	52%	30%	57%	47%
Corruption	64%	66%	20%	69%	72%	58%	17%	47%	51%	51%	23%	49%	66%
Street Crime	56%	43%	14%	74%	43%	66%	22%	41%	48%	50%	24%	44%	57%
Anti competitive Practices	N.A.	54%	29%	58%	57%	48%	31%	42%	51%	46%	33%	47%	56%
Organized Crime	53%	26%	15%	67%	39%	51%	13%	36%	45%	42%	17%	41%	53%
Infrastructure	63%	42%	21%	51%	67%	46%	22%	35%	33%	41%	25%	34%	58%
Judicial System	N.A.	43%	15%	32%	39%	45%	21%	40%	28%	35%	21%	34%	35%

% of enterprises rating constraint “major” or “moderate” as opposed to “no obstacle” or “minor”

Between individual regions, significant differences exist in the severity of constraints as well. The large variance across regions (and countries) in the relative severity of constraints as rated by firms points to the importance of assessing the results by region and country, rather than relying on worldwide averages. Consequently, the following section concentrates on more detailed regional patterns, which vary distinctly.

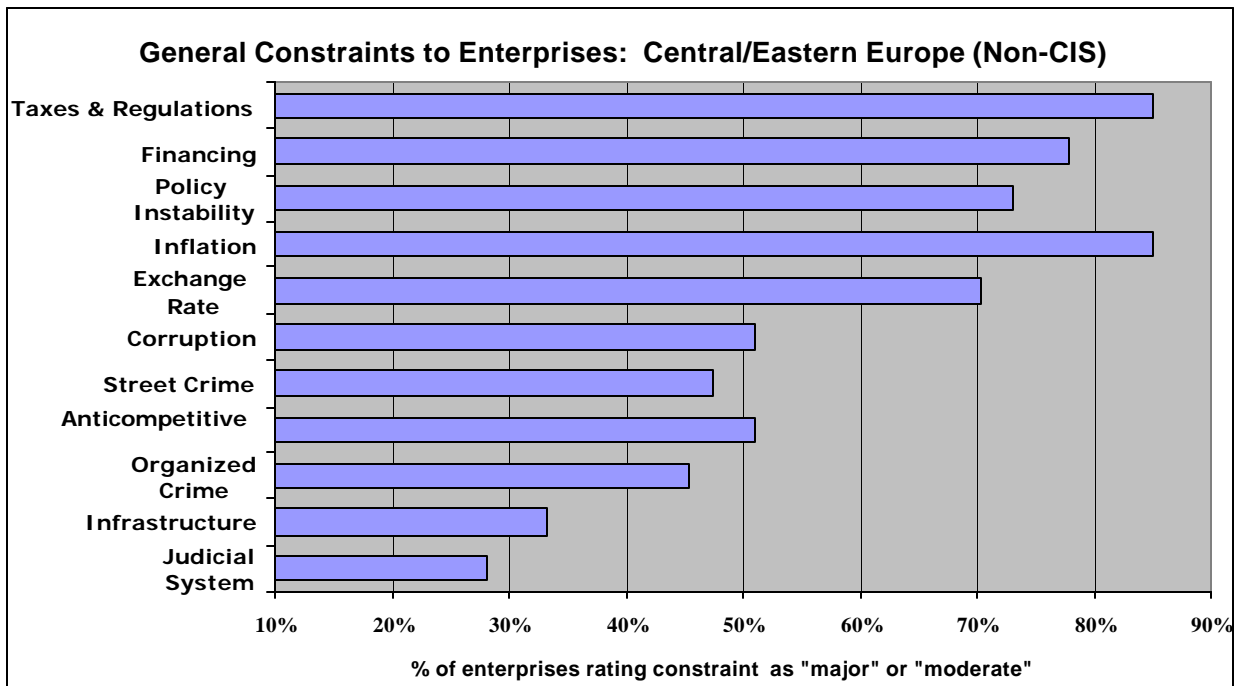
- In **Africa** (where the constraints of the judicial system and anticompetitive practices were not evaluated in parallel to other general constraints), financing, corruption, infrastructure, and inflation were evaluated by 60% or more of firms as moderate or major.

Figure 2.1: General Constraints to Enterprises: Africa



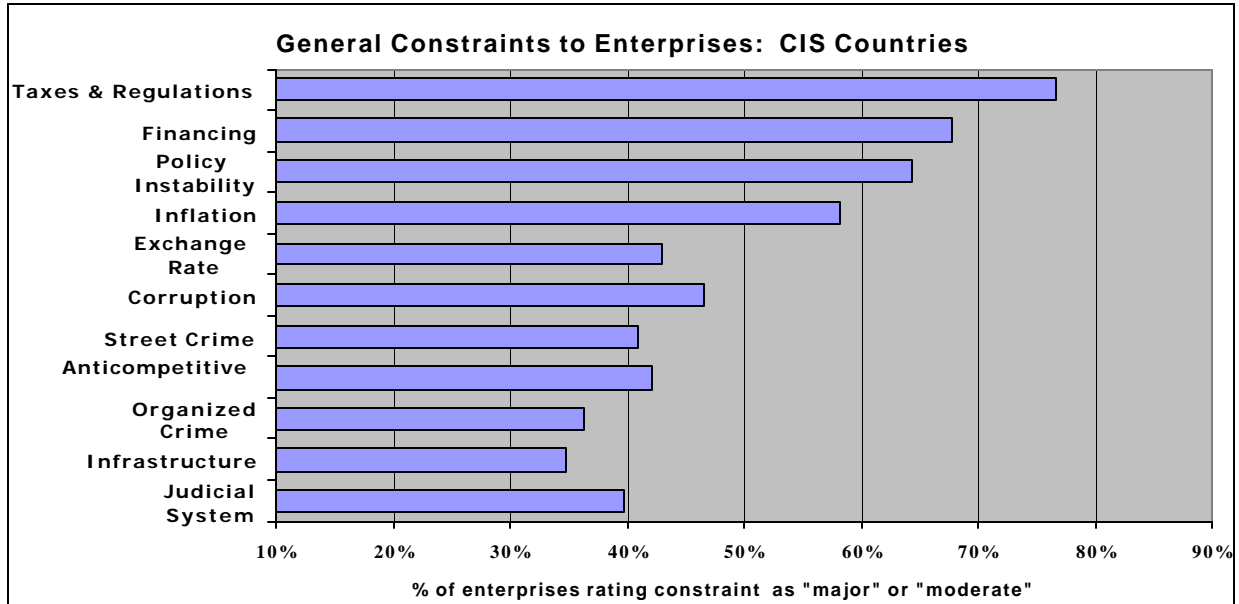
- In **Central and Eastern Europe**, taxes and regulations and inflation were judged to be the leading constraints, each of which was evaluated by at least 70% of firms as moderate or major. At least 60% of firms identified financing, policy uncertainty/instability, and the exchange rate as serious constraints. Taxes and regulations were unusually not constraining to most firms.

Figure 2.2: General Constraints to Enterprises: Central/Eastern Europe (Non-CIS)



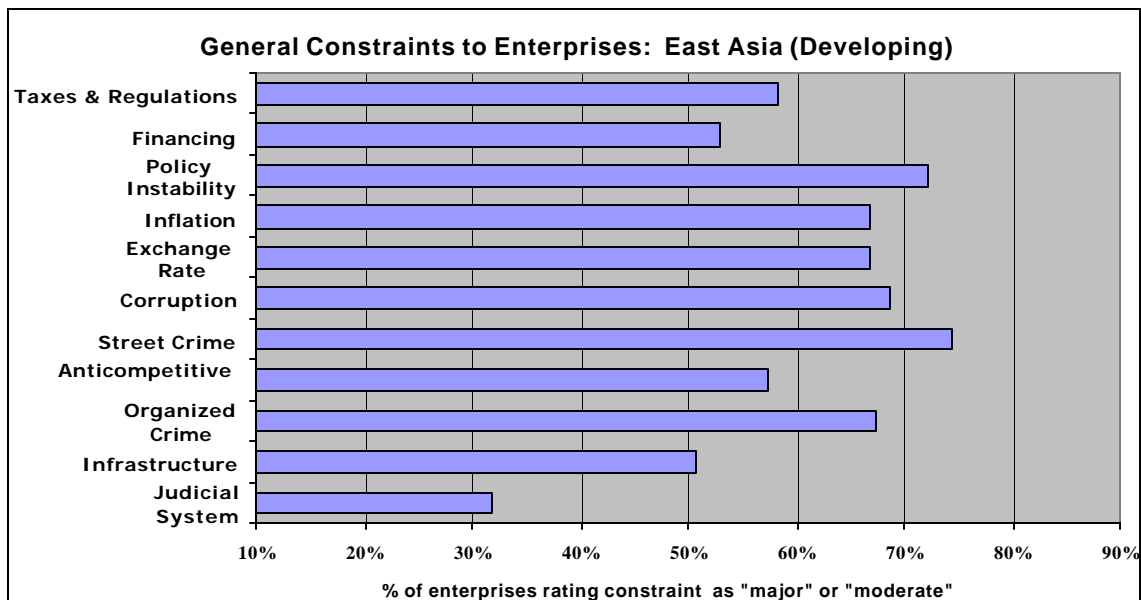
- For the **CIS countries** (former Soviet Union), taxes and regulations led all other constraints, identified by more than three-quarters of firms as serious. Financing and policy instability were serious constraints for at least 60% of firms, and inflation followed close behind.

Figure 2.3: General Constraints to Enterprises: CIS Countries



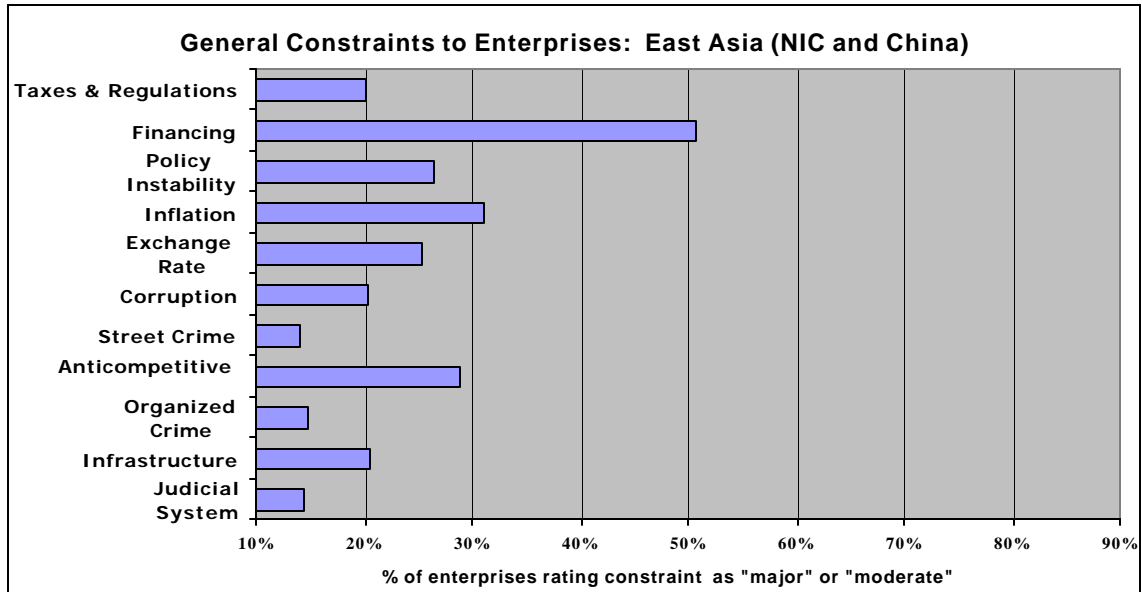
- **East Asian developing** countries stand out in having the highest number of constraints identified as moderate or major by more than half the firms—10 of 11. The leading constraints were street crime and policy instability, each identified by more than 70% of firms as serious, while more than 60% find corruption, organized crime, inflation, and the exchange rate to be serious constraints.

Figure 2.4: General Constraints to Enterprises: East Asia (Developing)



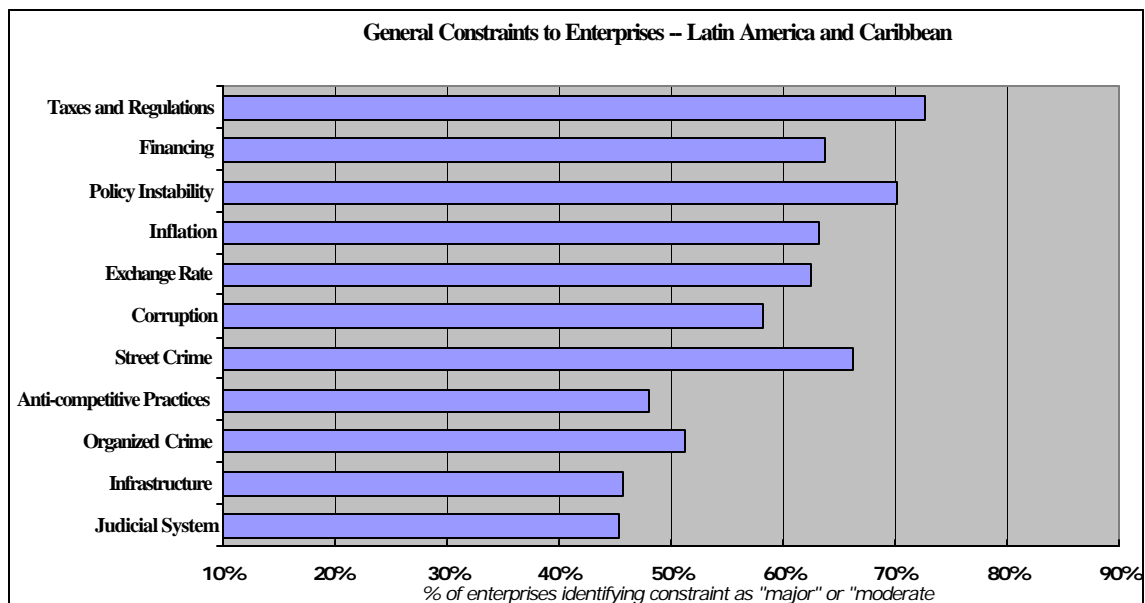
- In newly industrialized Asia and China, only financing was identified by more than half the firms as a moderate or major constraint. Not more than 31% of firms identified any other constraint as serious.

Figure 2.5: General Constraints to Enterprises: East Asia (NIC and China)



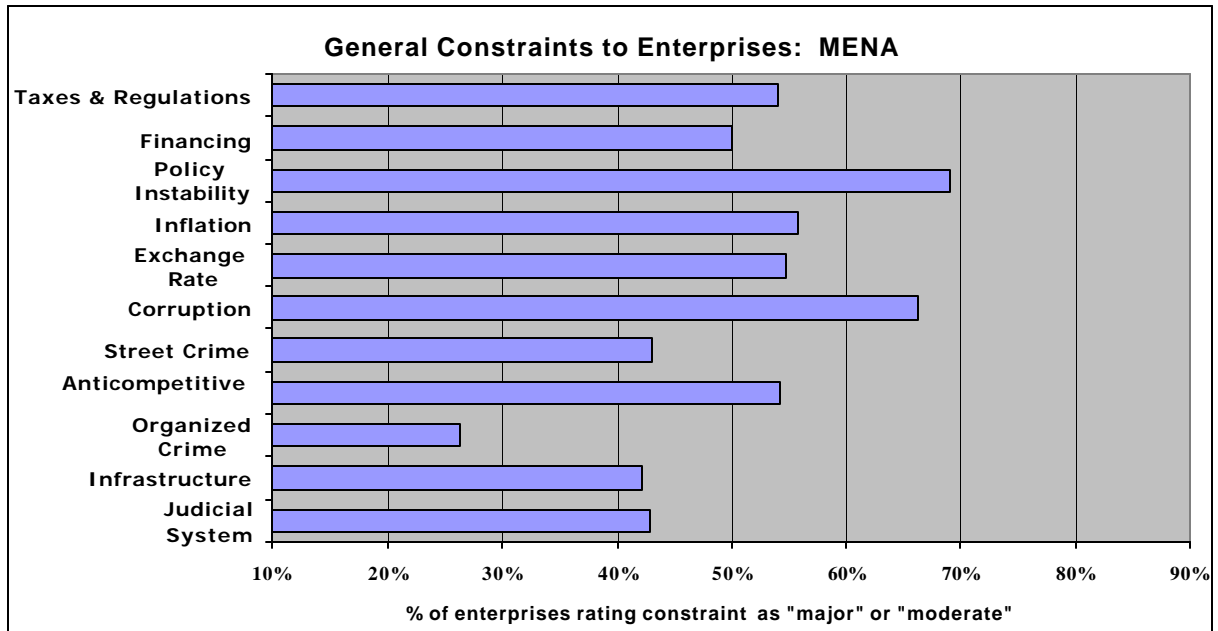
- In Latin America, 70% of firms identified taxes and regulations and policy uncertainty/instability as serious concerns, whereas more than 60% found street crime, financing, inflation, and the exchange rate to be moderate or major constraints. Nearly 60% found corruption seriously constraining.

Figure 2.6: General Constraints to Enterprises: Latin America and Caribbean



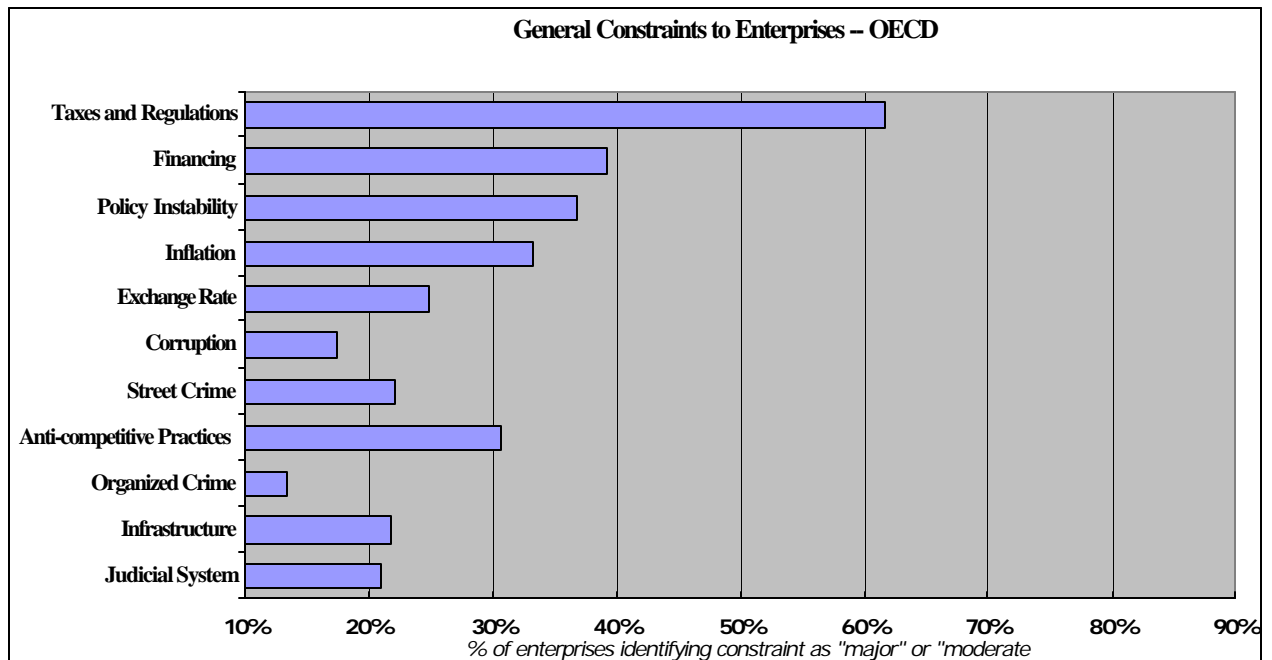
- In the **Middle East/North Africa** region, more than 65% of surveyed firms found policy uncertainty/instability and corruption to be serious constraints. More than half the firms identified taxes and regulations, inflation, the exchange rate, and anticompetitive practices as moderate or major constraints.

Figure 2.7: General Constraints to Enterprises: Middle East/North Africa



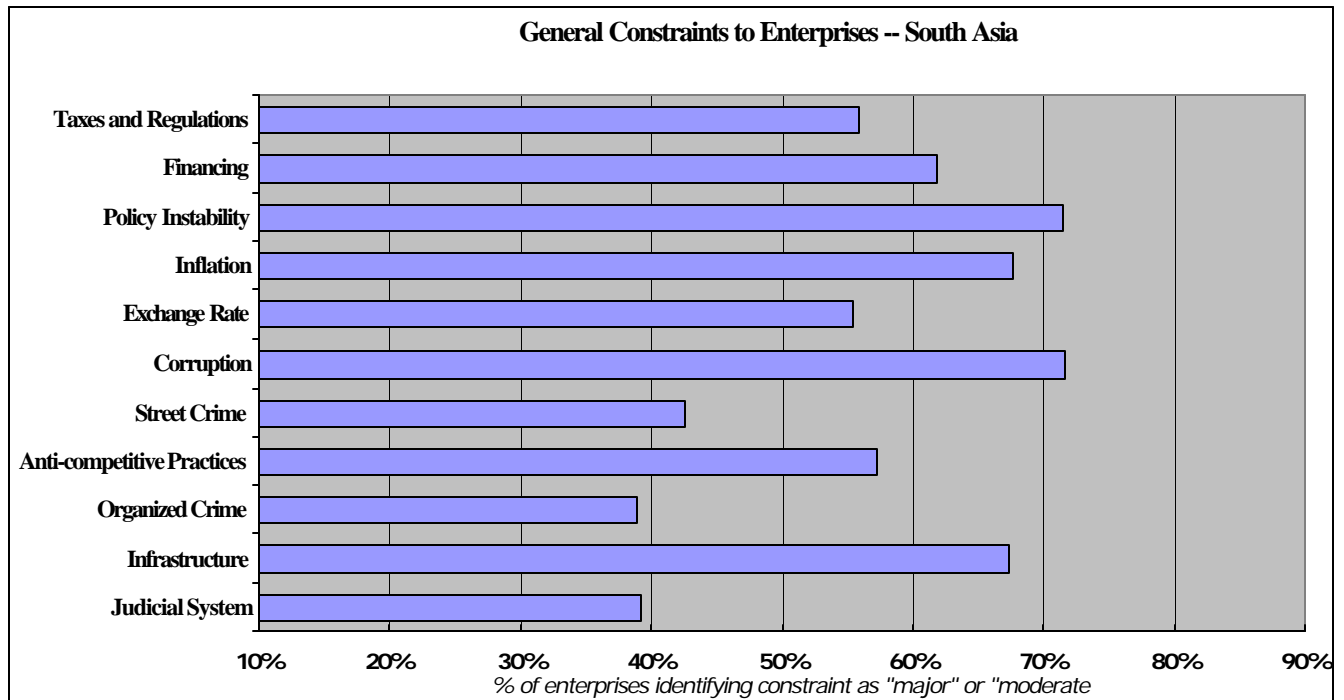
- Firms in **OECD** nations identified only one leading constraint, taxes and regulations, singled out by more than 60% of firms as serious. No more than 40% of firms identified any other constraint as moderate or major.

Figure 2.7: General Constraints to Enterprises: OECD



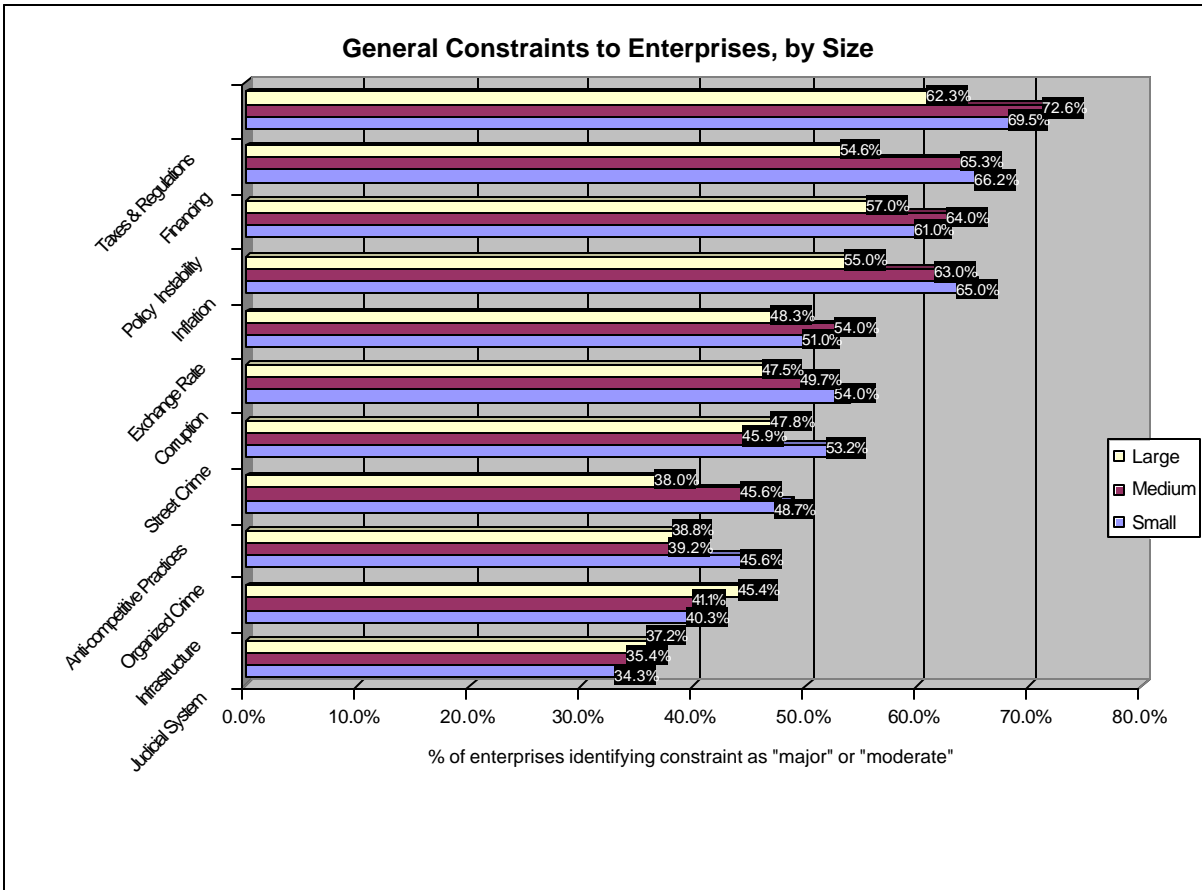
- In **South Asia**, policy uncertainty/instability and corruption led all other constraints, and was identified by 72% of firms as a serious constraint. More than 60% of firms identified financing, inflation, and infrastructure as serious constraints.

Figure 2.8: General Constraints to Enterprises: South Asia



For most categories of obstacles, small and medium enterprises identify themselves as more constrained than are large firms (see figure below). For the top two constraints, taxes and regulations and financing, a substantially higher percentage of SMEs than large enterprises rate these as serious constraints. Large differences also exist in perceptions of the constraints inflation and anticompetitive practices by other businesses or government, with a substantially smaller percentage of large firms identifying themselves as seriously constrained. For a subset of rule of law issues—corruption, street crime, and organized crime—small firms distinguish themselves from medium and large firms as being as more constrained. Only in infrastructure are large firms significantly more constrained in terms of the percentage of firms identifying this constraint as moderate or major.

Figure 2.9: General Constraints to Enterprises, by Size



Box 2.1: Do perceptions differ among foreign-owned firms?

How do firms with foreign capital perceive constraints differently from domestic firms? A recent analysis of average constraint scores suggests that on a global scale, foreign-owned and joint-venture firms identify themselves as less severely constrained than do domestically owned firms, except in infrastructure, for which foreign firms identify themselves as more constrained. However, within regions, many of these differences by ownership do not hold, except in Latin America and the transition economies of Europe (CEE plus CIS). The main exception is financing, where in every region, firms with foreign capital identify themselves as less constrained. The regression analysis presented in Section 4, however, suggests that most of these apparent differences in firm experience can be attributed to firm characteristics other than ownership.

	Global	Africa	L. America	E. Asia	T.Europe	OECD
Financing	LC	LC	LC	LC	LC	LC
Taxes & Regulations	LC		LC		LC	
Inflation	LC	LC		LC	LC	N *
Policy Instability	LC		LC		LC	N *
Anti-competitive Practices	LC	-	LC		LC	
Infrastructure	MC			N *		
Street Crime	LC		LC		LC	LC
Exchange Rate	LC	N *		N *		MC
Organized crime	LC	N *	LC		LC	
Corruption	LC		LC			
Judicial System		-				

Perceptions of General Constraints -- Foreign versus Domestic Firms

LC indicates those constraints for which the pooled sample of foreign firms is significantly less constrained than domestic firms. MC indicates that the pooled foreign sample is more constrained. N* indicates those factors, for which a significant difference in constraint score exists between domestic firms and either JV or wholly-owned foreign firms, but not with the pooled sample. If a factor is not marked with LC, MC, or N*, then no significant difference exists in mean score between domestic and foreign firms.

Source: Nithya Nagarajan et al. *Perceptions of the Investment Climate: Foreign vs. Domestic Investors* (FIAS: Unpublished Paper, 2001).

B. Major Constraints in Detail

The following sections examine each category of constraint in terms of the responses by region and firm size. In select cases, we also note differences between foreign and domestically financed firms. Each section then describes responses to detailed questions on that category of constraint.

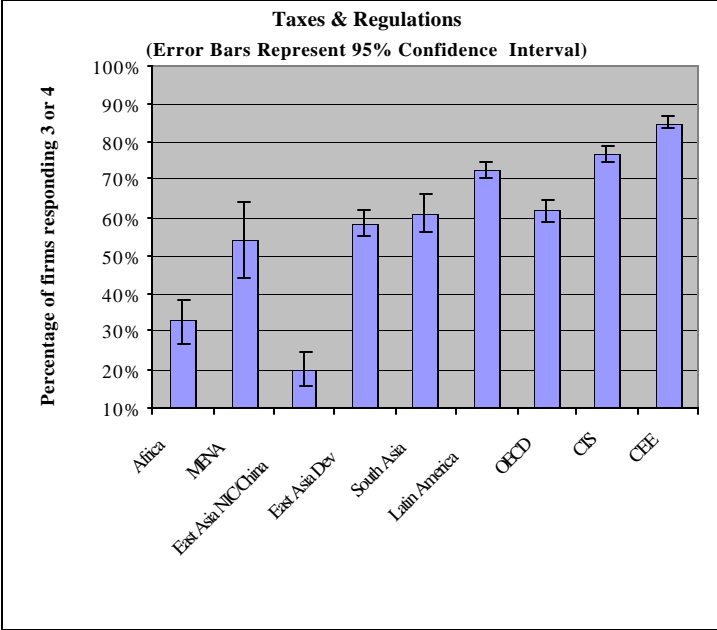
B.1 Taxes and Regulations

Inappropriately designed or administered tax and regulatory systems can substantially reduce a firm's ability to compete internationally, distort investment decisions, or deter investment entirely. Taxes and regulations are an important source of both direct and indirect costs for firms. Firms may identify regulations as burdensome for a variety of reasons: they may impose direct costs (e.g., formal and informal payments, facilitation costs, expenditures of staff time) or indirect costs (e.g., the inefficient allocation of firm resources in response to the incentives created by regulation and regulatory enforcement).

Figure 2.10 shows that a higher percentage of firms in the transitional economies of Central Europe and CIS find taxes and administration to be a serious constraint (a major or moderate

constraint). Close behind are firms in the Latin America/Caribbean region. In most other regions, more than half the firms found this category to be a serious constraint.

Figure 2.10: Taxes & Regulations



Conversely, only 4 in 10 firms surveyed in Africa found this to be a serious general constraint, and in the newly industrialized countries of East Asia (including China), only 20% found this category to be a serious constraint. As noted above, although the taxes and regulations category pose the leading constraint category for firms of each size group, a significantly lower percentage of large firms finds it to be a moderate or major constraint.

Figure 2.11: Taxes & Regulations

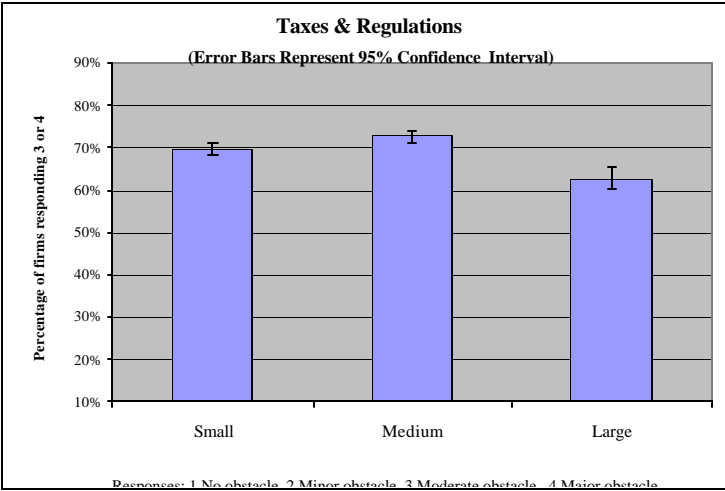
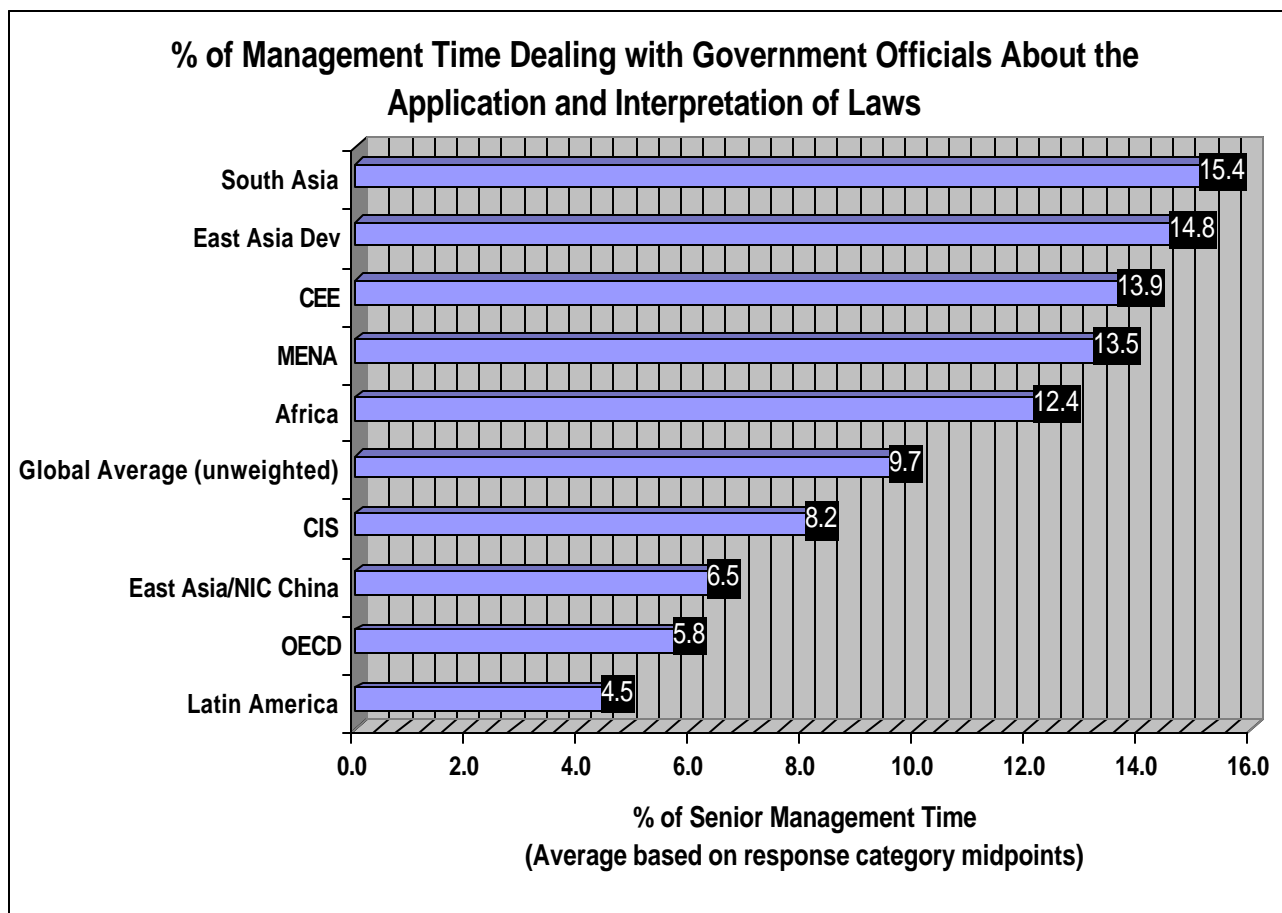


Figure 2.12: Percent of Management Time Dealing with Government Officials About the Application and Interpretation of Laws



One key dimension of regulatory compliance cost is staff time lost in addressing formal requirements and interacting with officials (Figure 2.12). WBES provides one measure of the time cost of regulatory compliance through its evaluation of time spent by senior managers who must work with government officials on the application and interpretation of laws and regulations. In this regard, firms in South Asia and developing East Asia have the highest costs, with an average of around 15% of senior management time spent dealing with public officials. Central and Eastern European firms rate close behind, with an average of 13%. Firms in MENA lose more than 12% of their time to officials, and for African firms, this figure is 11%. Firms in CIS claim to spend only about 8% of their time working with officials, firms in the newly industrialized countries of East Asia spend 6% of their time doing so, firms in OECD countries spend more than 5% of their time, and firms in the LAC region (the least burdened in this regard) spend just over 4% of their time doing so. Time lost to regulatory compliance means firms in poor investment climates must either operate with 10% less management time or, it may mean that larger firms must hire more managers.

Regulatory quality can be evaluated in other terms as well, including the transparency and predictability of rules and the fairness and consistency of their implementation. Firms rated the predictability of policies, laws, and regulations affecting them on a six-point scale ranging from “completely predictable” to “completely unpredictable.” The majority of firms in seven of nine

regions said that laws and regulations were somewhat unpredictable, whereas in Africa, CEE, and CIS, at least two-thirds of firms said that laws and regulations were unpredictable (these results are elaborated in the policy uncertainty section below).

Table 2.2: Potential Regulatory Constraints

	Latin America			East Asia			South Asia		East Asia
	CEE	America	CIS	Africa	Dev	OECD	Asia	MENA	NIC/China
High taxes	89.8%	82.9%	82.6%	76.2%	74.5%	72.3%	71.6%	53.6%	39.3%
Tax Administ'n & Reg'n	74.5%	62.5%	65.2%	59.3%	54.6%	59.0%	52.2%	50.8%	20.9%
Customs/ Trade Reg'	36.3%	55.9%	32.0%	48.6%	36.0%	28.0%	58.9%	44.3%	20.3%
Labor Reg'n	18.2%	52.5%	33.7%	38.0%	35.2%	47.7%	60.0%	32.6%	27.4%
Business Registra-tion	38.3%	55.3%	23.4%	25.5%	27.7%	32.4%	40.2%	25.9%	21.6%
Environ-ment	26.4%	37.2%	28.1%	21.7%	29.4%	37.8%	43.7%	24.1%	17.1%
Foreign Exchange/ Currency	29.8%	33.1%	20.9%	36.1%	35.2%	19.1%	40.5%	26.1%	17.8%
Fire/ Safety Reg'n	22.1%	28.5%	21.6%	15.9%	29.4%	29.8%	27.4%	21.6%	12.2%

The WBES asked firms to evaluate the severity of a list of potential regulatory constraints. In every region, the issue of high taxes topped this list (Table 2.2). Because taxes are generally an unavoidable and significant cost of doing business, it is not surprising that most businesses believe that taxes are too high. Firms in Latin America, Central and Eastern Europe, and the Commonwealth of Independent States were most likely to feel constrained; between 80% and 90% of firms in each region found that high taxes were a serious constraint.

In Africa, South Asia, and OECD nations, more than 70% of firms found that high taxes were a serious constraint, whereas a slight majority of firms in MENA identified this to be so. It is noteworthy that the majority of firms in newly industrialized East Asia did not identify high taxes as a serious constraint, and more generally, said they were not seriously constrained by any category of regulation.

Independent of the direct cost of tax payments, **tax administration** can impose additional costs on firms. Tax administration is a moderate or major constraint for more than 70% of firms in Central and Eastern Europe; for 65% of firms in CIS countries; for 63% of firms in Latin America; 59% of firms in Africa and OECD nations; and for more than 50% of firms in South Asia, developing East Asia, and MENA. East Asian industrialized countries are remarkably unconstrained—only 21% of firms rate tax administration as a serious constraint. As with high taxes, large firms are significantly, although not substantially, less constrained than SMEs.

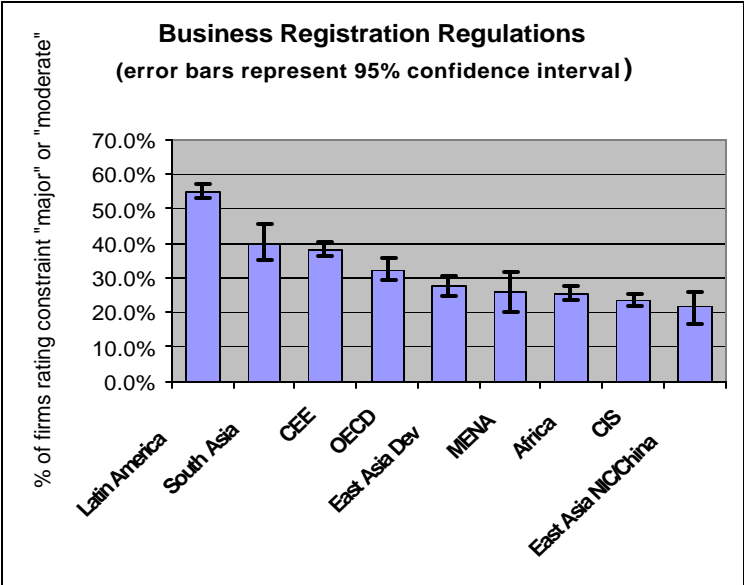
Customs procedures and trade regulations impose serious constraints for more than half of all firms in Latin America and South Asia and 44% of firms in the MENA region. More than a third of firms in developing East Asia and the CEE region rated this as a serious constraint. Small enterprises are significantly less constrained by customs and trade regulations than are large and medium-sized firms.

The average waiting time for goods to be processed through ports and customs varies substantially, ranging from around 2 days in OECD nations, East Asia, and China (a firm's median wait is generally less than half a day), to more than 9 days in Central and Eastern Europe (a median of 5 days), 11 days in South Asia (a median of 7 days), and more than 16 days in Africa (a median of 10 days). These estimates exclude outliers, or processes that take more than 90 days.

The degree of constraint imposed by **labor regulations** varies sharply by region. About 60% of South Asian firms and 50% of those in Latin America find that labor relations are a major or moderate constraint. Nearly half the firms in OECD nations say they are a serious constraint, yet only 27% of firms in East Asia and only 18% in Central and Eastern Europe find that labor relations are a serious constraint to business. Larger firms are significantly more constrained than medium-sized firms, and medium-sized firms are significantly more constrained than small firms. Many countries have explicit size thresholds at which labor regulations must be applied, which helps explain this pattern.

Business registration is a larger constraint to Latin American firms than it is to firms in other regions. Figure 2.13 shows that in Latin America, 55% of firms identify registration procedures as a serious constraint to their business, and in Central and Eastern Europe and South Asia, this number is 35%. Because registration procedures are often perceived as an entry barrier to small firms, it is interesting that virtually no difference exists in the responses of firms by size, with a slightly higher percentage of large firms finding business registration to be a constraint serious.

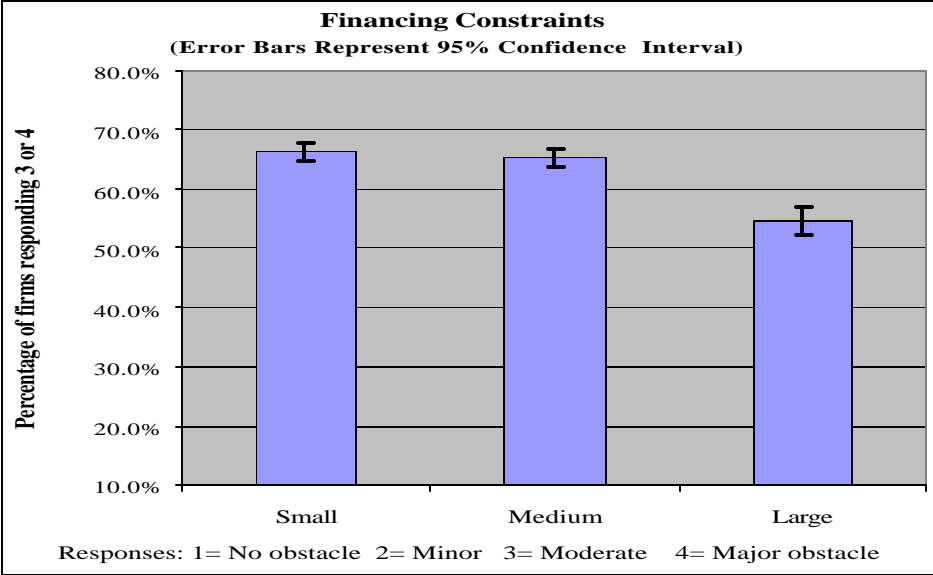
Figure 2.13: Business Registration Regulations



B.2 Finance

The second leading constraint for all firms is financing. Firms in Central and Eastern Europe are most likely to identify financing as a serious constraint, followed by those in CIS countries, and then those in Africa, South Asia, and Latin America. It is not surprising that whereas at least 50% of firms in all developing regions cited financing as a serious constraint, only 40% of firms in OECD countries found it to be so.

Figure 2.14: Financing Constraints



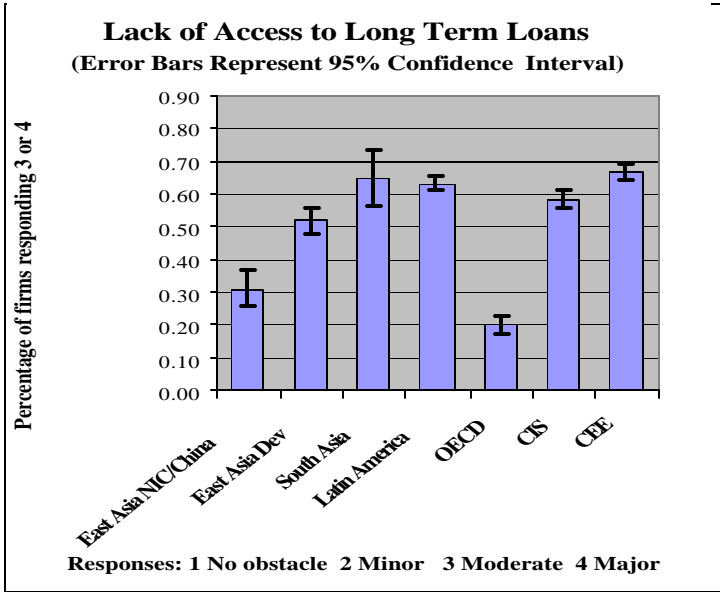
Whereas financing is the second leading constraint to small and medium enterprises in the survey, it is only the fourth leading constraint to large enterprises. Nevertheless, more than 50% of large firms identify financing as a major or moderate problem in their business.

Table 2.3: Financing Constraints

Financing Constraints	Africa	MENA	East Africa NIC/China	East Asia Developing	South Asia	Latin America	OECD	CIS	CEE
High interest rates	83.5%	67.4%	40.3%	72.5%	83.9%	87.6%	47.8%	80.6%	79.5%
Lack access to long term loan	n.a.	n.a.	31.2%	52.0%	65.1%	63.1%	20.0%	58.7%	67.0%
Collateral requirements	51.9%	45.2%	30.1%	43.6%	58.5%	65.1%	35.7%	49.7%	52.2%
Bank paperwork	47.1%	51.6%	29.9%	34.6%	56.6%	63.0%	38.9%	52.9%	48.3%
Inadequate credit info on clients	51.7%	46.3%	27.0%	48.4%	46.7%	46.1%	23.5%	40.1%	41.6%
Special connections	38.2%	33.3%	26.3%	39.6%	44.5%	46.5%	26.5%	35.1%	43.1%
Banks lack money to lend	28.4%	33.0%	20.6%	52.2%	35.1%	39.1%	14.3%	37.4%	46.8%
Access to specialized export finance	44.9%	39.8%	15.1%	33.7%	36.4%	34.7%	16.5%	35.5%	38.8%
Access to non-bank equity	43.1%	36.2%	13.0%	32.6%	34.9%	35.6%	18.1%	38.3%	42.0%
Access to lease finance	38.2%	29.3%	13.1%	34.9%	32.9%	34.1%	19.3%	32.7%	48.9%
Access to foreign banks	43.6%	29.3%	11.7%	41.5%	33.9%	35.0%	11.1%	35.3%	40.4%
Corruption	23.5%	27.4%	19.0%	45.1%	28.9%	18.6%	5.7%	24.3%	29.9%

High interest rates are a leading financial constraint across all regions, however, it is noteworthy that the majority of firms in industrialized East Asia, China, and OECD nations do not identify this as a serious constraint. This contrasts sharply with Latin America, where 88% of respondents identify interest rates as a leading constraint, as do 84% in South Asia and Africa, 81% in CIS, and 80% in CEE. There was no significant difference between small, medium, and large firms on this issue.

Figure 2.15: Lack of Access to Long Term Loans

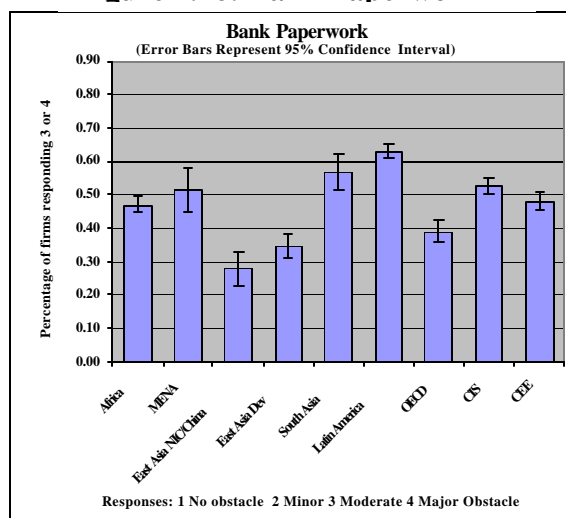


Access to long-term credit poses the next leading constraint, which was rated serious by more than half of all responding firms (this question was not posed in Africa and parts of the MENA region). This problem appears to affect a high percentage of firms in South Asia; at least 60% of firms in Central and Eastern Europe, South Asia, and Latin America; and more than 50% of firms in CIS and developing East Asia. Half the large firms said that finding long-term credit is a serious problem, whereas 56% of medium-sized firms and 58% of small firms found it to be a serious problem.

Collateral requirements impose a serious obstacle for 65% of Latin American respondents; 59% of South Asian respondents; and roughly half of those in Africa, Central and Eastern Europe, and CIS countries. In sharp contrast, only 30% of respondents in China and the newly industrialized countries of East Asia find that collateral requirements are a major or moderate constraint. As one might expect, this is a more serious issue for smaller enterprises than it is for larger ones; 55% of small firms and 51% of medium-sized firms rated this constraint as serious, whereas only 46% of large firms did so.

Bank paperwork imposes the next leading constraint, identified by around 47% of all responding firms as a major or moderate constraint. In Latin America, more than 60% of enterprises find bank paperwork to be a serious constraint, as do more than 50% of firms in South Asia, CIS, and the MENA region, with a slightly smaller percentage in CEE and Africa. Again, newly industrialized East Asia and China stand apart, with only 28% of firms saying that paperwork is a serious constraint. Even in developing East Asia, this constraint is considered to be major or moderate by only 35% of firms. A general pattern is that the smaller the firm, the more likely it is to find bank paperwork to be a business constraint.

Figure 2.16: Bank Paperwork



Lack of credit information on customers was identified as a serious constraint by more than 40% of respondents in the global sample. In Africa, this is considered a major or moderate constraint by more than 50% of firms, whereas in all other regions except OECD countries, China, and East Asia at least 40% of firms identify it as a serious constraint. Small firms are more likely to rate the lack of adequate credit information on clients as a serious constraint than do medium-sized firms, and medium-sized firms are more likely to do so than large firms.

Sources of finance vary markedly by region and firm size (Table 2.4). The WBES offered 11 possible sources of “fixed investment” financing and asked firms to estimate the percentage of financing from each source. However, in Africa and parts of the MENA region, the question was unfortunately posed differently in order to capture the leading sources of finance, rather than the amount of finance from each source.

Table 2.4: Sources of Finance (by region)

	<i>East Asia NIC/China</i>	<i>East Asia Dev</i>	<i>South Asia</i>	<i>Latin America</i>	<i>OECD</i>	<i>CIS</i>	<i>CEE</i>
Internal funds/ Retained Earnings	48.3	33.9	26.5	43.2	39.1	53.9	70.5
Local commercial banks	11.6	15.7	18.5	19.8	14.6	11.4	4.8
Family/Friends	3.3	9.9	6.3	4.3	2.3	8.6	7.3
Supplier Credit	7.9	3.2	2.5	10.2	4.8	4.6	5.8
Equity, sale of stock	5.8	2.7	6.4	3.2	8.5	8.6	1.4
Other State Sources	0.6	0.4	0.8	0.9	2.0	4.6	7.4
Foreign Banks	3.3	4.8	2.6	4.0	1.5	2.1	0.6
Leasing Arrangement	2.1	0.7	1.3	1.3	3.3	3.6	2.6
Other	1.1	1.8	5.5	2.9	1.5	1.4	1.4
Investment Funds/ Special Development Finance	2.6	1.2	4.4	2.2	2.3	1.7	1.3
Moneylenders	2.9	1.7	1.1	1.1	2.3	2.5	1.6

Internal funds and retained earnings provided the leading source of financing in all regions. In South Asia and Latin America, domestic commercial banks provide close to 20% of investment finance, and in developing East Asia and OECD nations, this figure is around 15%. According to respondents, only in Central and Eastern Europe did local banks fail to provide more than 10% of total investment finance. Family and friends were especially important in developing East Asia and CIS countries, accounting for an average of 10% and 9%, respectively, of investment financing. Supplier credit was a relatively important issue in Latin America, East Asia, and China. Equity of sale of stock provides an average of more than 5% of finance in CIS countries (perhaps because of the inclusion of privatized firms in the sample), OECD countries, South Asia, East Asia, and China. “Other state sources” (meaning other than public investment funds or development finance funds) were important only in CEE and CIS countries.

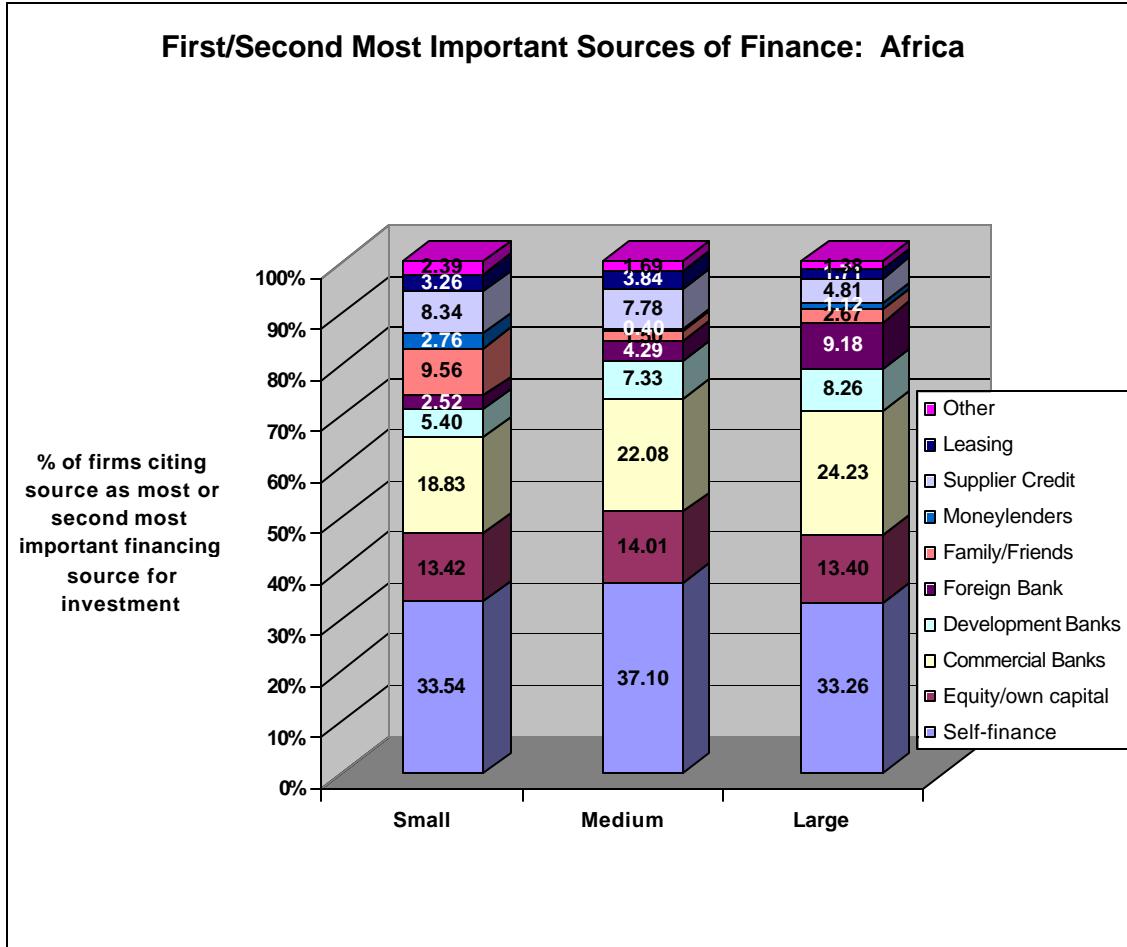
By size, SMEs in the sample rely less on commercial and foreign banks for investment finance than do large firms, and they depend more on internal funds and retained earnings. Small firms get less state support than do medium and large firms, but they receive much more financing from family and friends. (Table 2.5)

Table 2.5: Sources of Finance (by firm size)

	Small	Medium	Large
Money Lenders	2.37	1.44	0.98
Other	1.50	1.77	3.50
Inv. Funds/Special Dev. Finance	1.20	2.24	2.70
Leasing Arrangement	2.03	2.60	1.82
Foreign Banks	0.71	2.78	6.95
Family/Friends	11.69	3.04	1.12
Equity/Sale of stock	4.38	4.89	4.72
Other State Sources	0.75	5.65	4.36
Supplier Credit	5.28	7.51	6.17
Local Commercial Banks	10.18	14.79	17.68
Internal Funds/Retained Earnings	50.75	50.90	42.78

Figure 2.17 shows that in Africa, self-finance and internal funds appeared to be the most common source of finance, followed by a firm owner’s own capital or equity. Commercial banks played a leading role in financing about 20% of firms, and development banks featured prominently as well. Family and friends were the most important source of financing for small firms, while all firms benefited from supplier credit, but this was more common among SMEs than it was among large firms. For large firms, foreign banks often played a leading role in financing.

Figure 2.17: First/Second Most Important Sources of Finance: Africa

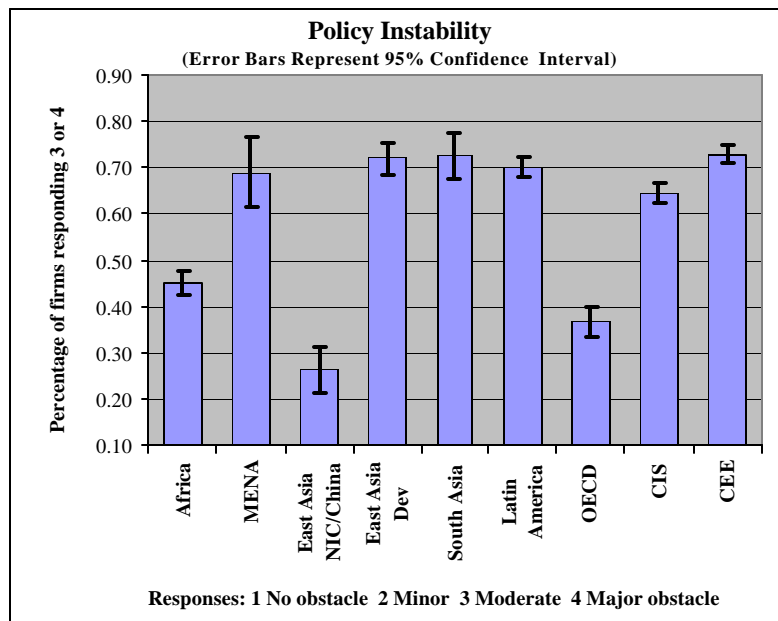


B.3 Policy Instability and Uncertainty

Policy instability and uncertainty, the third leading constraint cited by firms, varies substantially by region, but less so by firm size. At one extreme, more than 70% of firms in South Asia, Central and Eastern Europe, and developing East Asia find policy uncertainty/instability to be a serious constraint, with firms in Latin America, MENA, and CIS also giving this issue a serious rating.

At the other extreme, only 26% of firms in NIC East Asia and China identified this as a major or moderate constraint, whereas 37% of firms in OECD countries did so.

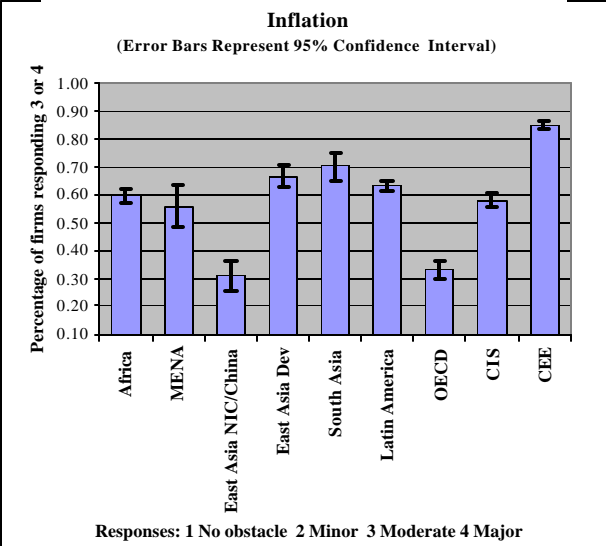
Figure 2.18: Political Instability



Medium-sized firms are most likely to find policy instability constraining, whereas large firms are significantly less to identify themselves as constrained than SMEs as a group, although by a small margin.

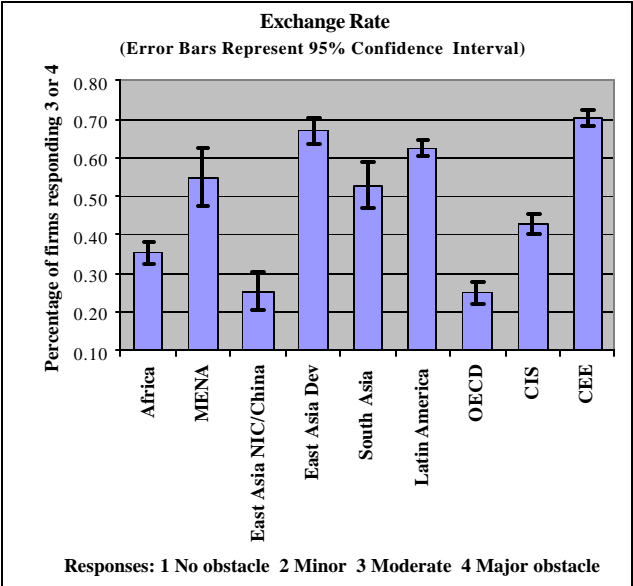
Macroeconomic policy instability can be seen as one element contributing to uncertainty. In this regard, the following two general constraints— inflation and exchange rate uncertainty—can be understood to be related. Concern about inflation somewhat echoes concern about policy instability by region. Firms in CEE countries are by far more likely to find inflation to be a serious constraint (around 85% do so), while between 60% and 70% of firms in South Asia, developing East Asia, Latin America, and Africa find inflation to be constraining, with firms in CIS countries and MENA providing high percentages as well. By size, large firms are significantly less likely to identify inflation as a major or moderate constraint than are small and medium firms.

Figure 2.19: Inflation



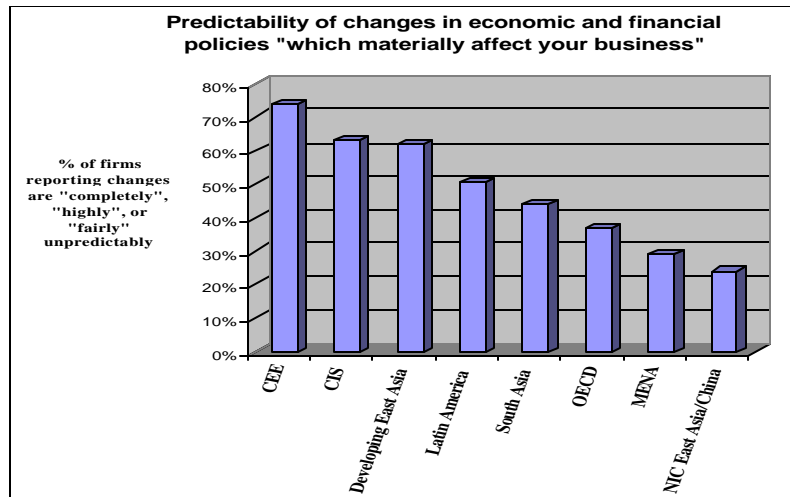
Exchange rate uncertainty follows a slightly different pattern, but with important similarities. More than 70% of CEE firms find that exchange rate uncertainty is a serious constraint, more than 60% of firms from developing East Asia and Latin America find it so, and more than 50% of firms from MENA and South Asia identify it as a major or moderate constraint. By contrast, around 25% of firms in newly industrialized East Asia and OECD countries find the exchange rate to be a problem. Medium-sized firms appear most sensitive to exchange rate problems, with small firms a bit less so, and large firms the least constrained.

Figure 2.20: Exchange Rate



Another dimension of policy uncertainty/instability is associated with the predictability, transparency, and consistency with which governments are perceived to generate economic and financial policies, and supportive laws and regulations that affect firms. The figure at right shows the percent of firms in each region that find changes in economic and financial policies affecting them to be unpredictable to some degree (as opposed to those firms finding them predictable to some degree). More than 70% of firms in Central and Eastern Europe and more than 60% in CIS countries and developing East Asia find economic and financial policies unpredictable. Some 50% of firms in Latin America and more than 40% in South Asia find these policies unpredictable.

Figure 2.21: Predictability of Changes in Economic and Financial Policies “which materially affect your business”



In CEE and Africa, nearly three-quarters of firms rated changes in rules, laws, and regulations affecting them as being unpredictable. In CIS countries, two-thirds of firms rated these changes as unpredictable; while in developing East Asia, Latin America, and MENA more than half of firms did so, as did 49% of firms in South Asia. Even in OECD nations, 45% of firms rated changes in the rules affecting them as unpredictable, while in East Asia less than 30% of firms did so.

Firms were also asked to evaluate the direction of change in the predictability of rules, policies, and regulations. The least encouraging result was in developing East Asia, where 41% of firms believed that predictability had declined; in CEE and Africa more than a third of surveyed firms agreed with this. Firms in OECD nations, East Asia, and China rated the best in this regard, with only 14% of firms noting deterioration in the predictability of rules and regulations affecting them.

Table 2.6: Legal and Regulatory Predictability, Transparency

<i>Legal and Regulatory Predictability, Transparency</i>	<i>Predictability of changes in laws, rules and regulations affecting firm</i>	<i>Evolution of predictability of laws and regulations over 3 years</i>	<i>Firms notified in advance</i>
	<i>% of firms rating "fairly", "highly" or "completely" unpredictable</i>	<i>"somewhat" or "much less" predictable</i>	<i>% of firms responding "seldom" or "never"</i>
CEE	0.74	0.37	0.68
Africa	0.74	0.37	0.37
CIS	0.66	0.35	0.60
East Asia Dev	0.59	0.41	0.28
Latin America	0.52	0.26	0.57
MENA	0.52	0.25	0.26
South Asia	0.49	0.29	0.39
OECD	0.45	0.14	0.31
East Asia NIC/China	0.29	0.14	0.24
Total	0.61	0.30	0.50

Table 2.7: Predictability of Laws

	<i>Predictability of Laws</i>	<i>Evolution of predictability of laws, polices and regulations over 3 years</i>	<i>Firms notified in advance</i>
	<i>% of firms rating "fairly", "highly" or "completely" unpredictable</i>	<i>"somewhat" or "much less" predictable</i>	<i>% of firms responding "seldom" or "never"</i>
Small	0.64	0.34	0.57
Medium	0.61	0.29	0.49
Large	0.55	0.23	0.39

Finally, the WBES measured one of the simplest steps governments could take to improve the predictability of policy change, notifying firms in advance of changes that affect them. In this regard, firms in CEE, CIS, and Latin American countries

clearly fared worse than those in other regions, with 68%, 60%, and 57% of firms, respectively, reporting that they were seldom or never notified in advance of changes affecting them.

Large firms are less likely to find rules, laws, and regulations to be unpredictable, and are less likely to perceive deterioration in the predictability of laws and regulations over the previous three years. Whereas 57% of small firms say they are seldom or never notified in advance, 49% of medium-size firms give such a negative assessment, and only 39% of large firms do so.

Two other measures of transparency and consistency of policies and laws as experienced by firms are the ease of availability of laws and regulations affecting firms and the consistency of interpretation of laws and regulations. If laws and regulations are unavailable, it may contribute to a perception of policy uncertainty, whereas if the interpretation of laws and regulations is inconsistent, rules affecting firms may appear unstable. The majority of firms agreed that laws and regulations affecting them are easily available. Developing nations in East Asia fared worse in this regard, with 39% of firms disagreeing that laws and rules were easily available. In Latin America, South Asia, and OECD countries, around one-third of firms disagree. In Africa, CEE and CIS, more than a quarter of firms disagree with this; this figure is lower in the MENA region. Small firms find information on laws and regulations less available than do mid-size and large firms by a significant margin, with 36% of small firms disagreeing, versus 28% of medium firms and only 24% of large firms.

Around half the firms in Latin America and CIS countries disagree that rules and laws are consistently interpreted, whereas 45% of OECD firms disagree, as do 42% of firms in South Asia, 40% of firms in developing East Asia, 37% of firms in CEE, and 36% of those in Africa. Differences by size are less dramatic, but larger firms find more consistency in the interpretation of laws and regulations than do medium and small firms.

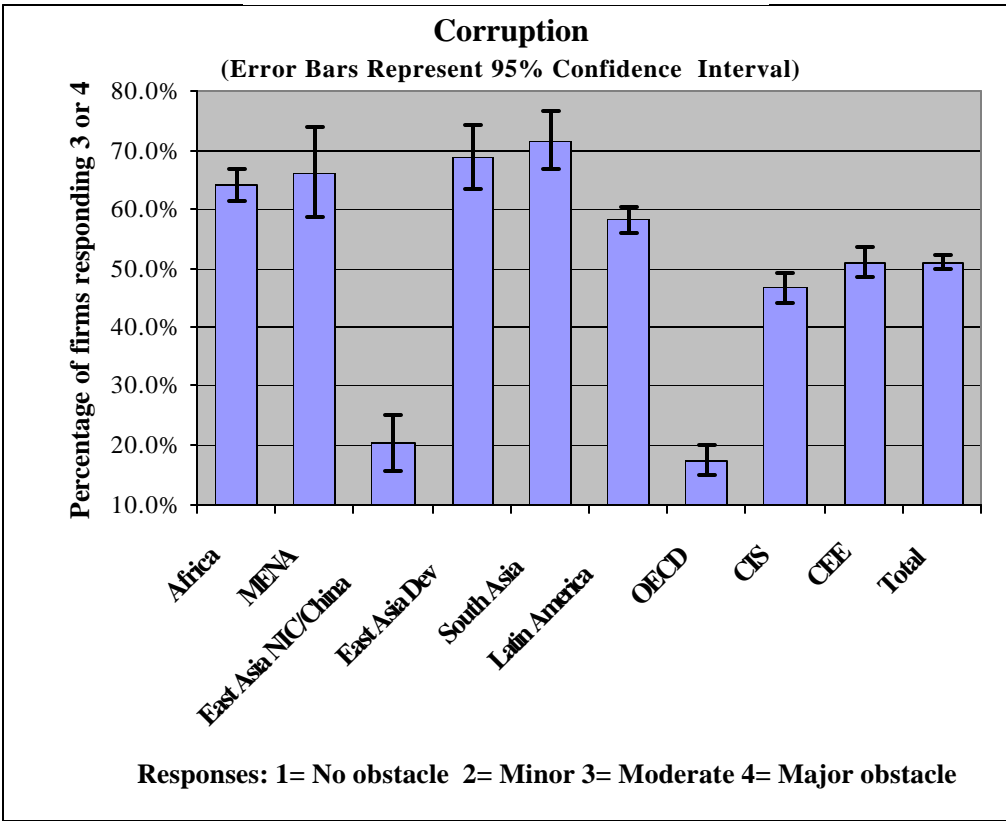
The final is whether government **listens to the business perspective** in the formulation of legal and policy reform.¹¹ In transitional European countries, MENA, and Latin America, the majority of firms suggest that this is a relatively rare event, while it is more common in Asia.

¹¹ "In case of important changes in laws or policies affecting my business operation the government takes into account concerns voiced either by me or by my business association."

B.4 Corruption¹²

Corruption was identified as a major or moderate business constraint by around half of the sample on average. Corruption was identified as a serious constraint by more than 70% of firms in South Asia and by nearly as many in developing East Asia. Two-thirds of firms in MENA and 64% in Africa found corruption to be a serious constraint, as did 58% in Latin America, and more than half the firms in Central and Eastern Europe. In CIS, 47% of firms found that corruption was a major or moderate constraint. By contrast, only 20% of firms in the newly industrialized countries of East Asia and China¹³ and 17% of firms in OECD countries found that corruption was a constraint. Small firms perceive corruption as a significantly greater obstacle than do medium or large firms, with 54% finding it a serious obstacle, compared with 50% of medium-sized firms and 47% of large firms.

Figure 2.22: Corruption



Corruption can take many forms, of which the most readily observable to most firms is bribery by enterprises. Respondents were asked if it was common for firms “in their line of business to have to pay some irregular ‘additional payments’ to get things done.” In South Asia and developing East Asia, more than 60% of firms said this was always, mostly, or frequently the case. In Africa,

¹² This section first focuses on traditional measures of corruption, namely administrative/bureaucratic bribery and such related forms. For a particular manifestations of ‘grand corruption’, referred to as ‘state capture’, see summary findings and analysis in section IV below.

¹³ The reader should note that this general constraint question was the only question on corruption that could be posed in China. The consultant carrying out the survey reported that surveys are subject to rigorous censorship by the State statistics agency and that posing detailed questions on corruption would not only invoke censorship, but might also derail the entire survey and even threaten the license of the consultant to carry out further survey work.

more than half of firms reported that such payments were at least frequently required. In MENA and Central and Eastern Europe, around a third of firms provided these responses, while in CIS and Latin America, more than a quarter of firms offered these responses. Only in OECD countries and East Asia (not including China, where corruption questions could not be asked) could this response be described as rare—only 12% of OECD firms and 11% of firms in newly industrialized East Asia pick these three most frequent response categories. By firm size, 40% of small enterprises choose the three most frequent response categories, as opposed to 34% of medium-sized enterprises and 31% of large enterprises.

Frequency does not by itself represent the severity of the problem. One aspect of severity is the uncertainty that discretion and rent-seeking may introduce. In some regions, clearly the “price” of getting things done is both well-established and well known. Some 70% of respondents in Latin America suggest they always, mostly, or frequently know in advance how much to pay officials informally, followed by 60% of firms in developing East Asia, 50% of those in South Asia, 48% of those in CEE, and 46% of those in CIS (this question was not asked in Africa and some MENA countries). Although large firms are less likely to find irregular payments necessary, they are somewhat more likely to know in advance how much to pay.

Table 2.8: Knowledge of Bribe Payments

	<i>Irregular payments to officials to things</i>	<i>Advance knowledge of amount additional payments</i>	<i>Service as agreed additional payments made</i>	<i>If payment made one official, govt official requires payment for service</i>	<i>If government official against rules, can go superior and get treatment without to unofficial</i>
Firms that responded always, mostly, or frequently (vs. sometimes, seldom, or never)					
South	65%	50%	83%	46%	32%
East Asia	62%	60%	76%	60%	26%
Africa	52%	not	33%	not	not
MENA	36%	not	53%	not	not
CEE	33%	48%	73%	28%	36%
CIS	29%	46%	75%	35%	38%
Latin	28%	70%	32%	70%	69%
OECD	12%	26%	62%	17%	45%
East Asia	11%	22%	42%	10%	25%
Total	13%	53%	59%	45%	45%

Equally important is whether or not the service “paid for” informally is delivered as promised. Some 83% of firms in South Asia report that it always, mostly, or frequently is delivered as promised, 76% of firms in developing East Asia reported this, and 75% of firms in CIS and 73% in CEE offered this assessment. This contrasts sharply with firms in Latin America and Africa, where only about a third of firms believe services will be delivered as promised. Small firms find service delivery after bribery to be more reliable than medium firms do (62% vs. 58%), and medium firms are more likely to find bribery to be more reliable than large firms (50%). Additional uncertainty arising from corruption may arise if additional requests for payment are received after the initial informal payment (bribe) has been made. Of the regions where this question was asked, Latin America and developing East Asia are the worst in this regard—

70% and 60% of responding firms, respectively, respond that once a payment has been made to once official, another official will always, mostly, or frequently request payment for the same service.

Table 2.9: Success of Bribe Payments

	<i>Irregular Additional Payments Made to Government</i>	<i>Advance Knowledge of Amount of Additional Payment</i>	<i>Service Delivered as Agreed if Additional Payment Made</i>	<i>If Payment Made to One Official, Another Govt Official Will Request Payment for Same Service</i>	<i>If Government Official Acts Against Rules, Can go to Superior And Get Correct Treatment without Recourse to Unofficial Payment</i>
<i>% of firms that responded "always", "mostly" or "frequently" (as opposed to "sometimes", "seldom" or "never").</i>					
Small	40%	53%	62%	44%	38%
Medium	34%	52%	58%	45%	48%
Large	31%	59%	50%	51%	53%

Table 2.10: Unofficial Payments

<i>Corruption Score</i>	<i>% of Revenues per annum in Unofficial Payments (1 - 7 scale)*</i>	<i>Time Delay With Respect to Imports</i>	<i>Firms Commonly Pay Irregular Payments (Scale: 1 - 6)**</i>
1	1.5	10.6	5.2
2	2.3	11.4	4.3
3	2.8	13.5	3.7
4	2.9	13.8	3.4
<i>* 1 - 0%; 2 - <1%; 3 - 1 to 1.99%; 4 - 2 to 9.99%; 5 - 10 to 12%; 6 - 13 to 25%; 7 - >25%</i>			
<i>** 1 - always 2 - mostly 3 - frequently 4 - sometimes 5 - seldom 6 - never</i>			

Except in Africa, parts of MENA, and China, the WBES survey asked that if an official acted against the rules, whether a firm could then appeal to a superior and receive correct treatment without recourse to an informal payment. In Latin America, 60% of firms said this was always, mostly, or frequently the case, as did 45% of firms in OECD. In CIS, 38% of firms thought this was at least frequently possible, as did 36% of firms in CEE. However, East Asia (both regions) appears not to invite such appeals, and only about a quarter of firms in either NIS countries or developing East Asia believed this was at least frequently possible. The perception of whether an appeal can be made successfully without a bribe rises dramatically with firm size—only 38% of small firms feel they can appeal to a superior and obtain correct treatment without recourse to informal payments, while 48% of medium-sized firms and 53% of large firms feel this is at least “frequently” possible.

Aside from the frequency of payment, the severity of bribery as a problem may be influenced by the cost of bribes. On the one hand, frequent payments could in theory, be quite small, whereas on the other hand, infrequent payments could be quite large. So WBES inquired (except in Africa, parts of MENA, and China) about the total percentage of revenues paid to officials as “unofficial” payments to public officials. On average (using response category midpoints and a value

Table 2.11: Percent of Revenues Paid in Unofficial Payments to Public Officials

<i>Percent of revenues paid in unofficial payments to public officials.</i>		<i>% of firms responding "0%"</i>
Africa	not asked	not asked
MENA	not asked	not asked
CEE	5.5	0.9
South Asia	5.0	18.8
East Asia Dev	4.6	22.7
CIS	3.4	3.4
Latin America	2.0	58.0
East Asia/NIC China	0.6	86.3
OECD	0.6	83.0
Average	3.0	38.7

of 33.3% for the category “over 25%”), payments are highest in CEE at 5.5% of revenues, South Asia at 5%, and developing East Asia at 4.6%. CIS firms report unofficial payments costing them 3.4% of sales, while those in Latin America say it costs some 2%. It is worth noting that 86.3% of firms in newly industrialized East Asia, 83% of firms in OECD countries, and 58% of firms in Latin America report paying 0% of their revenues in bribes. By contrast only 0.9% of firms in Central and Eastern Europe and 3.4% of firms in CIS countries report zero payments. By firm size, payments average 3.8% of revenues for small firms, 2.7% for medium-sized firms, and 1.7% for large firms, implying a regressive “tax” on revenues.

The amount these payments cost firms is clearly positively associated with the degree to which firms find corruption to be constraining. For example, if firms are grouped into those that find corruption was no obstacle or a minor obstacle, and those that find it a moderate or major obstacle, then 78% of the less-constrained group pay less than 1% of their sales in unofficial payments, while a majority of firms in the more constrained group (51%) pay more than 1% of their sales in informal payments. Each category above 1% of sales for bribes contains a higher percentage of the more-constrained group than of the less-constrained group. Incidentally, a higher corruption score is not only associated with higher average bribe payments, but also with a higher frequency of bribe payments and longer customs delays.

Table 2.12: Percent of Revenues Per Annum in Unofficial payments

<i>% of Revenues per annum in Unofficial Payments (1 - 7 scale)</i>							
	<i>0%</i>	<i><1%</i>	<i>1 - 1.99%</i>	<i>2 - 9.99%</i>	<i>10 - 12%</i>	<i>13 - 25%</i>	<i>>25%</i>
No obstacle -							
Minor obstacle	53.7	24.5	8.8	8.0	2.9	1.1	1.0
Moderate -							
Major obstacle	27.0	22.0	14.5	19.1	11.0	4.6	1.7
Overall Average	40.0	23.2	11.7	13.7	7.1	2.9	1.3

Petty corruption through bribes is only one form of corruption. Two other dimensions captured by WBES are payments in the award of government contracts, and influence over policy. First, firms were asked whether they were paying bribes for public procurement contracts or not, and the percentage of the payment value of a public contract one must offer as an informal payment to secure a government contract. Because many firms do not do business with the public sector (while others did not respond to this sensitive question), the responses need to be assessed with

particular caution, yet the average findings for the overall sample are indicative in that 45% of the respondent firms in the 80 countries surveyed admitted the need to provide such bribes, and on average, they paid about 11% of the contract’s value in bribe.

Table 2.13: Firm Influence Over Laws at the National Level of Government (by region)

<i>Does your firm have influence at the national level of government to influence laws? Firms that responded "always", "mostly", or "frequently" (as opposed to "sometimes", "seldom", or "never").</i>				
	<i>Executive</i>	<i>Legislature</i>	<i>Ministry</i>	<i>Regulatory Agency</i>
Africa	not asked	not asked	not asked	not asked
MENA	not asked	not asked	not asked	not asked
East Asia NIC	34%	30%	33%	29%
East Asia Dev	44%	43%	44%	50%
South Asia	56%	35%	52%	43%
Latin America	17%	14%	18%	20%
OECD	19%	20%	18%	21%
CIS	10%	10%	14%	11%
CEE	13%	12%	12%	15%
Total	17%	16%	18%	19%

A further dimension of corruption is the potential for influencing the policies, regulations, and laws of the state (which in its extreme form of misgovernance is manifested through state capture, which was measured and analyzed for transition economies in the BEEPS component of the WBES; see below for details). In all regions, the WBES asked firms whether they had influence (which in most instances could well be thought of as legitimate and legal means, contrasting state capture) at the national level to effect laws and regulations affecting them.¹⁴ Separate responses were recorded for the executive branch, for the legislature, for the ministerial level, and for regulatory agencies. Firms in South Asia and developing East Asia were particularly confident of their ability to influence laws affecting them. In South Asia, over half the responding firms suggested they could influence the executive at the national and ministerial levels, and more than 40% thought they could influence regulatory agencies. In developing East Asia, half the firms felt they could influence regulatory agencies, and more than 40% suggested they could influence the executive branch, legislative branch, and individual ministries. Also, large firms are more likely to identify themselves as having influence at the national level than either small or medium-sized firms. It should be noted, however, that the number of firms reporting they are influential is only one relevant dimension, because in many countries, just a few enormously powerful firms can wield influence throughout the economy—thus the impact of the influence of firms may not be mostly a function of the number of firms reporting having influence (to the contrary, if all firms are equally influential, the overall impact of influence would be expected to be more neutral).

Corruption is, of course, a two-way street—firms may benefit in certain ways from their ability to corrupt officials who might otherwise enforce laws or implement programs in a manner less favorable to them. In theory, this tendency may mute the adverse evaluation of corruption in some regions as a constraint to business.

¹⁴“When a new law, rule, regulation, or decree is being discussed that could have a substantial impact on your business, how much influence does your firm typically have at the national level of government on the content of that law, rule, regulation or decree? 5=Very influential, 4=Frequently influential, 3=Influential, 2=Seldom influential, OR 1=Never influential”

Table 2.14: Firm Influence Over Laws at the National Level of Government (by firm size)

<i>Does firm have influence at the national level of government to influence laws?</i>				
<i>% of firms responding that the firm is always, mostly or frequently influential.</i>				
	<i>Executive</i>	<i>Legislature</i>	<i>Ministry</i>	<i>Regulatory Agency</i>
Small	0.12	0.12	0.13	0.14
Medium	0.17	0.15	0.17	0.20
Large	0.28	0.26	0.29	0.30

One manifestation of weak governance, by virtue of corruption or lax enforcement, is the degree to which firms comply with laws, including tax laws. WBES asked firms to estimate the percentage of actual sales that typical enterprises reported to tax authorities. In Africa and MENA, less than 10% of firms estimated that firms reported 100% of their sales, although in Africa, all remaining firms suggested that underreporting did not exceed 10% of sales. Only in Africa, OECD, and South Asia did a majority of responding firms report average underreporting to be below 10% of sales. In developing East Asia, 68% of firms estimated underreporting of sales to exceed 20% of total revenues, in newly industrialized East Asia this was 60%, in Latin America it was 56%, and in CIS and CEE it was just over 50%. By firm size, underreporting is clearly perceived to be greater among small firms than either medium or large firms. Only 23.9% of small firms feel that firms like them report 100% of sales, and a minority (46%) feel that underreporting amounts to less than 10%.

Table 2.15: Percentage of Sales Reported to Tax (by region)

<i>Percentage of sales reported to tax</i>							
<i>% of firms in each</i>							
	<i>All 100%</i>	<i>90-99%</i>	<i>80-89%</i>	<i>70-79%</i>	<i>60-69%</i>	<i>50-59%</i>	<i><50%</i>
Africa	39.3	18.5	11.3	11.2	7.7	7.5	4.5
MENA	6.6	71.1	5.6	3.6	1.5	6.1	5.6
East Asia/NIC China	33.9	6.3	5.3	1.7	0.7	4.3	47.6
East Asia Dev	23.3	8.0	9.2	10.2	6.1	10.8	31.5
South Asia	37.8	17.9	7.3	3.3	5.3	11.6	17.0
Latin America	38.1	5.7	9.2	7.3	5.5	5.7	28.7
OECD	49.2	16.0	8.1	4.7	2.4	1.8	18.0
CIS	36.7	13.0	10.1	7.7	4.6	7.0	21.1
CEE	36.1	13.6	13.3	7.4	5.1	10.4	14.1
Total	31.2	24.3	8.5	6.0	4.0	6.2	19.2

Table 2.16: Percentage of Sales Reported to Tax (by firm size)

	<i>All 100%</i>	<i>90-99%</i>	<i>80-89%</i>	<i>70-79%</i>	<i>60-69%</i>	<i>50-59%</i>	<i><50%</i>
Small	23.9	22.6	9.4	7.6	4.7	8.1	21.6
Medium	36.1	22.5	8.8	5.9	4.2	5.4	15.6
Large	38.1	31.6	5.9	3.1	2.2	3.1	13.9
Total	31.6	24.2	8.5	6.0	4.0	6.1	17.7

Box 2.2 Controlling for Perception Bias —The “Kvetch” Factor¹: Addressing Possible Errors in Cross-Country Comparisons

In econometric work performed on the basis of survey data containing an element of subjectivity or perception (as reflected in the nature of a firm’s responses to the multiple questions applied during the interview), one faces the challenge of possible spurious correlation between the dependent and independent variables: firms that are doing well (performance measures often being the dependent variable) may have a rosier view of the obstacles to enterprises (the independent variables) than would be warranted from an objective standpoint. Conversely, firms that perform poorly or that operate unofficially, may exaggerate their account of the obstacles they find and or be overly critical in their assessment of the effectiveness of government policies and its provision of services.

In the context of a particular firm’s propensity to complain across all questions this potential spurious correlation resulting from a possible tendency of firms to view many questions with the same subjective lense, this phenomenon has been labeled as the “kvetch” factor. If these variables are indeed affected by some unobservable common perceived view factor across variables by the same firm (such as the propensity to kvetch, or its converse; namely, a tendency to gloat throughout the survey interview), then this measurement error would lead coefficient estimates to be biased, and the likelihood of observing spurious correlations among variables whose true underlined correlation is insignificant cannot be ruled out.

To address this possible source of misspecification we first identify from the survey a number of possible kvetch control independent variables that fulfill the condition of being a public good provided by the government which is commonly faced by all firms within a country, and thus it can be presumed that each firm’s response’s deviation from the country mean is a proxy to the extent of such firm’s kvetch factor. Given that the firm-level econometric specifications we perform included country effects, direct inclusion of the universal public good suffices as proxy of the kvetch effect, as the subtraction from the country mean is implicitly taken care of by the country effect dummies.

Specifically, we identified four different kvetch control proxies, each one inserted separately in the set of econometric specifications: extent of government efficiency; extent of helpfulness by government, quality of public works, and quality of the postal service.² The first two proxies that we use in these tests, of a generic nature, have the advantage of being less subject to enormous variations across different locations (within a city), while the two variables of specific infrastructure nature, are less subject to preferential provision, or exclusion, by the government to a firm. In Table 4.2 above, this was done with two different variables from the same survey instrument: the degree of government inefficiency as perceived by the firm, and also the firm’s view on how helpful is the government to enterprise. Insofar as there is a significant kvetch factor, it would be picked up by these variables. In all cases we find that inclusion of the control variables do not affect the magnitude or high significance of the other variables in the specifications.³

¹ According to the Webster, kvetch is an accepted term from Yiddish meaning propensity to gripe, or to complain continuously. For related econometric treatment of this potential kvetch perception bias in analyzing survey data based on an element of subjective assessment, see also Kaufmann and Wei (1998) and Hellman et al (2000).

² Further econometric details on this procedure appear in Kaufmann, Mastruzzi, and Zavaleta (2001) and Hellman et al. (2000).

³ These results were also replicated with the other two kvetch control variables (not shown here); namely, quality of public works and of postal services, and also in these cases the magnitude and significance of the explanatory variables were not altered by inclusion of alternative kvetch control variables. Second, as an additional test, we also performed a two-stage procedure to purge the possible kvetch bias from all independent variables, through a two-stage approach: first we regressed each individual explanatory variable on a kvetch control variable (inefficiency of government). The residuals of each regression were then used in the second stage to determine the effect of these residual variables on the dependent variable, namely under-reported revenues. Thus, while we found some evidence that some degree of a ‘kvetch factor’ may be at play (particularly in the cases of efficiency of government and quality of public works as proxies, whose coefficients are significant), we did not find evidence suggesting that the ‘kvetch’ factor is a source of misspecification and bias of the estimates for the explanatory variables.

Section III: Quality of Public Services

A key dimension of the business environment, and an indicator of governance, is the quality of public services. WBES explored the general characteristics of government services and the qualities of individual services as well. One dimension of service is whether or not firms find government helpful to the conduct of business. In this regard, government was regarded as least helpful in transition Europe: in Central and Eastern Europe, where 63% of firms found national government unhelpful and 53% found local government unhelpful; and in CIS countries where 47% of firms found national government unhelpful and 43% found local government unhelpful. Local government was slightly more unhelpful in Latin America and the Caribbean, where 44% of enterprises found it unhelpful. By sharp contrast, only 13% of MENA firms and 14% of developing East Asia firms found government unhelpful to some degree. Helpfulness can be interpreted negatively, if it takes the form of favoritism protection, and some will argue that a neutral response is the best outcome.

Table 3.1: Helpfulness of Government

	<i>Helpfulness of national government</i>	<i>Helpfulness of local govt</i>
% of firms responding "mildly" or "very" unhelpful		
CEE	63%	53%
CIS	47%	43%
Latin America	41%	44%
Total	40%	40%
OECD	38%	35%
Africa	33%	40%
South Asia	32%	34%
East Asia Dev	14%	15%
MENA	13%	18%
Asia/China	11%	17%

or

WBES explored both the overall efficiency of government in delivering services and the quality of individual services. In response to the general question, more than 60% of firms in Central Europe, Latin America, and CIS countries believe government is to some extent inefficient in delivering services. Nearly 60% of South Asian firms also identify government as inefficient, while half of respondents in OECD countries regard their government as inefficient to some degree. Small firms have the most negative view of government efficiency in service delivery, followed by medium firms, with large firms providing the most favorable evaluation.

Table 3.2: Efficiency of Government Service Provision (by region)

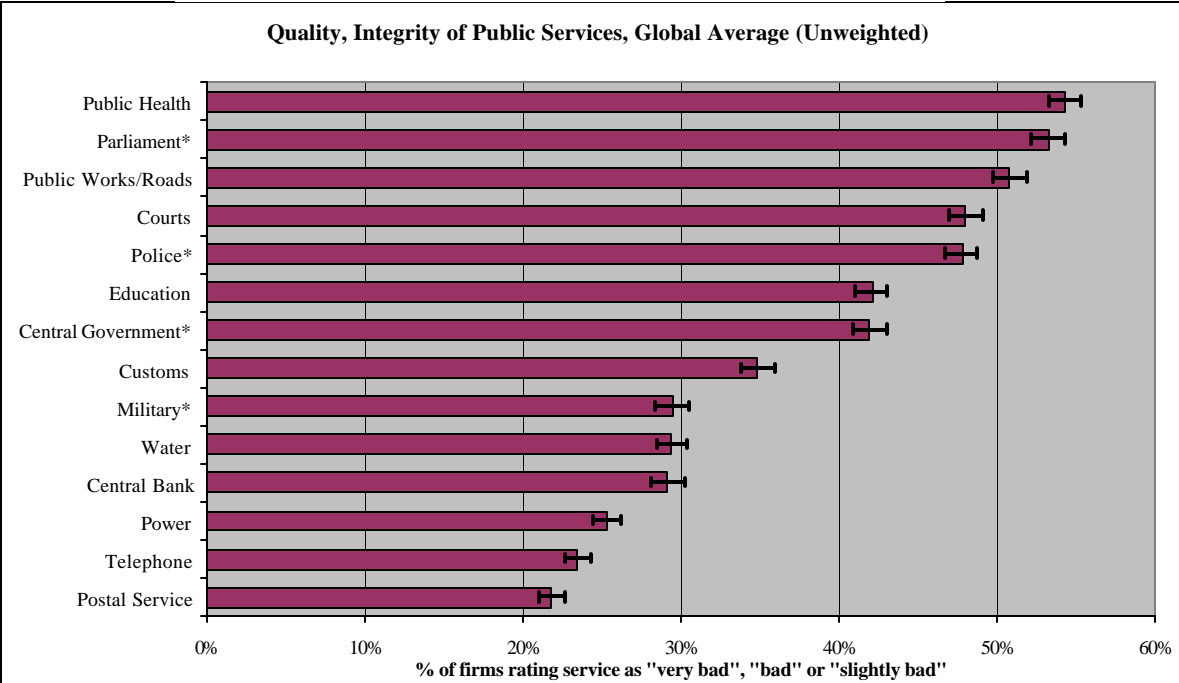
<i>Efficiency of Govt Service Provision</i>	<i>% firms that rate a 4,5,6 (inefficient)</i>
CEE	70%
Latin America	63%
CIS	63%
South Asia	58%
OECD	50%
East Asia Dev	40%
East Asia NIC/China	16%

Table 3.3: Efficiency of Government Service Provision (by firm size)

<i>Efficiency of Govt Service Provision</i>	<i>% of firms rating government as inefficient.</i>
Small	0.62
Medium	0.58
Large	0.54

A majority of firms give a negative evaluation of three services: public health, parliament, and public works/roads. Between 40% and 50% of firms gave a negative evaluation to courts, police, education services, and central government leadership. More than a third gave a negative ratings to customs. The most highly rated agencies were the postal service, telephone service, and electric power service, which were rated favorably by at least three-quarters of respondents.

Figure 3.1: Quality, Integrity of Public Services



By region, while some services were not evaluated in all regions, the average of services rated was lowest for Central European countries, followed by those in Africa, then South Asia and Latin America, and CIS countries. The most positive ratings average was assigned by firms in newly industrialized East Asia countries, followed by MENA countries.

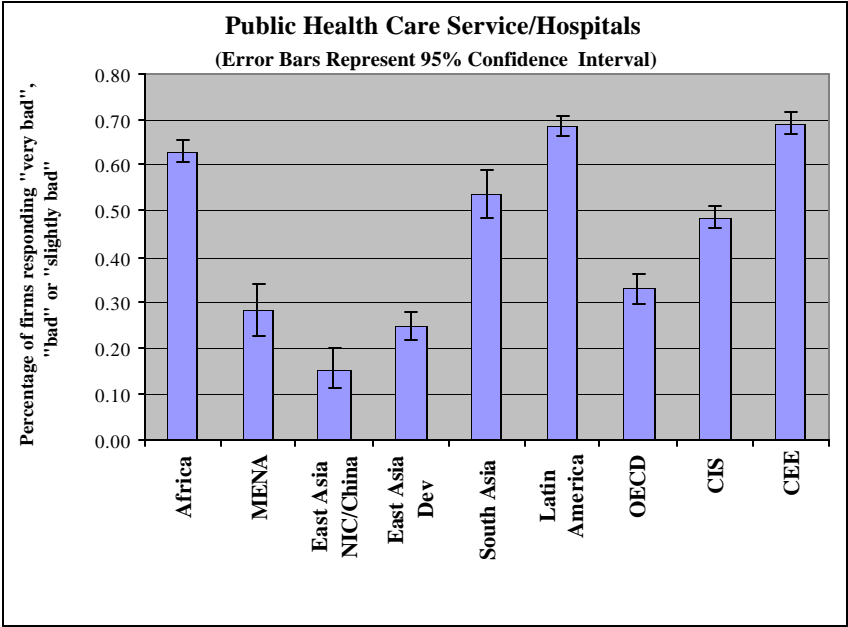
Table 3.4: Quality of Public Services (by region)

% firms that rate a 4,5,6 (slightly bad, bad, or very bad)			East Asia	East Asia	South	Latin				Overall
	Africa	MENA	NIC/China	Dev	Asia	America	OECD	CIS	CEE	Average
Postal Service	32%	7%	7%	9%	26%	26%	25%	13%	26%	22%
Telephone	35%	5%	7%	15%	29%	21%	22%	16%	34%	24%
Power	39%	9%	8%	19%	48%	26%	12%	17%	32%	25%
Central Bank	na	na	9%	35%	25%	24%	20%	21%	51%	29%
Water	43%	14%	9%	25%	39%	28%	14%	25%	37%	29%
Military*	32%	10%	7%	26%	9%	32%	22%	21%	50%	29%
Customs	38%	14%	8%	32%	47%	37%	21%	30%	49%	35%
Central Govt*	34%	3%	n.a.	30%	40%	36%	43%	44%	63%	42%
Education	50%	16%	11%	25%	50%	54%	37%	30%	50%	42%
Police*	57%	14%	12%	37%	61%	58%	26%	38%	63%	48%
Courts	39%	21%	15%	34%	35%	59%	42%	55%	57%	48%
Public Works/Roads	53%	20%	14%	41%	55%	49%	43%	57%	62%	51%
Parliament*	40%	14%	12%	33%	60%	64%	45%	58%	70%	53%
Public Health	63%	28%	15%	25%	62%	68%	33%	49%	69%	54%

*not asked in China due to government censorship polices.

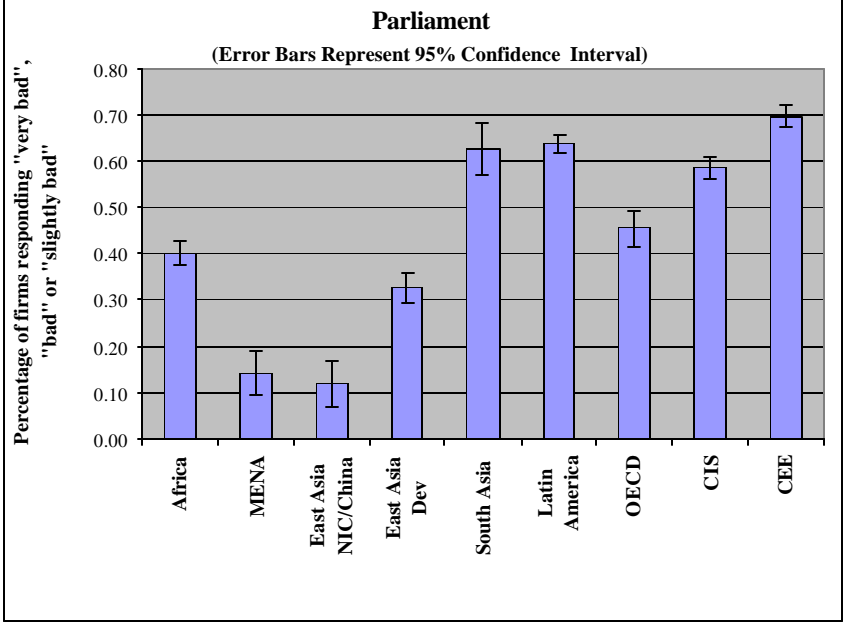
The regional results show sharp differences in perceptions of services by region. Hospital and health care services provide one clear example. In four regions, Central and Eastern Europe, Latin America, Africa, and South Asia, more than half of respondents offered a negative evaluation of these services, with CIS firms offering a similar response. These services are viewed favorably in newly industrialized East Asia and China, and in developing East Asia and OECD countries, at least two thirds of firms rate these services favorably.

Figure 3.2: Public Health Care Service/Hospitals



Ratings of parliament also varied, although with a different pattern. Some 70% of firms in Central and Eastern Europe, more than 60% of firms in Latin America and South Asia, and nearly 60% of those in CIS countries gave a negative evaluation to their parliament. By contrast, evaluations of parliament in newly industrialized East Asia and MENA were overwhelmingly favorable, with at least 85% of firms providing a rating of slightly good or better.

Figure 3.3: Parliament



The next least favorably-rated service was public works and roads. More than half of respondents in Central and Eastern Europe, South Asia, CIS countries, and Africa rated the quality of these services as poor. Just under half of Latin American firms held a similarly negative view. Only in newly industrialized East Asia, China, and in MENA countries was the rating of this service category sharply positive, with more than 80% of responding firms providing a rating of slightly good or better.

Figure 3.4: Roads/Public Works

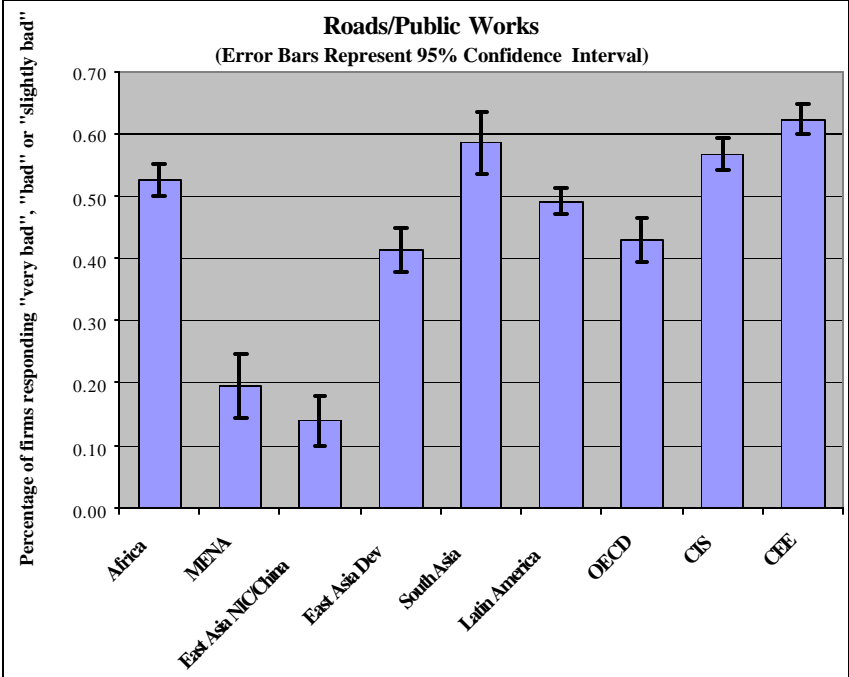
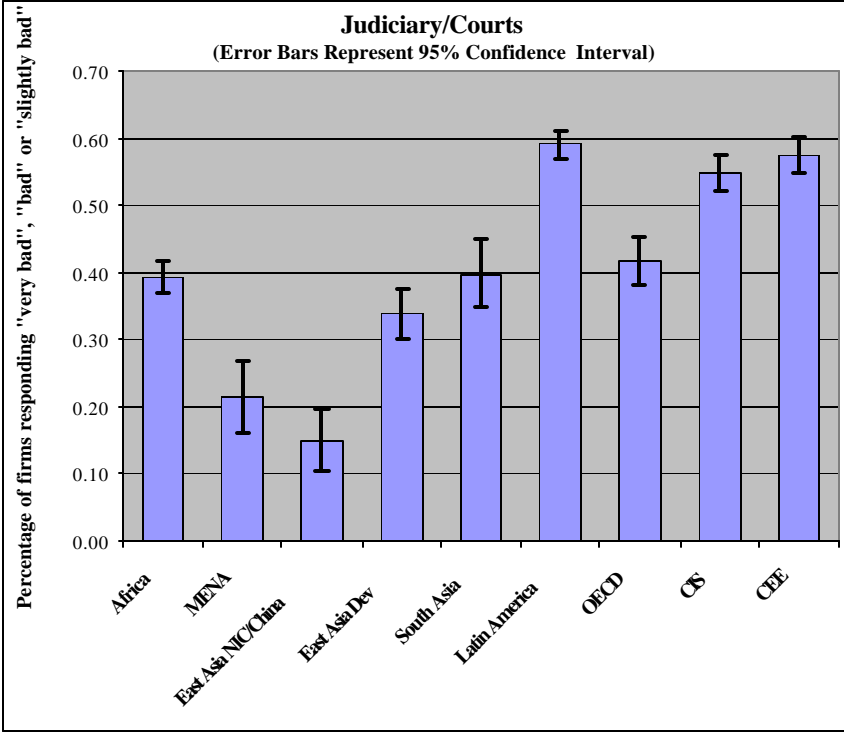


Figure 3.5: Judiciary/Courts

The next most frequently negatively-related government service was the judiciary and courts. More than half the firms in Latin America, CIS, and CEE countries rated the courts negatively. Surprisingly, more than 40% of firms in OECD countries gave courts a negative review, while around 40% of those in Africa and South Asia did as well.

WBES respondents also rated detailed characteristics of the courts, which sheds some light on the basis for these general ratings.

The most obvious characteristic of courts regarded as negative is the speed with which they operate.



Globally, 85% of firms responded that courts were never, seldom, or only sometimes quick (as opposed to always, usually, or frequently). The most negative review of quickness was in Latin America, where 94% of firms responded in the three least frequent categories, followed by Africa, where 86% of firms found courts infrequently quick. A second dimension in which courts were found wanting is their consistency, where 65% of firms across regions found them never, seldom, or only sometimes consistent. Latin American firms held the dimmest view of their courts in this regard as well, with 79% reporting that courts were infrequently consistent. In Central and Eastern Europe, 78% of firms and 65% of those in CIS held a similarly negative view of court consistency. Courts are regarded as never, seldom, or only sometimes affordable by 64% of firms in the sample, including 77% of OECD firms, 71% of Latin American/Caribbean firms, and 65% of CIS firms. Fifty-eight percent of firms rated courts in the three least frequent categories for honesty, led by 79% of CEE firms and 70% of LAC firms, as well as 59% of firms in developing East Asia and 57% of those in CIS. Fifty-seven percent of firms rated courts for being fair and impartial, led by firms in CEE (74%) and Latin America (70%) as well. Finally, another 57% of firms rated courts' enforcement of judgments as happening never, seldom, or sometimes, including 68% of firms in CEE, 67% of firms in Latin America, and 59% of firms in developing East Asia.

Table 3.5: Qualities of the Court System (by region)

<i>Qualities of the Court System</i>	<i>Fair & Impartial</i>	<i>Honest</i>	<i>Quick</i>	<i>Courts - Affordable</i>	<i>Courts - Consistent</i>	<i>Courts - Enforceability</i>
<i>% of firms responding that "never", "seldom" or "sometimes" as opposed to "always", "usually" or "frequently"</i>						
Africa	47%	52%	86%	58%	59%	50%
MENA	23%	23%	47%	23%	26%	29%
East Asia NIC/China	23%	27%	42%	37%	29%	25%
East Asia Dev	55%	59%	81%	74%	51%	59%
South Asia	31%	37%	81%	61%	48%	47%
Latin America	70%	70%	94%	71%	79%	67%
OECD	48%	38%	87%	77%	59%	49%
CIS	56%	57%	90%	65%	65%	56%
CEE	74%	79%	80%	57%	78%	68%

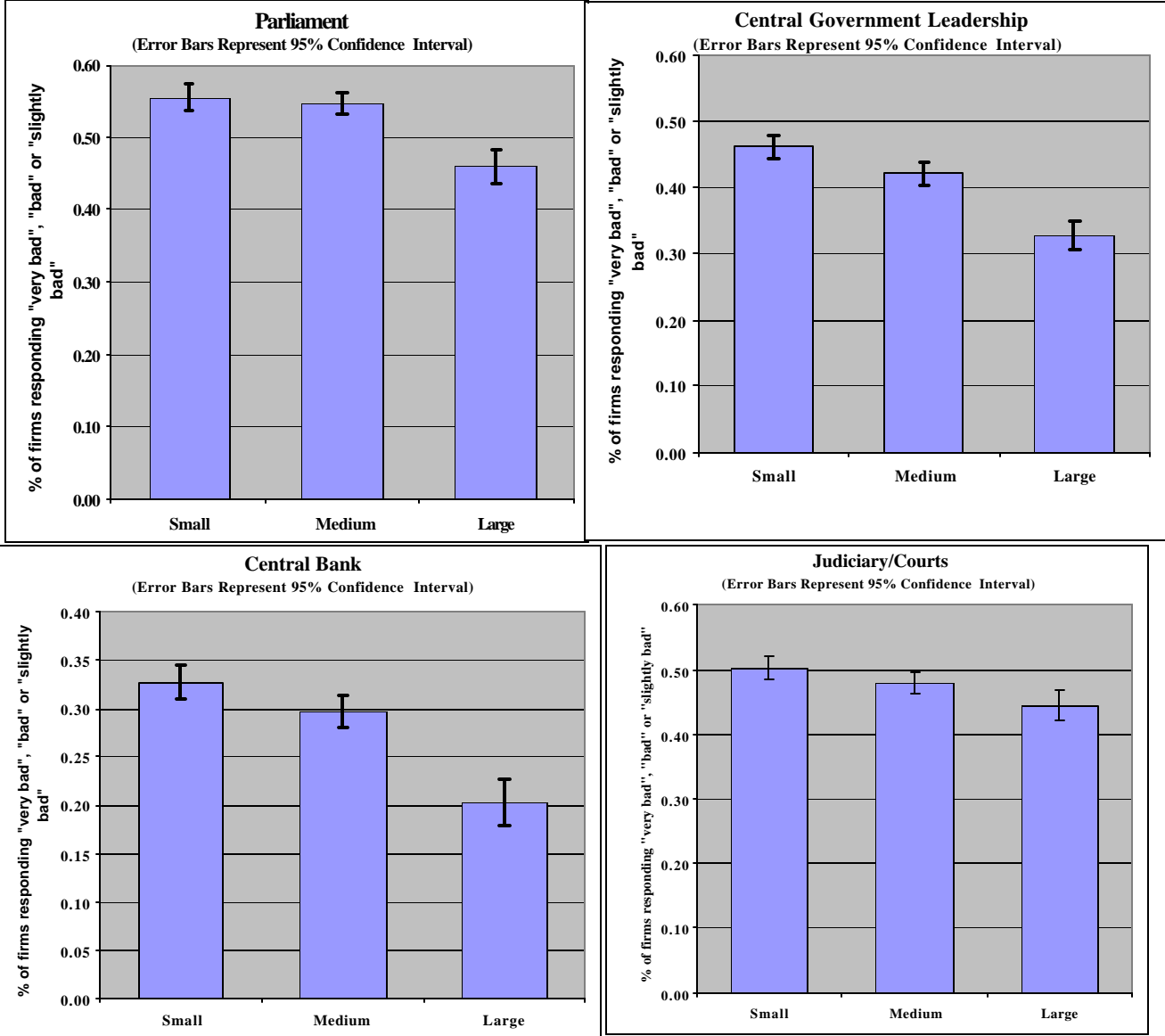
By size, the overall percentage of firms giving a slightly bad, bad, or very bad rating to public services declines slightly with size, from 39% of small firms to 35% of large ones. Large firms evaluate parliament, central government, and the central bank considerably better than do small and medium firms (see Table 3.6), with at least a 9% point difference in their negative rating. They also have a more favorable view of roads and courts. It is not possible to judge from the data whether this is

Table 3.6: Qualities of the Court System (by firm size)

	Small	Medium	Large	Ave.
% of firms rating service as "slightly bad", "bad" or "very bad"				
Postal Service	21%	22%	24%	22%
Telephone	23%	24%	22%	24%
Power	26%	25%	25%	25%
Central Bank	33%	30%	20%	29%
Water	31%	29%	27%	29%
Military	31%	30%	26%	29%
Customs	37%	35%	32%	35%
Central Gov't	46%	42%	33%	42%
Education	41%	43%	43%	42%
Police	49%	48%	46%	48%
Courts	50%	48%	44%	48%
Public Works/Roads	53%	51%	46%	51%
Parliament	55%	55%	46%	53%
Public Health	54%	55%	55%	54%

simply a difference in perception or whether large firms are better served by political institutions and certain public services. A number of services, including health, education, police, telephone and postal services, receive closely parallel ratings by firm size.

Figure 3.6: Parliament, Central Government, Central Bank and Judiciary/Courts



Section IV: Business and Governance Constraints and Enterprise Performance

This section explores the use of indicators derived from WBES in explaining firm-level outcomes. The first part uses econometric analysis to identify the correlates of reported firm-level growth and investment. A second part presents an important application of the data in analyzing “unofficialdom” (i.e., a firm’s hiding of output). This section provides an example of the abundance of applications that such globally comparative data affords.

A. The Relationship between Business and Governance Constraints and Enterprise Growth.

In this section we turn to an empirical analysis of the correlation of constraints with micro outcomes—sales growth and investment. We are interested in exploring whether constraints in the business environment, as perceived by enterprises, are associated with lower sales or investment growth. This has important ramifications for policy makers because enterprise growth is correlated with the constraints to business, and policies that address these constraints could have large productivity gains for the economy.

To determine the correlations between growth-sales and investment-and the environment, we estimate regression models that include the constraint rankings for key environment variables, controlling for firm attributes such as firm size, export and foreign ownership status, and country differences. We recognize that the causality might run in the opposite direction; there might be simultaneity between constraints and growth, and that some of these constraints may even be endogenous. As a result, the regression estimates might be subject to bias. However, given the absence of an empirical link between key environment constraints and growth, our objective is to highlight the associations between different business constraints and growth without making inferences on causality.

Two specifications are tested. In the first specification, the dependent variable is the sales growth over a three-year period (e.g., 1996–1999) reported by firms in the survey. This variable is regressed on key business environment attributes such as corruption, policy instability, taxes and regulations, and financing constraints, as well as firm attributes such as firm size, age, export status, and foreign ownership. Firm attributes are all represented by indicator variables. The main attributes of the business environment such as financing, corruption, making policy changes, and taxes are qualitative perceptions in the survey. To better quantify some of these variables, they were all converted to binary indicator variables (0,1). Corruption is measured as the frequency of additional payments made by enterprises on a scale of 0–1, with 0 representing the three least frequent responses (never, rarely, sometimes) and 1 representing the three most frequent responses (always, usually, frequently) on a six-point scale. Similarly, consultation of businesses on legal and policy reform¹⁵ is represented by a binary variable representing frequency. A negative coefficient would reflect a negative relationship between higher frequency of these variables and growth. High taxes and financing constraints are measured on a scale of 0–1 with 0 indicating a response of no obstacle or minor obstacle, and 1 indicating that a response of moderate obstacle or major obstacle. A negative sign on the coefficient of any of these constraint variables, as measured, would reflect the negative relationship between these constraints and

¹⁵ “In case of important changes in laws or policies affecting my business operation the government takes into account concerns voiced either by me or by my business association.”

growth. Because the variables representing the perceptions of the environment are significantly correlated with each other, stepwise regression methods were employed to determine the most important constraints correlated with growth. Firm size, age, export and foreign ownership status of firms are represented by indicator variables. Finally, indicator variables were included to represent country effects—the reference country in the table is Albania.¹⁶ Table 4.1 reports the estimated regression parameters.

Table 4.1: Constraints to Enterprise Growth

Dependent Variable: Sales Growth Previous Three Years.

Determinants	Estimate (standard error)
Business Constraints	
Financing	-4.63* (1.64)
High taxes	-2.04* (0.83)
Consultation of businesses	-1.61* (0.63)
Corruption	-3.95** (1.61)
Firm Characteristics	
Medium-sized firm	2.10 (1.24)
Large-sized firm	4.57** (1.96)
De novo (since 1994)	-8.34* (1.1)
Exporter	19.64* (2.02)
Foreign investment	1.04 2.13
Constant	14.822 (11.24)
Adjusted R2	0.12
Number of Observations	4560

*** significant at 1% ; ** significant at 5%

Country indicators were included in the above regression. Estimates are available from authors on request.

The results reported in Table 4.1 reveal two interesting findings. First, consistent with the literature,¹⁷ we find that firm attributes including firm size, and export status is positively and significantly associated with higher sales growth, while firm age is negatively associated with growth. Second, and more importantly, the results indicate that after controlling for country differences and variations in firm attributes, including age, size, export and foreign ownership status, business constraints are significantly associated with sales growth. Among the key constraints, the results indicate that financing, high taxes, corruption, and policy uncertainty are moderate to major constraints to businesses and are significantly (negatively) associated with sales growth. For example, the coefficient for finance suggests that a firm that identifies itself as

¹⁶ Because 80 countries and one territory participated in the sample, this required 80 country indicators (for each country/territory other than Albania). For reasons of space, their coefficients are not listed here.

¹⁷ See for example, Batra and Tan, "Inter-Firm linkages and Total Factor Productivity Growth in Malaysian Manufacturing," The World Bank, (forthcoming); and Mark Roberts and James Tybout (eds), 1996, *Industrial Evolution in Developing Countries: Micro Patterns of Turnover, Productivity and Market Structure* (2001).

constrained to a moderate or major degree by financing, on average, reports a growth rate that is 4.63 percentage points lower than one that is not so constrained. A firm seriously constrained by corruption reports, on average, a growth rate 3.95% lower than one that is not so constrained.

In the second specification, the dependent variable is change in investment over a three-year (1996–1999) period reported by firms in the survey. As in the earlier model, this variable is regressed on key business environment attributes such as corruption, policy instability, taxes and regulations, and financing constraints, as well as firm-level attributes such as firm size, age, export status, and foreign ownership. As before, constraints are represented by indicator variables (0,1) where 0 represents no obstacle or minor obstacle, and 1 represents moderate or major obstacle. The results of the regression are reported in Table 4.2. Policy uncertainty in this regression is measured by changes in predictability of government policies, laws and regulations over the last three years, where a 1 indicates no change or a decline in predictability and a zero indicates an improvement in predictability.¹⁸

Table 4.2: Constraints to Enterprise Growth
Dependent Variable: Investment Growth Previous Three Years.

Determinants	Estimate (Standard error)
Business Constraints	
Financing	-2.46* (0.62)
High taxes	-1.69** (0.73)
Predictability of policies	-3.75* (1.47)
Corruption	-2.57*** (1.45)
Firm Characteristics	
Medium-sized firm	2.30 (1.51)
Large-sized firm	2.07 (2.01)
De novo (since 1994)	-4.93* (1.02)
Exporter	10.62* (1.75)
Foreign investment	0.38 1.84
Constant	46.34* (9.19)
Adjusted R2	0.13
Number of Observations	3006

*** : significant at 1% ; ** : significant at 5% ; ***=Significant at 10% level.

Country indicators were included in the above regression. Estimates are available from authors on request.

First, analyzing the firm attributes, it is clear that younger firms and firms that export have, on average, higher investment growth than older firms and nonexporters. Among the business

¹⁸ The question was, “In the last three years, the laws, regulations and policies affecting my business have become: (1) much more predictable (2) somewhat more predictable (3) unchanged (4) somewhat less predictable (5) much less predictable.”

environment attributes, the results indicate that a decline in predictability of changes in economic policies over the last three years, corruption, high taxes, and financing are significantly and negatively associated with investment growth.

Together, the implications of these findings are significant. At the most basic level they suggest that, controlling for a broad variety of factors, several of the constraints firms rated as most important are significantly related to the actual performance of firms. Second, they imply that, with other things being equal, countries with poor conditions in four categories (financing, corruption, high taxes, and business consultation) saw their existing businesses grow an average total of 10.5 percentage points less than those with positive ratings in all of these categories. Countries with poor conditions in the areas of financing, high taxes, corruption, and policy predictability saw their businesses grow an average of 10.5 percentage points less than those with positive ratings in all of these categories. This is at least strongly suggestive of the types of results obtainable with substantial improvements in policy. While it may be difficult and take years to reform taxes, financing, corruption, and policy predictability, the evidence suggests that higher growth and investment are associated with such improvements.

B. Behavioral Response of the Firm to official constraints: Determinants of Unofficialdom—An Econometric Application

The richness of the WBES data set permits a great variety of empirical analysis on determinants of enterprise behavior and performance. Clearly, the possible applications of this data set go far beyond the confines of a single paper to explore.¹⁹ To illustrate the type of analysis that is possible, this part of the section presents an analysis of the determinants of unofficial enterprise behavior.

Why do officially registered firms hide output and turn unofficial? The richness of the worldwide enterprise data set permits us to test the importance of the various potential determinants of the decision of the sample firms (all officially registered) to hide part of their output. Each firm provided an estimate of the percentage of sales revenues they do report. On average, the firms in the sample do not report 19% of their gross revenues (i.e., a significantly larger portion of their net income).²⁰

A priori, the decision of the firm to hide their output may be related to the low benefits it derives of operating officially, and the low cost of crossing over to the unofficial economy. More specifically, we can draw from the framework used in Johnson, Kaufmann and Shleifer (JKS) 1997 for the unofficial economy in transition, subsequently extended for 69 countries worldwide (Johnson, Kaufmann and Zoido-Lobaton, 1998, and Friedman et al., 2000). In the JKS model, the

¹⁹ Other papers utilizing the WBES data (as well as the data and survey instruments themselves) are available at the WBES website: <http://www1.worldbank.org/beext/resources/assess-wbessurvey-alt.htm>

²⁰ A priori, the decision of the firm to hide their output may be related to the low benefits it derives of operating officially, and the low cost of crossing over to the unofficial economy. More specifically, we can draw from the framework utilized in Johnson, Kaufmann and Shleifer (JKS) 1997 for the unofficial economy in transition, subsequently extended for 69 countries worldwide (Johnson, Kaufmann and Zoido-Lobaton, 1998, and Friedman et al., 2000). In the JKS model the firm makes a rational economic choice whether to operate officially or unofficially based on the incentive it faces, the latter are determined by the government provision (or lack thereof) of public goods (such as rule of law, honesty). Against such framework, we can test with the WBES micro-economic dataset what the main determinants of the unofficial economy are.

firm makes a rational economic choice whether to operate officially or unofficially based on the incentive it faces, the latter are determined by the government provision (or lack thereof) of public goods (such as rule of law and honesty). Against such framework, we can test with the WBES microeconomic data set what the main determinants of the unofficial economy are.

To do so, we performed OLS regressions with this firm-level sample, including country effects. The basic econometric specifications in Table 4.3 present the various possible determinants of the unofficial economy behavior of registered firms. A number of policy-related variables are shown to be significantly related to the firm's extent of underreporting of revenues. On the economic and financial policy side, macroeconomic, regulatory, and tax constraints are significant; where these policies are below par, a firm will tend to operate unofficially. Further, governance-related constraints are important. In particular, corruption and some legal variables related to property rights protection—such as copyright violations—are rather significant in determining the propensity of a firm to operate unofficially.

The econometric investigation at the firm level also allows investigation of whether enterprise characteristics, controlling for policy and governance variables, matter as well. As seen in Table 4.3, firms that are not large (i.e., small or medium), produce for the domestic market (nonexporters), lack foreign investment, and are located in large cities (but not necessarily in the capital), tend to engage more in unofficial activity. By contrast, the coefficients for de novo firms, sector dummies, and private ownership are insignificant, implying that, controlling for other factors, a firm's age, sector, or mode of ownership are not explanatory factors in the extent of the firm's underreporting.

Table 4.3: Underreported Revenues, Corruption and Protection of Property Rights
(using full sample) dependent variable: underreported revenues (in %, sample mean = 19%)

Determinants	1	2	3	4	5	6
Business Constraints						
Financing constraint	0.27 0.85	0.11 0.33	0.46 1.44 ⁺	0.44 1.32	0.27 0.79	0.09 0.25
Inflation constraint	-0.01 -0.03	-0.03 -0.12	0.07 0.31	0.01 0.04	-0.05 -0.23	-0.09 -0.37
Policy instability constraint	0.60 2.64***	0.77 3.24***	0.77 3.48***	0.81 3.55***	0.65 2.78***	0.81 3.30***
Infrastructure constraint	0.58 1.65 ⁺	0.37 0.98	0.75 2.15**	0.88 2.44**	0.73 2.00**	0.51 1.29
Tax/regulatory constraint	1.37 3.38***				1.26 2.97***	
Rule of Law						
Bribery (% of revenues)	0.29 5.47***	0.33 5.53***	0.31 5.70***	0.34 6.17***	0.33 5.91***	0.37 5.97***
Copyrights violations		2.31 7.31***				2.36 7.11***
Firm Characteristics						
Private ownership	0.24 0.20	-0.52 -0.39	0.23 0.19	0.25 0.21	0.24 0.20	-0.55 -0.41
Small-sized firm ^o	4.35 4.43***	4.28 4.07***	4.40 4.48***	4.50 4.38***	4.47 4.35***	4.54 4.13***
Medium-sized firm ^o	0.93 1.05	1.18 1.25	0.97 1.09	0.84 0.91	0.78 0.85	1.07 1.09
De novo (since 1994)	-0.14 -0.28	-0.02 -0.05	-0.13 -0.26	-0.05 -0.10	-0.07 -0.13	0.10 0.18
Exporter	-0.46 -0.65	-1.02 -1.33	-0.54 -0.76	-1.00 -1.32	-0.90 -1.19	-1.16 -1.41
Foreign investment	-3.53 -4.28***	-3.24 -3.67***	-3.58 -4.33***	-3.40 -4.00***	-3.38 -3.97***	-3.06 -3.35***
Location, small city ^{oo}	-0.18 -0.18	-0.13 -0.12	-0.17 -0.18	-0.09 -0.08	-0.11 -0.11	-0.07 -0.07
Location, large city ^{oo}	1.62 1.87*	1.41 1.51 ⁺	1.61 1.87*	1.87 2.11**	1.87 2.11**	1.72 1.79*
Manufacturing ^{ooo}				1.72 0.84	1.56 0.77	2.06 0.91
Service ^{ooo}				-0.10 -0.04	-0.04 -0.02	1.65 0.62
Agriculture ^{ooo}				-0.52 -0.26	-0.57 -0.28	0.55 0.24
Construction ^{ooo}				1.98 0.91	1.87 0.86	2.16 0.90
Adjusted R2	.22	.23	.21	.22	.22	.23
Number of Observations	4775	4166	4781	4386	4381	3802

*** significant at 1% ; ** significant at 5% ; * significant at 10% ⁺ significant at 15%

Notes : From the survey, business constraints were rated on a scale from 1 to 4, where 1 implies “no constraint” and 4 “major obstacle”. These include inflation, financing, infrastructure, tax/regulation, policy instability constraints, as well as quality of courts, protection of property rights, copyright violations and constraints to exercise ‘voice’ of the firm. Bribery is expressed as percentage of revenues. Fixed country effects were used for all countries, except for Latvia (benchmark) to account for differences across individual countries. World averages were used for some variables in those countries that were entirely missing observations for that specific variable, in order to maximize the efficiency of estimators without affecting their lack of bias. All firm characteristics are defined as a binary choice.

^o Large firms constitute the benchmark; ^{oo} Location in capital constitutes the benchmark; ^{ooo} Other sectors constitute the benchmark

Source: Kaufmann, D., Mastruzzi, M., and Zavaleta, D., “Sustained Macro-Economic reforms, Tepid Growth: A Governance Puzzle in Bolivia?”, World Bank, 2001

The magnitude and significance of the coefficient measuring corruption, and the availability of various measures of corruption in the survey, warrants probing deeper into this issue. Overall, the literature treating corruption presents it as a negative factor in development.²¹ However, in the theoretical literature some strands put forth more subtle approaches, with equivocal results.

In particular, one such strand that challenges the simple notion that corruption per se is an unambiguous negative is the “unpredictability of corruption” hypothesis, which posits that it is not corruption per se that has perverse effects, but its unpredictability instead.²² The WBES firm-level dataset permits to empirically evaluate this subtle corruption hypothesis. Such an unpredictability of corruption hypothesis is tested through three separate questions in this survey: uncertain price of the corrupt service, uncertainty whether other officials may subsequently request additional bribe payments, and uncertainty in the delivery of the purchased service. Yet as reported in Table 4.4 below, we find that controlling for other factors, there is no significant relationship between the degree of unpredictability of corruption, on the one hand, and the degree of underreporting of revenues by the firm, on the other. By contrast, the magnitude and significance of the level of corruption variables, proxied by the amounts of bribes paid or by the frequency of bribery, remain very high—irrespective of which (and if any) unpredictability of corruption component is used in the econometric specifications.²³

Table 4.4: Underreported Revenues vs. Unpredictability of Corruption

Determinants	1	2	3	4	5	6
Business Constraints						
Financing constraint	-0.04 <i>-0.11</i>	0.42 <i>1.16</i>	0.30 <i>0.67</i>	0.11 <i>0.26</i>	-0.12 <i>-0.30</i>	0.24 <i>0.67</i>
Inflation constraint	-0.15 <i>-0.52</i>	-0.12 <i>-0.49</i>	-0.31 <i>-0.99</i>	-0.09 <i>-0.32</i>	0.03 <i>0.10</i>	-0.04 <i>-0.18</i>
Policy instability constraint	0.77 <i>2.76***</i>	0.74 <i>2.94***</i>	0.82 <i>2.71***</i>	0.58 <i>2.05**</i>	0.51 <i>1.90*</i>	0.55 <i>2.23**</i>
Infrastructure constraint	0.89 <i>2.07**</i>	0.68 <i>1.72⁺</i>	0.80 <i>1.75*</i>	0.39 <i>0.91</i>	0.42 <i>1.04</i>	0.22 <i>0.59</i>
Tax/regulatory constraint	1.30 <i>2.44**</i>	1.25 <i>2.72***</i>	1.40 <i>2.50**</i>	0.73 <i>1.39</i>	0.76 <i>1.51⁺</i>	0.80 <i>1.78*</i>
Unpredictability of Corruption						
Bribery (% of revenues)	0.28 <i>4.68***</i>	0.29 <i>4.91***</i>	0.27 <i>4.38***</i>			
Frequency of bribing				2.16 <i>6.90***</i>	1.84 <i>6.23***</i>	2.01 <i>8.07***</i>
Corrupt service unpredictability			-0.01 <i>-0.03</i>	0.44 <i>1.51⁺</i>		
Corrupt payment unpredictability	0.01 <i>0.03</i>				0.26 <i>0.95</i>	

²¹ See Rose-Ackerman, 1978, Klitgaard 1988, Shleifer and Vishny, 1994, Mauro 1997.

²²In other words, in settings where corruption is predictable, the premise is that corruption would not have harmful effects compared to where the degree of unpredictability of corruption is much higher. Predictability of corruption is characterized by both the bribe payer and receiver knowing ‘what it takes’ in terms of payments required, to whom the payment needs to be made, and the degree of certainty that the privately purchased ‘service’ from the official will actually be delivered.

²³ In Table 2 we also find similar results to those reported in Table 1 in terms of which firm characteristics matter, controlling for other factors: firms that are not large (small or medium-sized), produce for the domestic market (nonexporters), lack foreign investment, and are privately owned, tend to engage more in unofficial activity. By contrast, the coefficients for both de novo firms and for location are insignificant, implying that, controlling for other factors, neither the firm’s age nor its location of headquarters is a determinant.

Corrupt extra request unpredictability		-0.10			0.10	
		-0.37			0.40	
Government inefficiency				1.30	1.39	1.05
				3.28***	3.59***	3.01***
Firm Characteristics						
Private ownership	-0.44	0.10	-0.11	0.05	-0.97	-0.44
	-0.32	0.08	-0.07	0.04	-0.75	-0.36
Small-sized firm	4.42	4.94	5.23	5.50	4.60	4.75
	3.43***	4.49***	3.63***	4.06***	3.71***	4.40***
Medium-sized firm	0.84	0.97	2.01	2.26	1.18	0.89
	0.73	0.98	1.54 ⁺	1.84*	1.06	0.92
De novo (since 1994)	-0.23	0.19	-0.20	0.09	0.04	0.36
	-0.36	0.35	-0.31	0.15	0.07	0.67
Exporter	-0.89	-1.30	-1.59	-1.22	-0.53	-1.18
	-0.97	-1.60 ⁺	-1.57 ⁺	-1.29	-0.61	-1.49 ⁺
Foreign investment	-3.64	-3.37	-3.88	-3.07	-2.81	-2.92
	-3.42***	-3.69***	-3.24***	-2.75***	-2.76***	-3.26***
Location, small city	-0.13	0.18	-0.17	-0.01	0.00	0.01
	-0.11	0.16	-0.13	-0.01	0.00	0.01
Location, large city	1.42	2.18	1.38	1.24	1.29	1.53
	1.36	2.26**	1.25	1.20	1.31	1.65 ⁺
Manufacturing	1.81	1.94	1.97	1.74	1.82	2.04
	0.85	0.93	0.69	0.62	0.83	0.95
Service	0.34	0.38	0.24	0.67	1.05	1.14
	0.13	0.16	0.08	0.22	0.42	0.46
Agriculture	-0.64	-0.04	-0.63	0.18	0.50	0.66
	-0.30	-0.02	-0.22	0.07	0.23	0.31
Construction	1.39	1.70	1.62	1.63	1.73	1.73
	0.60	0.77	0.54	0.56	0.74	0.75
Adjusted R2	0.19	0.19	0.19	0.18	0.17	0.20
Number of Observations	3262	3902	2926	3347	3369	4223

*** significant at 1% ; ** significant at 5% ; * significant at 10%⁺ significant at 15%

Note: From the survey, business constraints were rated on a scale from 1 to 4, where 1 implies no constraint and 4 implies a major obstacle. These include inflation, financing, infrastructure, tax/regulation, policy instability constraints, as well as quality of courts, protection of property rights, copyright violations and constraints to exercise 'voice' of the firm. Bribery is expressed as percentage of revenues. Although not reported in table, fixed country effects were used to account for differences across individual countries. World averages were used for some variables in those countries that were entirely missing observations for that specific variable, in order to maximize the efficiency of estimators without affecting their lack of bias. Finally, all firm characteristics are defined as a binary choice.

^o Large firms constitute the benchmark ^{oo} Location in capital constitutes the benchmark ^{ooo} Other sectors constitute the benchmark

Source: Kaufmann, D. , Mastruzzi, M., and Zavaleta, D., "Sustained Macro-Economic reforms, Tepid Growth: A Governance Puzzle in Bolivia?", World Bank, 2001

C. Severity of Constraints and Firm Characteristics: Size Matters, in Complex Ways

The details of the WBES data set permit an investigation of how a variety of firm characteristics affect their experience and perceptions of constraints. For example, the data allow an investigation of whether the implicit tax imposed by inappropriate government policies and regulations is evenly or unevenly distributed across different types of firms within a country. To do so, the authors regressed the various constraints against firm characteristics, controlling for country effects.

An econometric review of the many key potential obstacles to business suggests that firms that are private, smaller, newer, devoid of FDI, and that cater to the domestic market generally tend to face more acute business constraints than firms that are older, larger, exporting, have FDI, or are state-owned.²⁴ There are some notable exceptions regarding some business constraints, however: older firms report being more constrained by political instability than younger firms, and exporters are hit harder by inflation than nonexporters, for instance. In terms of firm size, on a global scale, on average, small and medium firms report being more constrained than large firms along most dimensions,²⁵ either because their objective conditions are better or because they can better cope with them. Large firms are more constrained than small and medium firms by only one constraint: infrastructure.

The analysis of firm characteristics allow a subtle reading of the data (see Table 4.5 for econometric table and Figure 4.1-4.8 for graphical illustration, below). For example, one observes that corruption is perceived as more constraining by smaller and younger firms, but also by those with government or public ownership and those that export. An *inadequate exchange rate regime* appears to be felt more by medium-sized firms, younger firms, and those with some state ownership.

One notable result that emerges from this econometric exploration is that of the “forgotten middle.” While conventional wisdom suggests that the smaller the firm, the more severe the constraint, the detailed evidence suggests that often medium-sized firms identify themselves as equally or even more constrained than do small firms. In particular, medium-sized firms show no statistical difference in their response from small firms to a number of general constraints, including finance and corruption; report a statistically significantly higher constraint from taxes and regulations (as well as the specific constraint of “high taxes”), exchange rate problems, infrastructure and policy instability; and report a higher frequency of informal payments than do small firms.

These more subtle results suggest that efforts to level the playing field, which unduly focus on microenterprises and small enterprises, may overlook important constraints to medium-sized enterprises.²⁶ To focus only on small firms would ignore the plight of mid-sized firms (hence the

²⁴ Probit models for the different constraints are estimated using firm characteristics as explanatory variables.

²⁵ See No. 43: Firm Size and the Business Environment: Worldwide Survey Results, August 2001, by Mirjam Schiffer and Beatrice Weder.

²⁶ In some cases, this pattern may relate to a “threshold effect,” in which obstacles may not constrain entry so much as they deter growth from small to medium size. “The **threshold burden** comprises a discontinuity in the structure of costs that results where some fiscal or bureaucratic burden is imposed only on firms above a minimum size. This discontinuity can lead some firms to rein in expansion—or to expand inefficiently by creating quasi-independent enterprises, each smaller than the threshold at which the tax and regulatory requirements are imposed.” See Levy,

notion of the forgotten middle'. In fact, the complexity that characterizes the way in which different obstacles appear to affect different types of enterprises reinforces the rationale for focusing on across-the-board reduction of obstacles to businesses, rather than (the often unproductive) earmarking of targeted policies according to firms' characteristics, such as size.²⁷

Table 4.5: Results of Least Square Estimates: Obstacle Severity on Firm Characteristics

Dependent variable	Explanatory variables							
	Small Size Firm	Medium Size Firm	Firms with foreign ownership	Firms with government control	Firms that export	Located in Large city	Located in Small city	N
Finance	0.222* (0.034)	0.159* (0.031)	-0.329* (0.030)	0.105* (0.036)	0.065* (0.025)	0.021 (0.029)	0.055 (0.034)	9211
Taxes and regulations	0.071* (0.026)	0.080* (0.026)	-0.096* (0.025)	-0.169* (0.029)	0.005 (0.021)	0.002 (0.025)	0.018 (0.028)	9384
Inflation	0.173* (0.030)	0.096* (0.027)	-0.084* (0.027)	-0.076* (0.032)	-0.053** (0.022)	-0.032 (0.027)	0.011 (0.030)	9111
Exchange rate	0.089* (0.033)	0.031 (0.030)	0.058** (0.028)	-0.108* (0.036)	0.116* (0.025)	0.021 (0.029)	0.089* (0.034)	8990
Corruption	0.205* (0.034)	0.112* (0.031)	-0.054 (0.031)	-0.165* (0.037)	0.003 (0.025)	0.016 (0.031)	0.029 (0.036)	8359
Tax Administration	0.053 (0.032)	0.063** (0.029)	-0.057** (0.028)	-0.175* (0.034)	0.012 (0.023)	0.011 (0.028)	0.071** (0.032)	9479
Infrastructure	-0.082 (0.032)	-0.022 (0.029)	0.007 (0.028)	-0.128* (0.033)	-0.018 (0.023)	0.019 (0.027)	0.047 (0.032)	9119
Policy instability	0.041 (0.032)	0.035 (0.029)	-0.018 (0.029)	-0.113* (0.034)	0.012 (0.023)	-0.033 (0.028)	-0.004 (0.032)	9016
High Taxes	0.074* (0.027)	0.085* (0.029)	-0.093* (0.026)	-0.238* (0.031)	-0.004 (0.021)	0.017 (0.026)	0.028 (0.029)	9695

Note: *=significant at 1%; **=significant at 5%; ***=significant at 10%.

Notes: All dependent variables are constraints measured on a scale of 1-4 with 4 = major obstacle and 1=no obstacle.

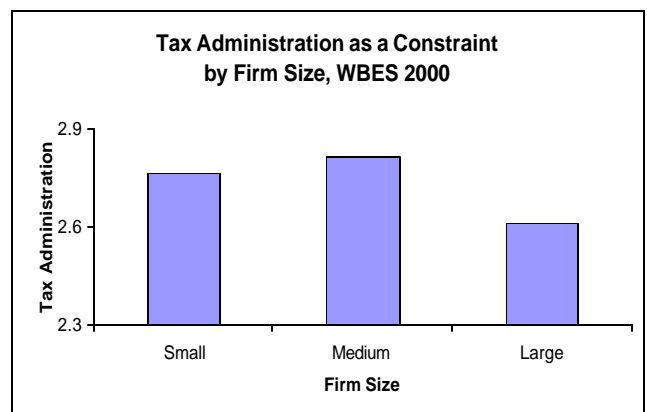
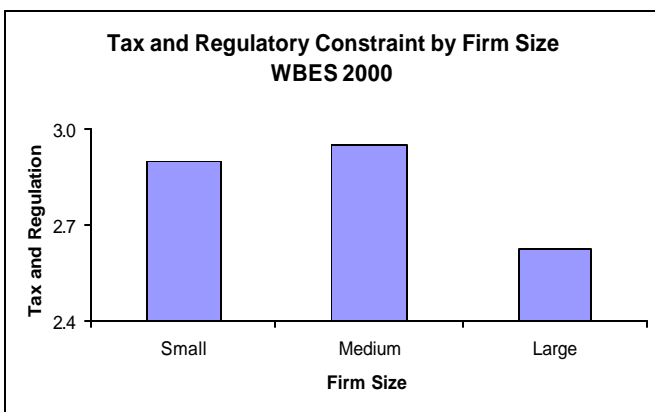
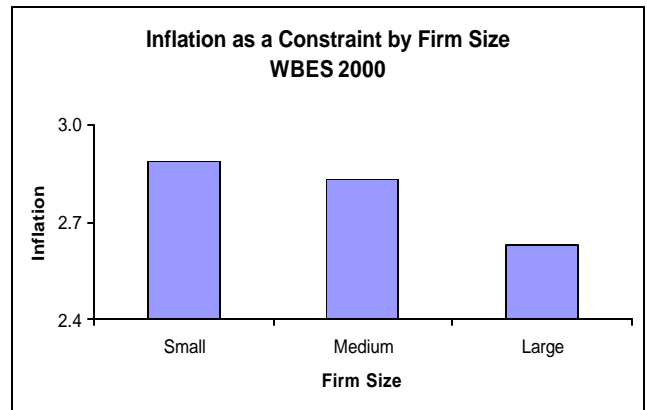
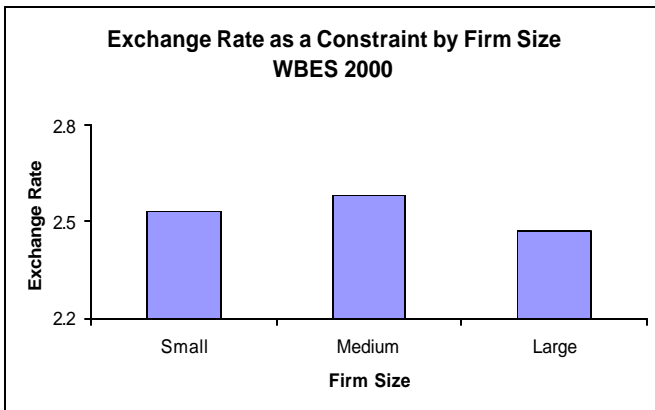
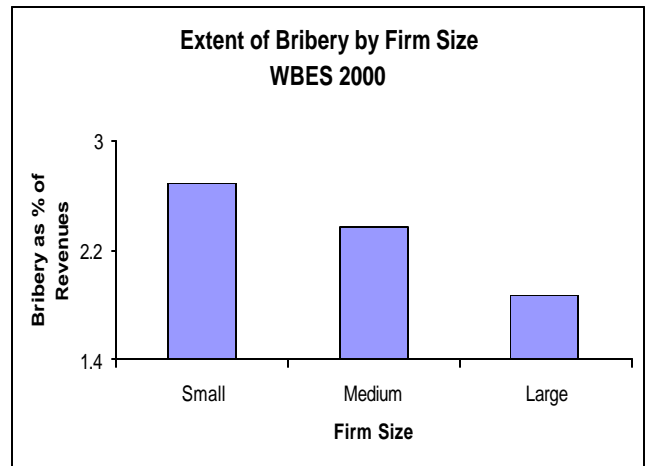
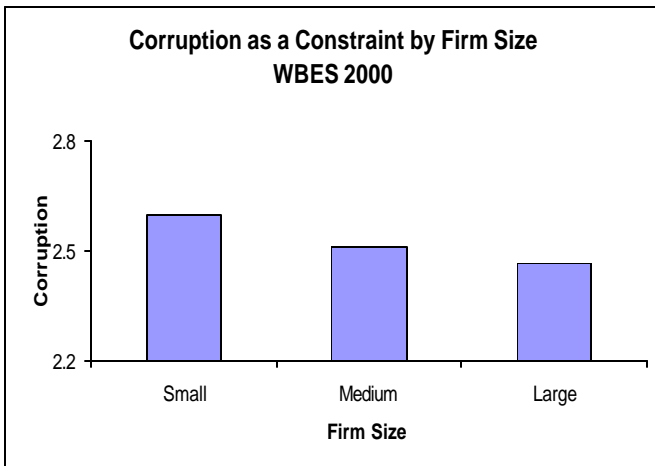
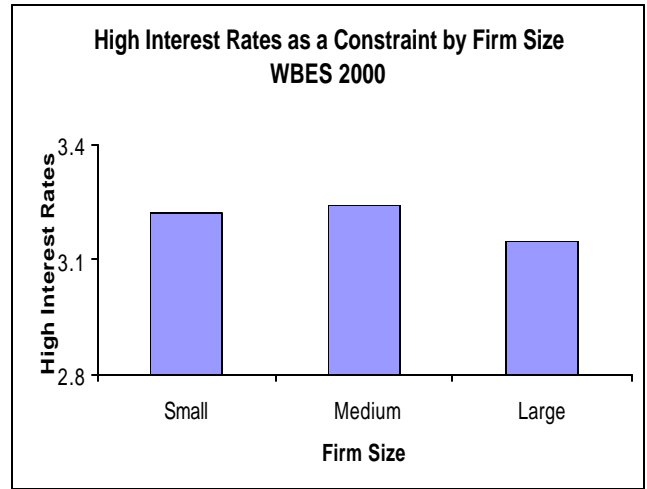
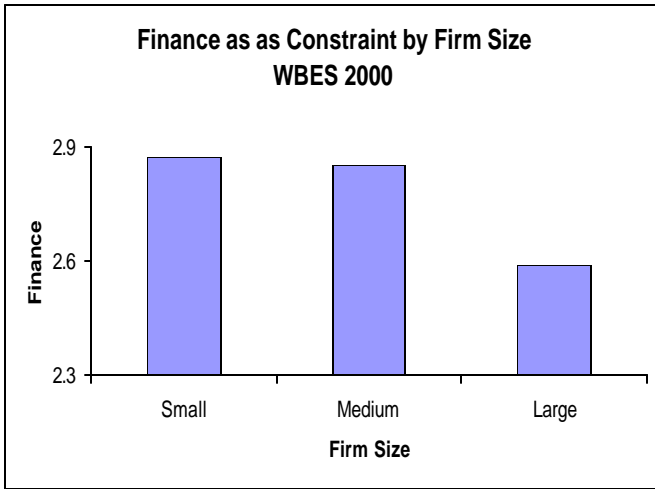
Foreign ownership, export orientation, government control are represented by indicator variables with a value of one for presence and zero otherwise. Firm size and location are represented by indicator variables---Large firm size is the omitted category for size; Firms in the capital city constitute the omitted category for location.

Country dummies have been included in regressions but not reported here.

B., in *Obstacles to the Development of Indigenous Small and Medium Enterprises in Sri Lanka and Tanzania: An Empirical Assessment*, World Bank Economic Review, Volume 7, Number 1, January 1993.

²⁷ Even the qualified generalizations provided above require particular caution when we study a particular country, or region.

Figure 4.1-4.8: Severity of Constraints by Firm Size



Box 4.1: Firm Performance and State Capture in Transition—Survey-Based Unbundling of Governance for Analysis of the Firm’s Role in Shaping the Business Environment.

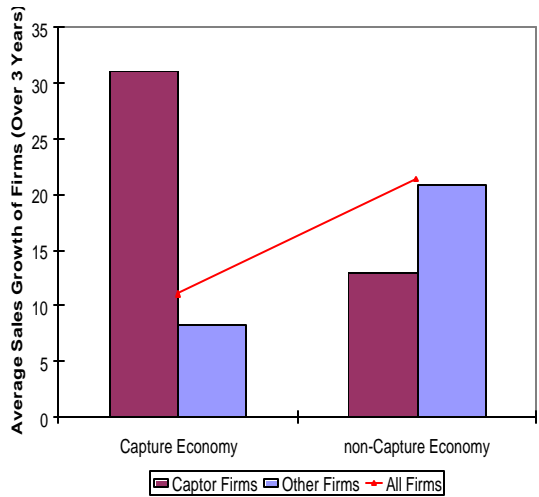
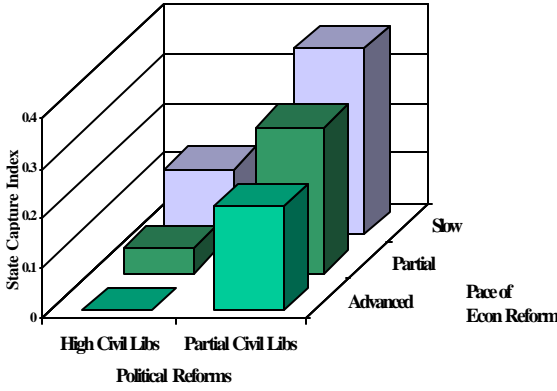
State capture, a form of grand corruption, was measured and analyzed for 22 transition economies in the transition Europe version of the enterprise survey (the “BEEPS”). State Capture is defined as the efforts by firms to shape the laws, policies, and regulations of the state to their own advantage by providing illicit private gains to public officials. In transition economies, corruption has taken on a new image: that of so-called oligarchs or related elite enterprises manipulating policy formation and even shaping the emerging rules of the game to their own very substantial advantage. Though this form of grand corruption is increasingly being recognized as the most pernicious and intractable problem in the political economy of reform, few systematic efforts have been made to distinguish its causes and consequences from those of other forms of corruption. WBES permitted an empirical exploration.

By taking the average share of firms affected across six institutions—parliament, the executive, criminal courts, the civil courts, the central bank, and political parties—a state capture index for each country is developed. The evidence indicates that there is a very large gap between countries where this form of corruption is a serious problem, which are called high-capture economies, and those where it is seen as a relatively modest problem, called low-capture economies. Among the low-capture economies are both the most reform-minded in the region, while high-capture group includes countries regarded as partial reformers in both political and economic terms; indeed, their political regimes tend to be characterized by a greater concentration of power and limitations on political competition. State capture is negatively related to the level of civil liberties.

This version of the WBES also permitted the identification of firms that have paid bribes to influence the content of laws, rules, or regulations (i.e., the *captor firms*). As seen in Fig.4.2, in high capture economies, captor firms grow more than twice as fast as other firms (in contrast with low-capture the overall enterprise sector in such economies grows at somewhat less than half the rate of firms in low-capture economies). Capture is therefore a large “tax” on noncaptor firms, while state capture provides the captor firms with substantial private gains. The data also suggest that once a country has fallen into the trap of a capture economy, foreign direct investment can magnify the problem.²⁸

Fig B4.1: State Capture and Reform

Fig B4.2: Private Benefits and Social Costs of State Capture



²⁸ Joel Hellman and Daniel Kaufmann *Confronting the Challenge of State Capture in Transition Economies Finance and Development* (IMF: September 2001, Volume 38, Number 3)

Annex to Section IV: Glossary of Terms for Variables in Empirical analysis, and Background Econometric Results from Worldwide Business Survey (WBES)

1. Under-Reported Revenues: Recognizing the difficulties many enterprises face in fully complying with taxes and regulations, what percentage of total sales would you estimate the typical firm in your area of activity reports for tax purposes? (%)
2. Constraints in: Financing; Policy Instability; Exchange Rate; Inflation; Corruption; Tax/Regulations (for each): Please judge on a four point scale how problematic are the following factors for the operation and growth of your business: [1, no obstacle; 4, major obstacle]
3. Bribery: On average, what percent of revenues do firms like yours typically pay per annum in unofficial payments to public officials? (%)
4. Availability of Laws: In general, information on the laws and regulations affecting my firm is easy to obtain. [1, fully agree; 6, fully disagree]
5. Quality of Services: Please rate the overall quality and efficiency of services delivered by the following public agencies or services (education, judiciary/courts, public works, postal system, water, police, Central Bank). [1, very good; 6, very bad]
6. Copyrights Violations: Please judge on a four point scale how problematic the following practices of your competitors are for your firm ('they violate my copyrights, patents or trademarks'): [1, no obstacle; 4, major obstacle]
7. Frequency of bribery: Thinking about government officials, it is common for firms in my line of business to have to pay some irregular additional payments to get things done. [1, always true; 6, never true]
8. Corrupt Service Unpredictability: If a firm pays the required additional payment the service is usually also delivered as agreed. [1, always true; 6, never true]
9. Corrupt Payment Unpredictability: Firms in my line of business usually know in advance about how much this additional payment is. [1, always true; 6, never true]
10. Corrupt Extra Payment Unpredictability: If a firm pays the required additional payment to a particular government official, another government official will subsequently require an additional payment for the same service. [1, always true; 6, never true]
11. Government inefficiency: How would you generally rate the efficiency of government in delivering services? [1, very efficient; 6, very inefficient]
12. Government unhelpfulness: Please rate your overall perception of the relation between Government and/or bureaucracy and private firms on the following scale. All in all, for doing business I perceive the state as: [1, very helpful; 5, very unhelpful]

Section V: Conclusions and Implications

The results of the World Business Environment Survey show that important dimensions in the climate for business operations and investment can be measured, analyzed, and compared across countries, and that important governance aspects are centrally related to the business environment and investment climate. Further, the survey findings suggest that key policy, institutional, and governance indicators are connected to important outcomes, including sales by firms and investment growth, and the extent of unofficialdom. And they point to the value of monitoring such indicators over time, because progress in these indicators should yield real improvements in enterprise performance.

In particular, the WBES provides empirical confirmation for some commonly held truths, while providing little evidence for others. For example, it provides a clear connection between taxation, financing, and corruption on the one hand, and growth and investment on the other. It suggests the role for consultation with key economic stakeholders in providing an effective environment for firm growth. It suggests that weak investment climate conditions associated with macroeconomic stability, regulatory and tax constraints, and weak governance all play a role in unofficialdom, hence the size of the “shadow” economy.

In addition, as the extensive use of country control variables and “kvetch control” indicates, perceptions are only imperfectly related to underlying physical and cost conditions. Furthermore, this type of business survey paves the way toward a deeper understanding of a firm’s behavior in shaping the business environment and investment climate. A major finding of a related research project associated with this survey effort is that, contrary to convention, a firm ought not be seen merely as a passive business and investment climate “taker, in which the orthodox presumption has been that the government is the primary source of all business constraints. Instead, the data from transition countries that permitted an in-depth analysis of “state capture” highlighted empirically the extent to which powerful firms play a key role in shaping the policies, laws, and regulations that form the business environment and investment climate, thus positing the notion that some firms become business climate “makers,” particularly in some countries where state capture or other related forms of firm influence is prevalent. This nexus pointing to the effect of a firm’s strategy on the business climate through its (privately induced) effect on public misgovernance further illustrates how important is to view both governance and the investment climate within an integrated framework. It is not just that the climate for business and investment is determined in large measure by governance-related variables, but furthermore, the actions of selected firms in many countries contribute to the shaping of such governance and investment climate in the first place.

Another salient finding of this work refers to the enormous variance in the manifestations and severity of different types of constraints across countries and regions. This implies a limited value of worldwide generalizations about the severity of a particular type of constraint. It also suggests the importance of the need to unbundle generic clusters of constraints; that is, a governance or corruption constraint in one country will have different severe manifestations than in another country, for instance. The country specific data, initial analysis, and findings emerging from both this Voice of the Firms report, as well as related papers and outputs from this project

(see the bibliography) points to the value of monitoring business environment indicators over time.

Another key finding of this work lies in the enormous variance in the nature and severity of different types of constraints across countries and regions. This implies that the global generalizations regarding the severity of a particular constraint is of limited value. It also suggests the importance of “unbundling” generic clusters of constraints; for example, a regulatory or governance constraint in one country will have different manifestations than in another, albeit both may be severe.

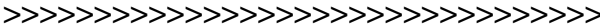
The complex interaction between firm size and severity of reported constraints by enterprises found in this work poses a challenge for policy makers. The relationship between firm size and the severity of a constraint is not found to be unambiguously declining (with the smallest firms invariably facing the most daunting constraints) but instead of a rather nonlinear nature for some constraints (mid-sized enterprises report that for several business constraints, they are at least as severely affected as smaller firms). If such findings are validated through further such empirical studies, some implications emerge. First, it would then be prudent to focus specifically on each particular constraint and in the ways they affect firms of different sizes, because depending on the constraint, small, medium, (or larger) firms may be affected most gravely. Second, given the prevalence of types of constraints for which mid-sized firms are worst afflicted, it is warranted to study in more depth the obstacles to growth for mid-sized enterprises in particular, given their importance as potential or actual engines of growth in many countries. And third, these results would argue against targeted policies to small (or medium) enterprises based on the notion that such policies are needed to level the playing field.

Furthermore, the country-specific data, initial analysis, and findings emerging from the WBES in this paper and other empirical work (see the bibliography) points to the value of measuring and monitoring the business environment indicators over time. The relationship shown between key WBES indicators and firm-level outcomes suggests that progress in these business and governance indicators should be associated with real improvements in enterprise performance over time. Now that this survey approach implemented (roughly) simultaneously across regions and many countries has been implemented on such a large multipartnership, it would be highly valuable to repeat it, and institutionalize its implementation every three years or so.

In order to carry out similar projects in the future, implementation of the WBES offers a few lessons. First, because WBES was a multipartner venture, coordination by all participants on a core instrument and uniform implementation would enhance its reliability and comparability across many more variables. Second, it is important to account for inherent biases and measurement errors in any enterprise survey of this type. This necessitates care in interpretation, use of control variables (Section IV), and it points to the need for complementing the results of a firm survey with other data rather than considering this single survey as the unique input to an investment climate assessment.

Finally, for the next survey of firms (starting in 2002 for some regions), it will be important to obtain a larger sample size in each country (to lower the measurement error) and to ensure that implementation is comparable with the approach taken during WBES 2000. This is particularly

true for economy-wide sampling, for replicating the core questions, and to have a similar interview framework for gathering information on a firm's influence and response to the governance and policy environment.



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