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Consequences of Business Regulation

South America at the outset of the 21st century

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Abstract

This is a study of Latin America's economic development and how business regulation contributes to or hinders that process. We specifically focus on three nations: Chile, Brazil, and Bolivia, to illustrate the main differences across the region. We have studied the effects of business regulation on corruption, the size of the informal sector and how these in turn influence economic development as a whole. We have found that cumbersome regulation is likely to cultivate corruption and give rise to a large informal sector, thus hampering formal economic growth. Conclusively we claim that reducing regulation, alternatively improving the level of governance and rule of law, is beneficial for the development of the formal private sector. Additionally such progress in the political and economic environment is conducive to improving overall welfare.

Key words: business regulation, economic growth, corruption, informal sector, South America

Words: 9,409

Table of contents

1. Introduction.....	p. 1
2. Method.....	p. 3
2.1 Approach.....	p. 3
2.2 Geographical framework.....	p. 4
2.3 Theoretical framework.....	p. 7
3. Data.....	p. 10
3.1 Parameters of the standardized firm.....	p. 10
3.2 Business start-up variables.....	p. 11
4. Analysis.....	p. 15
4.1 Country background: Brazil.....	p. 15
4.2 Country background: Bolivia.....	p. 18
4.3 Country background: Chile.....	p. 21
4.4 Business regulation, corruption and the informal sector.....	p. 23
4.5 Business regulation and economic growth.....	p. 28
5. Conclusion.....	p. 33
List of references.....	p. 37
Appendix 1.....	p. 40
Appendix 2.....	p. 43
Appendix 3.....	p. 43

1. Introduction

“The world over, the private sector is the major contributor to GDP and employment and so is the engine of the economy.”¹

The economic development in Latin America in recent years has not lived up to its potential. The living standards are below world average and although there are many causal factors involved, among the most prominent are surely the lack of *de facto* economic freedom and an established rule of law. According to The Fraser Institute (2006), Latin America has failed to improve in every key area of market reform, including government size, rule of law and property rights, sound money, freedom to trade, and regulation. However, there are large variations in the level of development within the Latin American region. We have chosen to focus on three countries that exemplify the spectrum of scenarios to be found in Latin America today. The first is Chile, which is the model country of the region. Chile is the most economically developed of all Latin American countries, and, as The Fraser Institute notes, is the only nation that has established a high coherence with the rule of law and managed to adopt wide-ranging market reforms in conformity with western economic standards. Brazil is fairly mediocre when it comes to economic freedom, even by Latin American standards.² However, being the largest country in the region, it has a much larger domestic market and higher economic potential than its neighbors. Although Brazil still lies slightly above Latin America’s average level in the ranking of rule of law, this index has been decreasing dramatically in the past ten years, making it difficult for Brazil’s economy to achieve long-term improvements. Lastly, we have chosen to focus on Bolivia, another extreme that exemplifies a weak economy and the poorest population in Latin America.

Our purpose with this essay is to explore how factors pertaining to private entrepreneurship contribute to successful economic development in each of these countries, to identify the causes for stunted economic growth in the private sector, and

¹ OECD, 2004

² Fraser Institute, 2006

to discuss which measures could be taken in order to improve economic progress in each of these countries.

Business regulation is a subject that has received more attention in recent times. Our key source of information is the *Doing Business* Index and research papers related to those reports from the World Bank's working group. Nonetheless, as the researchers behind this index assert themselves³, it would be fair to say that the discussion around the subject's relation to government imperfections was spurred by Peruvian economist Hernando de Soto. In De Soto's seminal work *The Other Path* (1989), his view is described as representing "the 'mercantile' state as a monstrous impediment to business acumen" and that "even a humble street vendor would have incalculable potential for entrepreneurship were it not for the intrusions of a state bent on thwarting individual freedom".⁴ We will also address corruption and bureaucratic setbacks to the extent of its relation to doing business, but our study focuses primarily on analyzing official policy and its implications for entrepreneurship and (formal) private sector growth. As a contemporary and ongoing area of debate it is of interest to give this topic particular attention, and our aim is to investigate whether improving regulations concerning business start-up will have a lasting effect on economic growth and standards of living. The Inter-American Development Bank has come to the following conclusion:

*"In order to maintain sustainable rates of economic growth that can have an impact on reducing poverty, the next few years should be devoted to a special push to further the development of the private sector."*⁵

The costs and regulations that concern business start-up may seem trivial in relation to overall national development, but, on the contrary, we believe that there is indeed a relationship between these factors. In this study we wish to examine that relationship and verify the importance of entrepreneurship for growth and economic welfare.

³ Djankov et al, 2002:2

⁴ In Fernández-Kelly & Shefner, 2006:2

⁵ Inter-American Development Bank, 2004:4

2. METHOD

2.1 Approach

In this study we mainly use a positivistic approach to scientific research. Our empirical data is almost entirely quantitative, describing numerical variables involved in different processes of starting a business (for example, the *number* of application procedures/documents or the *number* of days necessary to complete a certain process). Thus, we do not make qualitative inquiries into the essence of the variables used in our study, reasons for which should be made clear in subsequent paragraphs, but do, nonetheless, provide a thorough account of what factors constitute each variable used in our analysis.

In accordance with the positivistic approach, our epistemological view on the subject at hand assumes that there is an objective reality that can be measured. We see the regulations established by governments as factual protocol that cannot be subject to varying interpretation, but rather, in their intended purpose, to establish unequivocal rules concerning the legal process of starting a business. It is possible that certain jurisdictional clauses within these regulations may be open to interpretation, but the rhetorical content of the procedural documents is not pertinent to our present study. Simultaneously, it could be argued that the informal procedures that do indeed occur in the reality of our case studies have implications for the objectivity of our empirical data. We do, however, address aspects of informality that are embedded in the systems that we analyze, but their implications actually serve to further strengthen our conclusions.

The empirical objectivity of positivism also postulates that there should be “independence between the ‘reality’, the researcher and instruments of research”.⁶ We adhere to this approach in believing that the researchers behind the *Doing*

⁶ Sumner & Tribe, 2008:60

Business studies, and the instruments that they use, do not significantly influence the data they collect and present in their reports- at least not enough to undermine the conclusions that can be drawn from their results. We justify these assumptions with the knowledge that the data collected is extracted from officially published information. As mentioned, this information regards prescriptions about legal procedures and can therefore not be manipulated by researchers nor their instruments. Furthermore, the classification of the data used follows international standards that are applicable to any country, except possibly some rogue exception that does not figure into the scope of our study.

Notwithstanding the quantitative foundation of our study, there are aspects of our analysis and conclusions that are based on a somewhat more phenomenological approach. We do examine the qualitative implications of the numerical and graphical data presented, and attempt to draw conclusions about causal relationships inherent in or produced by consequences of the system that forms our object of study. We do acknowledge that multidirectional relationships are possible, in fact undeniable, and that values will shape the way we observe such relationships as well the way in which such relationships are formed.⁷ For example, the values inherent in the cultures of the countries we use in our case studies are likely to define the construction of their regulations and the way in which people behave in relation to those rules. Yet it is important to state that these relationships do not influence the data used in our analysis, as described previously, and hence do not compromise the objectivity of the research material that forms the foundation of the study.

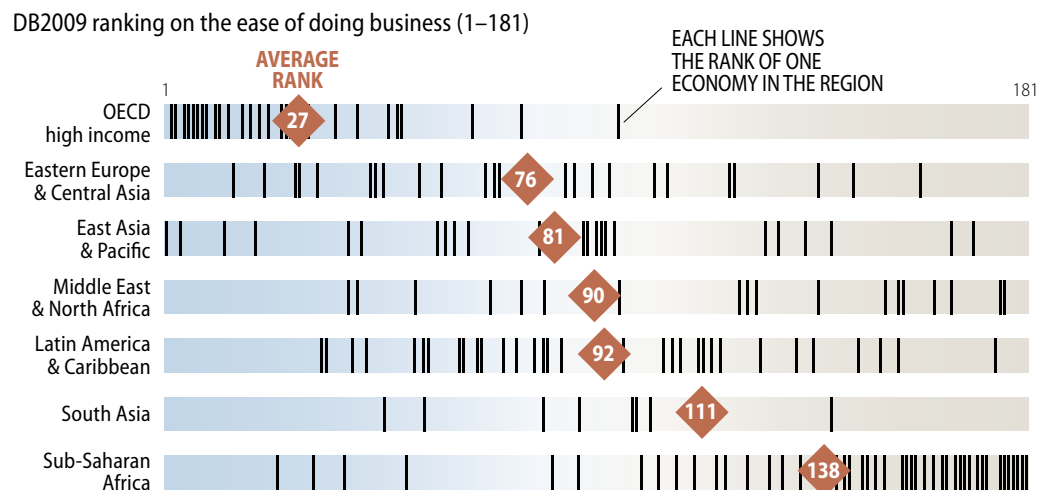
2.2 Geographical framework

At this stage it seems appropriate to describe our chosen framework for this study. Firstly, we have limited our study geographically to the South American continent. As compared to the average economic development of the African and Asian regions, South America tends to rank somewhere in between the other two, and

⁷ Maykut & Morehouse, 1994

the Latin American region also holds an average position in terms of the ease of doing business, as can be observed in the following figure.

Figure 2.2.1: *Doing Business* world rankings



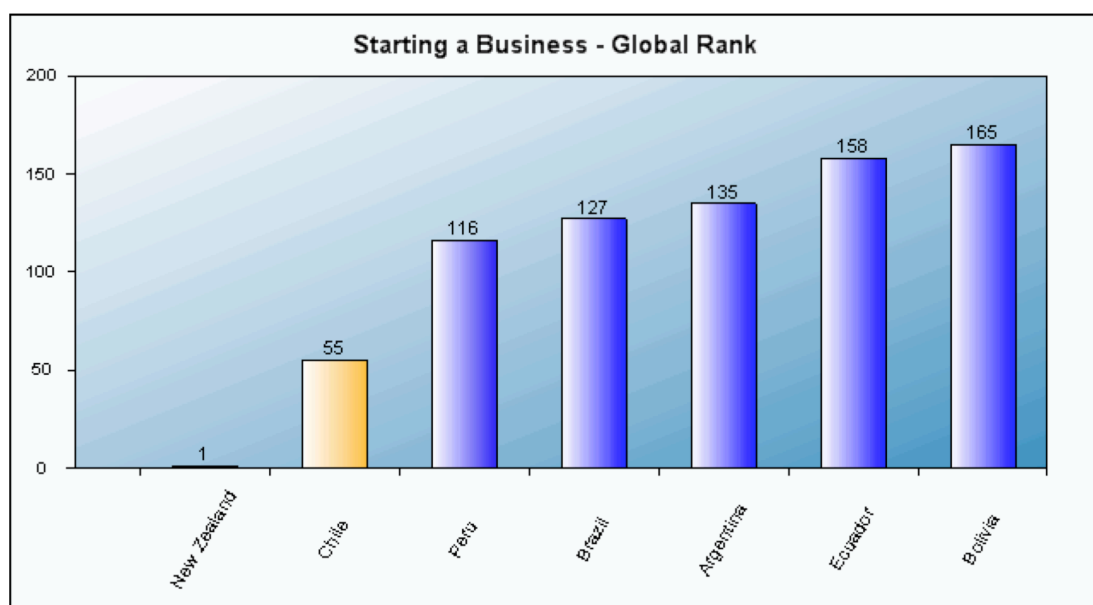
Source: *Doing Business* database.

Our framework offers a simplified view of the larger picture, which is nonetheless our intention for purposes of clarity and understanding. We have further chosen to focus on three countries in specific that aim to serve as a representative sample of the region. A limited scope of examination is necessary not only to confine the study at hand, but also to provide a picture that is accessible and comprehensive. We feel that this is best achieved by choosing a few nations that are representative of the entire spectrum of variables discussed herein. This selection is based on total size of the economy, measured by Gross Domestic Product (GDP), levels of per capita Gross National Product (GNI) adjusted to Purchasing Power Parity (PPP), and time required to start a business.⁸ Our choice of focused country studies consists of Brazil, Chile and Bolivia. We find these to make up a representative sample of the region for the following reasons. Brazil is by far the largest economy of the region, but only average as concerns per capita income and lagging far behind in terms of time necessary to start a business. Chile’s economy is very stable, with a per capita income well above that of Brazil even if national income is smaller, and the most efficient

⁸ World Bank (2008), see *Appendix 1* for raw data

country when it comes to starting a business. Last, and least in terms of national GDP and per capita GNI, Bolivia still maintains the median position in relation to the number of days required to start a business. These three countries thus provide a sample that stretches out along the spectrum of our variables and approximates the aggregate average of the region, also in relation to their global rank in starting a business, as shown below.

Figure 2.2.2: Starting a Business rankings



(1)

(2)

(3)

Source: Doing Business database

We have also taken other factors, such as corruption, economic freedom and rule of law, into account in the choice of our case studies. Furthermore, the political divergence of these countries' past and present provide a basis that may illuminate their respective legislative structure and market approach.

2.2 Theoretical framework

As stated previously, we rely mainly on the positivist approach to scientific research. In accordance with the basic ideology of Logical Positivism⁹ we use methods of inference to make conclusions about the implications of business regulation. *A priori* logical reasoning is used, in as much as we lack previous experience of undergoing the processes that constitute our object of study. Therefore, we attempt to deduce what significance factors inherent in the regulatory environment has for the economic prosperity of a country, deriving possible explanations for these phenomena and related effects from applicable socioeconomic theory. For instance, we wish to examine whether the interests of bureaucrats influence the manner in which the regulatory system is built up and how it is managed in practice. Continuing with the ontology and method of research in our logical approach, we also depend on the *a posteriori* practice of induction, as the bulk of our research is based on using empirical evidence to test our predictions. By inductive reasoning, we make conclusions from the data observed in the *Doing Business* evaluations and hope to establish a descriptive correlation between the variables we have identified as central to our study. In our case, that implies making generalizations about the nature of business regulation and how the extent and consequences of regulation are related to economic growth produced by the private sector.

There are two different theories surrounding the issue of rent extraction, which is itself directly related to business regulation policy. The more classical view, presented by Pigou (1939)¹⁰ as ‘public interest theory’, holds that government regulation is necessary to keep inferior entrepreneurs off the market place and that this will be socially beneficial. The more modern, liberal economic theory opposing this view derives from ‘public choice theory,’ stating that regulations are socially inefficient and generally imposed to produce an opportunity for rent extraction. There are two aspects of the public choice theory that aim to explain the rent-seeking phenomenon that promotes persistent bureaucratic business regulation.

⁹ Sumner & Tribe, 2008:60

¹⁰ In Djankov, 2008:3

Firstly, there is Stigler's (1971)¹¹ 'theory of regulatory capture.' This theory says that excessive entry regulation is created or maintained by interest groups that are part of the country's existing industry, mostly large business owners. These interest groups lobby government to retain high barriers to entry in order to minimize competition in their market area and thereby uphold their own profits. This is socially inefficient as it hampers competition, leading to higher prices and less consumer choice, and reduces incentives for firms to operate efficiently and responsibly.

The second aspect of public choice theory is known as the 'tollbooth theory.'¹² As the name indicates, this theory relates to how opportunities can be established in order to extract rent. Like tollbooths, the government can impose any number of procedures, or "stations," that the applicant needs to complete (or pass through) in order to attain his or her goal. Each additional regulation that incurs a cost for the applicant becomes a rent for the government or creates a procedure during which a government official is able to demand a bribe. Shleifer and Vishny¹³ point out that "an important reason why many of these permits exist is probably to give officials the power to deny them and to collect bribes in return for providing the permits." Needless to say, such proceedings are illegal and not every government official is corrupt, but the fact still remains that the government receives more money when imposing regulations that incur a fee. Furthermore, as we shall present evidence for later in the essay, countries that are perceived as more corrupt are prone to have more extensive entry regulation.

In the next section we describe which parameters are used in the study of business regulation, accounting for the variables that are relevant for this analysis and which theories are used as a basis for interpreting the effects or explaining the emergence of such regulation. The dissection of regulations concerning business start-up requires the categorization of a standard type of business, which is then used to compare varying aspects of regulation prevalent in different countries. Hence, as mentioned, this study combines elements of qualitative and quantitative investigation.

¹¹ *In* Djankov, 2008:4

¹² Djankov, 2008:5-7

¹³ *In* Djankov, 2008:5

Although mainly based on numerical findings from different types of indexes and rankings, we also have an analysis addressing issues that underlie the quantitative data, as well as exploring the implications of the data presented. As our study is based on statistics derived from mass-scale measurements, censuses and indexes, it is evident that we rely almost solely on secondary sources of information. Because of the magnitude of the data involved, this becomes a necessary method of research but does not exclude our own critical evaluation of data and conclusions to be drawn thereof. The quantitative foundation of our research is inherent in the data from the *Doing Business* reports. We do not command the necessary resources to carry out such extensive research on our own, and we find no reason to do so, as we rely on the veracity of the existing research. Furthermore, we acknowledge and choose to employ the neoliberal perspective that tends to characterize World Bank literature, finding it to be an appropriate approach to the use of the economic variables in this study. The World Bank's research group, i.e. the authors, behind the *Doing Business* publications have run econometric regressions on the data collected and found their results to be robust and significant in the context presented.¹⁴ In this essay we will not attempt to replicate such regression analyses. Instead, we devote our attention toward formulating qualified conclusions by method of inference and, in the positivist manner, describing and comparing observations about the nature of the results and their relation to other phenomena relevant in the systems of our case studies. While relying on the information provided in our research, we have defined our own approach to the use of that information in formulating our analysis.

¹⁴ Djankov et al, 2002:24-28; Doing Business database

3. DATA

3.1 Parameters of the standardized firm

The Doing Business report uses a set of standard parameters to define the type of business that is studied, in order to compare entry regulation across different industries and countries. The data presented are based on studies of laws and regulations and surveys of local lawyers, which the researchers find to produce a “more precise and objective measure of the business environment than other available perceptions-based measures of institutions”.¹⁵ A ‘standardized firm’¹⁶ is defined as follows:

- performing general industrial or commercial activities,
- operating in the largest city (by population)
- being exempt from industry-specific requirements
- not participating in foreign trade nor trading in goods that are subject to excise taxes (ex. liquor, tobacco, gas)
- being a domestically-owned limited liability company with capital subscribed in cash at the amount of at least ten times GDP per capita or the minimum capital required by the law
- renting (not owning) its land and business premises
- having 5-50 national resident employees one month after business start-up
- having a turnover of up to ten times its start-up capital
- not qualifying for investment incentives

¹⁵ Djankov et al, 2006:2

¹⁶ Djankov et al, 2002:7

The validity of these assumptions has been tested and found to be robust.¹⁷ The parameters used generally apply to the simplest form of business type, allowing for the widest and closest comparison across different industries and countries.

3.2 Business start-up variables

Modern enquiries into the nature of business-entry regulation tend to use official country data as a basis for the study, rather than observing measures of corruption or bureaucratic inefficiency. The main reason for this is the fact that official statistics are easier to evaluate. It also allows for the creation of a ‘standard of measurement’ that can be used for every country, in order to have a relatively homogenous sample for a cross-country or time-series analysis. Furthermore, these standards of measurement provide an incentive for all nations to follow the same procedures regarding both data collection and, hopefully, regulation. Finally, the use of official numbers prevents governments from criticizing or denouncing the results from studies under the pretense that the data used is inaccurate. Naturally, it is also important to evaluate the accuracy of official information and compare this to other available figures. Although the aforementioned underlines that we focus on the use of official data, we will also make some generalized, more qualitative, observations on the relationship between business regulations and poor governance, mainly concerning corruption.

Four types of data that commonly apply to the evaluation of the business start-up procedure are used.

The first variable constitutes the official requirements that the government demands entrepreneurs complete in order to start a new business. This is measured by the number of procedures that need to be carried out to obtain all necessary permits and to inform and register with all pertinent authorities. It is relevant to mention that it is possible, in some countries, to hire the services of an outside entity that will take

¹⁷ Doing Business database

care of the start-up procedure for the entrepreneur- often at a much shorter time but for a substantial fee, i.e. a privatized form of rent-seeking. This is still an economically inefficient phenomenon that promotes the persistence of bureaucratic procedures (given that these service providers have to pay, or rather bribe, relevant government officials to attain special attention). In the Doing Business Index, a practical requirement is classified as a “procedure” if the entrepreneur needs to interact with outside entities, such as state and local government offices, lawyers, auditors or notaries.¹⁸ Any procedures that are voluntarily undertaken with a lawyer without the law prescribing it do not count as procedures, nor does any process that can be avoided or undertaken after starting the business in question. However, if the completion of an act requires interaction with more than one administrator, each necessary interaction will count as a separate procedure. To summarize, the data describing the extent of official requirements aims to encompass such activities that will delay the commencement of the entrepreneur’s (legal) business.

The second variable is the official cost of business start-up. This is estimated by the total of all express costs related to forms, fiscal approvals, legal expenses, notary charges, etc. Only official fees are measured in this criterion, and thus do not include any potential expenses or bribes that may be involved in the registration process. The costs measured apply to the standardized type of business mentioned earlier. Furthermore, the results of the study do not encompass the opportunity cost of the time spent by the entrepreneur in completing the start-up procedure, nor are government expenses taken into account by these measurement standards. Nonetheless, the results used have been tested using a good estimate of these aspects and proven to give the same conclusions.¹⁹

The third variable studied in this context is time. This refers to the time it takes from the moment that a person begins to register a new company until the entire registration process is completed and the person in question is licensed to operate his or her business. This variable is measured in number of days and, as mentioned, relates only to all *official* procedures that need to be completed in order to start a

¹⁸ Djankov et al, 2002:8-9

¹⁹ Djankov et al, 2002:6-10

business. The Doing Business Index does not include potential further delays in the registration process incurred by abusive bureaucracy or plain corruption. A short discussion on the subject is offered in the analysis with some ideas concerning its implications for business growth, but any potential influence from such corruption only worsens the position of the country in question, thereby underscoring the results and conclusions made. The time necessary to acquire information on how to go through the registration process is ignored when composing the index, and it is further assumed that all procedures are known at the outset of the entire process.²⁰ In measuring the time necessary for business start-up licensing, a visit to each bureaucratic institution for a certain transaction counts as one day in the process. This is justified, at the least, as a reasonable average estimate as there are many instances in which an applicant has to travel a substantial distance to the required institution, as well as the fact that a significant wait is involved with each procedure in most countries.

The final variable that will be observed in this study is the down payment required to be licensed to start a business. This variable is measured by the minimum amount of capital that must be paid in the start-up registration procedure, in terms of the percentage of GNI per capita of the respective country. In our case studies only one country, namely Bolivia, requires such a down payment. One may question the existence of such a procedure and two perspectives seem prominent. Firstly, the requirement may be justified in as much as it forces the applicant to understand the financial commitment that is necessary in starting a business and encouraged to create a sound budget. The darker side of the equation leads to the conclusion that by incurring a fee, opportunities for rent extraction, whether corrupt or legal, are produced to the advantage of bureaucracy and/or officials.

²⁰ Djankov et al, 2002:9

Figure 3.2.1: *Starting a business data*

Country	Year	Rank (globally)	Procedures (number)	Duration (days)	Cost (%GNI per capita)	Paid in Min. Capital (% of GNI per capita)
Bolivia	2004	-	15	60	184.4	4.8
	2005	-	15	60	182.3	4.6
	2006	-	15	50	162.2	4.1
	2007	-	15	50	150.1	3.8
	2008	160	15	50	134.1	3.4
	2009	165	15	50	112.4	2.8
Brazil	2004	-	17	152	13.1	0
	2005	-	17	152	11.7	0
	2006	-	17	152	10.1	0
	2007	-	17	152	9.9	0
	2008	125	17	152	10.4	0
	2009	127	18	152	8.2	0
Chile	2004	-	9	27	12.1	0
	2005	-	9	27	10	0
	2006	-	9	27	10	0
	2007	-	9	27	10.3	0
	2008	42	9	27	9.6	0
	2009	55	9	27	7.5	0

Source: World Bank, Doing Business database

As can be seen in the table the number of regulations, the costs, and the time involved in starting a business vary largely between the three countries. There are a few discernible conclusions to be drawn from the data presented. Firstly, Bolivia is the only country to demand a down payment as a prerequisite to the mere commencement of the business start-up procedure. Furthermore, the cost of starting a business is the highest in Bolivia, despite this being the poorest country in the region. Meanwhile, Brazil exhibits the highest number of procedures required and the most

time-consuming process, increasing the opportunity-cost of lost income from alternative employment during this enterprise. In Chile the cost of starting a business is almost as high as in Brazil, however, the process is not as extensive as in either Brazil or Bolivia. Additionally, per capita income is higher in Chile²¹ and thus leads us to believe that the cost of undertaking the business start-up process is less detrimental for Chileans (although national income disparities should also be taken into account).

²¹ See Appendix 1

4. Analysis

4.1 Country background: Brazil

“Brazil is Latin America’s largest market, the world’s fifth-most populous country and the world’s tenth-largest economy in GDP terms.”²² However, although Brazil has the potential to be one of the world’s most prosperous economies, the country’s development seems to be limited by hindrances created by its own government. While the country’s active export policy has contributed to booming earnings since 2003 when Brazil finally transformed a trade deficit of 4.6% of GDP to a surplus for several years to come, the figures have since decreased and in 2007 the surplus shrank to a mere 0.1% of GDP, leading one to expect a deficit in 2008 current account.²³ One of the main obstacles for economic development is the poorly structured government revenue system. Although the tax burden is not especially high, with a top income tax rate of 27.5%, widespread tax evasion is still common.²⁴ With an unemployment rate of some 10%, and 31% of the population living below the poverty line, it is clear that the Brazilian government has room for improvement. In addition, 40% of workers are not formally registered and thus fail to benefit from the protection of the labor code, besides not paying any income taxes.²⁵

Considering the difficulties in starting a business in Brazil, as much because of the direct costs involved as the loss of income during the overwhelming 152 days it takes to complete the official process of a start up,²⁶ the fact that a third of the country already lives in poverty is disturbing and gives a clear explanation as to why Brazil’s economy is not developing nearly as rapidly as it could be- considering its labour

²² The Economist, 2008

²³ The Economist, 2008

²⁴ The Economist, 2008

²⁵ Business Anti-Corruption Portal, 2008

²⁶ Doing Business database, 2008

potential and extensive endowment of natural resources.²⁷ Evidently the regulatory environment is complicated and according to the World Economic Forum Competitiveness Report 2007-2008, the three most problematic factors in doing business in Brazil are tax regulations, labor regulations, and inefficient government bureaucracy. Attempts to avoid these complications have in turn led to an escalation in the use of bribes,²⁸ and thus the first obstacle Brazil needs to tackle to ensure an improvement in economic development and general welfare is the widespread political corruption that has developed due to unfavorable regulations.

Private firms in Brazil argue that the most restricting constraint imposed on their business is corruption.²⁹ According to a 2006 survey conducted by Simmons & Simmons, *International business attitudes to corruption*, 43% of Brazilian companies claim that they have failed to win a contract or gain new business in the past 12 months because a competitor had paid a bribe.³⁰ Also, the 2005 business survey conducted by PricewaterhouseCoopers revealed that 45% of companies operating in Brazil had experienced a fraud of some sort between 2003 and 2005, which is an increase from the 39% of companies reported in 2003, indicating a rise in the level of corruption.³¹ Unfortunately, these numbers are not entirely unexpected since only 32% of Brazilian companies questioned in a 2005 survey on corruption reported having codes forbidding “facilitation payments”, and a mere 24% of companies had laws prohibiting bribes.³² The alleged corruption is not limited to private companies enforcing unjust measures on each other. In fact, companies are very likely to meet demands for bribes from licensing agencies such as tax and customs.³³ State taxes show the highest vulnerability to corruption and in 2003 a staggering 53% of companies operating in Brazil reported being subjected to requests for indirect

²⁷ World Factbook, 2008

²⁸ Business Anti-Corruption Portal, 2008

²⁹ Søreide & Abramo, 2008

³⁰ Simmons & Simmons, 2006:5

³¹ Business Anti-Corruption Portal, 2008

³² Simmons & Simmons, 2006:14

³³ Business Anti-Corruption Portal, 2008

payments by tax authorities. Also, “A quarter of the companies in the survey complained that they were forced to make contributions to election campaigns of politicians in return for favorable treatment in, for example, public contracts and obtaining public licenses and permits.”³⁴ The high level of political corruption has led to widespread public distrust in the political and economic system. Although current president Lula da Silva himself is viewed as an honest politician, many of his closest allies have been convicted for involvement in corruption scandals. The situation is so severe that only 35% of Brazilians have trust in the government and a mere 16% have confidence in political parties.³⁵ According to Freedom House 2008, Lula da Silva’s anti-corruption campaign has been largely ineffective and the current congress is one of the most corrupt in Brazil’s political history.³⁶ In effect, Brazilian companies have a negative international reputation and many companies have reported difficulty in obtaining loans from foreign banks because of their fraudulent image. However, when Brazilian international business development directors were questioned about their awareness of their country’s legislation governing foreign bribery only 16% of the respondents claimed to have detailed knowledge on the topic, while all of 70% admitted to being totally ignorant on the subject,³⁷ which presents an explanation to foreign suspicion. In addition, Brazilian companies do not seem to be doing all they can to escape the stereotype that apprehends them. Although Brazil has signed the OECD anti-bribery convention,³⁸ it was the country where companies were least likely to review their own integrity procedures “in the light of the increased international focus on corruption,” out of the seven countries included in the survey, with only 12% of companies having done so.³⁹ Also, when questioned about the

³⁴ Business Anti-Corruption Portal, 2008

³⁵ Business Anti-Corruption Portal, 2008

³⁶ Business Anti-Corruption Portal, 2008

³⁷ Simmons & Simmons, 2006:10

³⁸ The Convention on Combating Bribery of Foreign Public Officials in International Business Transactions of the Organization for Economic Cooperation and Development (OECD), also known as the Anti-Bribery Convention, was signed in 1997 and became effective the 26th of July of 1999. Up to this moment, the Convention has 37 member - countries. (Mexican Ministry of Public Administration, http://200.34.175.29:8080/wb3/wb/SFP/ocde_convencion_info_ing), retrieved 19/11/2008

³⁹ Simmons & Simmons, 2006:10-11

expected effects of anti-corruption laws, Brazilians were the most pessimistic with 38% of respondents believing that corruption would essentially increase as a result of further legislation.⁴⁰

For the country to thrive economically reforms must be made and the regulations on business start up must be altered. Until governance reaches a sufficient level, the tax burden is decreased to make tax evasion less attractive, and the business start up time is shortened, eliminating the use of bribes to speed up an otherwise impossibly long process, corruption in Brazil will be eminent and continue to encumber the country's economic development.

4.2 Country background: Bolivia

Bolivia is one of the poorest countries in South America. The skewed distribution of wealth and the large social gaps result in a difficult situation for the country's inhabitants, specifically the native population, which makes up more than 60% of the total population.⁴¹ Out of the 8.4 million people living in Bolivia, 63% of them live in poverty and 34% of the population earn less than 2 dollars a day.⁴² In addition, the inflation rate is at around 12%,⁴³ deterring any incentive for saving and thereby also investment. According to the Heritage Foundation, the economy is only 53% free and Bolivia ranks 25th out of 29 regional countries in economic freedom.⁴⁴ During the past few years, Bolivia has suffered through political turbulence with six presidents since 2001,⁴⁵ but in the 2005 election left wing radical Evo Morales of the MAS (Movimiento al Socialismo) won with over 50% of the votes. Despite Bolivia's

⁴⁰ Simmons & Simmons, 2006:21

⁴¹ Utrikesdepartementet Sverige, 2004

⁴² US Congressional Research Service report, 2007

⁴³ Index Mundi, 2008

⁴⁴ Heritage Foundation, 2008

⁴⁵ US Congressional Research Service report, 2007

controversial policies and unstable political situation, the economy has developed relatively well. Economic growth has been at an average level of 4% in the past few years and this is much due to globally strong business cycles and the high prices of the country's export products.⁴⁶ This is a remarkable improvement to the economic crisis that Bolivia faced in the early 1980's and the country's previous foreign debt of nearly 3 billion US dollars. Bolivia's development has continued in a positive direction since the end of the hyperinflation in 1985. However, this achievement also brought about a sharp reduction in real wages and temporarily increased the poverty level, which already was a serious problem. Poverty is now the main issue that Bolivia has to tackle, and their economic development is key in doing so. Another significant problem in Bolivia's economy is the heavy dependency upon the drug industry, which *per se* proliferates the informal economy. Coca farming has existed in parts of Bolivia since Inca times, and since the expansion of the international drug trade in the 1980's and 90's it has become even more important to the country's economy and increasingly widespread throughout Bolivia. After the implementation of the "Dignity Plan", an aggressive attack by the Bolivian armed forces against coca farming, rural poverty increased and was subsequently followed by a generation of social protest movements.⁴⁷

Officially, Bolivia meets the necessary conditions for a functioning private sector and foreign companies are subject to the same requirements as local companies without discrimination. Also, labor costs are relatively low and because of favorable foreign investment laws the Bolivian market is relatively attractive. However, in practice, doing business in Bolivia is considerably more difficult. Starting a business in Bolivia takes 50 days and entails 15 procedures.⁴⁸ Although that is not an exceptionally long time in relation to other Latin American countries, most public agencies are located in the capital,⁴⁹ making it difficult to start a business anywhere outside La Paz. Most limiting, however, are the expenses of a business start-up

⁴⁶ Utrikesdepartementet Sverige, 2004

⁴⁷ Library of Congress, 2006

⁴⁸ The World Bank, Doing Business, 2008

⁴⁹ Business Anti-Corruption Portal 2008

amounting to a staggering 112.4% of GNI per capita.⁵⁰ Considering the extreme poverty that characterizes this country, that is a price that most cannot afford.

According to the World Economic Forum Global Competitiveness Report 2007-2008, the two most problematic factors in doing business in Bolivia are policy instability and corruption; and as noted in Transparency International's Global Corruption Barometer 2007, 41% of Bolivians are convinced that the level of corruption will continue to rise,⁵¹ increasing poverty and further contributing to the extreme social inequality Bolivia is facing. The national police, customs, and justice system are rated as the most corrupt, and Bolivia ranks 105th out of 163 countries in Transparency International's Corruption Perception Index.⁵² Although several laws have been passed to indirectly deal with corruption, there is no single law that directly targets corruption as a criminal offence.⁵³ According to a 2005 survey conducted by the *Red Anticorrupcion Bolivia* (Bolivian Anti-corruption Network) a total of 115 million dollars was paid in assorted bribes between individuals and public institutions during 2005, and most of the bribes were actually demanded of the poor Bolivian households rather than the rich.⁵⁴ Allegedly, 900 million dollars disappear from the national treasury every year as a result of bribery and fraud, and more than half of companies operating in Bolivia report having experienced requests for 'special payments' from tax officials.⁵⁵

⁵⁰ Doing Business database, 2008

⁵¹ Business Anti-Corruption Portal, 2008

⁵² Transparency International, 2008

⁵³ Business Anti-Corruption Portal, 2008

⁵⁴ Business Anti-Corruption Portal, 2008

⁵⁵ Business Anti-Corruption Portal, 2008

4.3 Country background: Chile

Chile has served as a model of a country with stable growth and increasing exports, growing investments, a stable inflation and a continually decreasing international debt. Among Chile's exports, including fish, fruit, chemicals, paper and pulp, copper is by far the most prosperous resource, and although the export of copper since the 1970's has decreased from representing an astounding 88% of the country's exports to a somewhat more modest 40% in modern day, this dependency still makes Chile's economy vulnerable to changes in the world market price. One of the few concerns for Chile's economic situation is the country's dependency on the copper industry. This became evident during the late 1990's when the economic crisis in Asia had negative effects on the country's economy.⁵⁶ However, being the world's largest producer of the metal, Chile still had Latin America's fastest-growing economy in this previous decade and has managed to overcome threats of economic instability. Another issue that has received increased attention in recent years is the country's uneven wealth distribution. Chile's president Michelle Bachelet has given priority to social issues and one of the government's main goals is now to make sure that all Chileans benefit from the country's economic growth.⁵⁷ In the last decade, Chile's GDP has shown continuous high growth averaging about 6% per year, and in 2007 they achieved a commendable GDP per capita of 14,400 USD (at PPP).⁵⁸ This positive development is largely due to the fact that the price of copper has increased dramatically and reached its highest level in more than 40 years.⁵⁹ Somewhat ironically, another reason for such a positive development is the fact that, despite Pinochet's prolonged dictatorship, Chile has been "free of the coups and arbitrary governments that have blighted the continent"⁶⁰ in the last few decades. In 2008,

⁵⁶ Jönsson, 2008

⁵⁷ BBC, 2008

⁵⁸ World Factbook, 2008

⁵⁹ Oppenheim, 2008

⁶⁰ BBC, 2008

Chile's CPI (Corruption Perception Index) score is 6.9, placing Chile just below economically developed countries such as the United States and Japan, and at an equal level to France in the ranking.⁶¹ Although its ranking on the CPI scale has decreased somewhat in the past four years from a 7.3 in 2004 to a 7.0 in 2007, and finally a 6.9 in 2008, Chile is still by far the least corrupt country in Latin America.⁶²

According to the World Bank's Doing Business report, Chile is one of Latin America's most liberal countries when it comes to starting a business. It takes a relatively short time and an affordable amount of money to start a business in Chile, which has played an important role in the country's economic development. Chile holds South America's highest ranking in the World Bank's Doing Business Index.⁶³ However, the country still has obstacles to overcome in order to increase private sector growth. As negotiations of OECD membership arose, it was observed that the amount of GDP invested in research and development was a mere 0.67% in 2004, which is fairly low in comparison with OECD countries averaging about 2.25%.⁶⁴ According to the OECD Secretary-General Angel Gurría, "Chile needs to boost innovation if it is to achieve high and sustainable growth while further reducing poverty and persistent income inequality."⁶⁵ Gurría also affirms that "improving Chile's education system should be a priority as the lack of skilled human resources is a major bottleneck for Chile's social and economic development."⁶⁶ Obviously, as can be said for most any country in the world, Chile's political and economic system still has room for improvement, but their current standards of freedom and stability far exceed the 'accepted' standards of the general region.

⁶¹ Transparency International, 2008

⁶² *ibid*

⁶³ Doing Business

⁶⁴ OECD, 2007

⁶⁵ OECD, 2007

⁶⁶ *ibid*

4.4 Business regulation, corruption and the informal sector

As stated by Schneider, “The increase of the intensity of regulations (often measured in the numbers of laws and regulations, like licenses requirements) is another important factor, which reduces the freedom (of choice) for individuals engaged in the official economy.”⁶⁷ This explains why the majority of Latin American countries find themselves with an informal sector that far exceeds that of the average developed country.

Figure 4.4.1: Size of the informal sectors in Latin American countries

No.	Country	Shadow Economy (in % of off. GDP) using the DYMIMIC and Currency Demand Method		
		1999/00	2001/02	2002/03
1	Argentina	25,4	27,1	28,9
2	Bolivia	67,1	68,1	68,3
3	Brazil	39,8	40,9	42,3
4	Chile	19,8	20,3	20,9
5	Colombia	39,1	41,3	43,4
6	Costa Rica	26,2	27,0	27,8
7	Dominican Republic	32,1	33,4	34,1
8	Ecuador	34,4	35,1	36,7
9	El Salvador	46,3	47,1	48,3
10	Guatemala	51,5	51,9	52,4
11	Haiti	55,4	57,1	58,6
12	Honduras	49,6	50,8	51,6
13	Jamaica	36,4	37,8	38,9
14	Mexico	30,1	31,8	33,2
15	Nicaragua	45,2	46,9	48,2
16	Panama	64,1	65,1	65,3
17	Paraguay	27,4	29,2	31,4
18	Peru	59,9	60,3	60,9
19	Puerto Rico	28,4	29,4	30,7
20	Uruguay	51,1	51,4	51,9
21	Venezuela, RB	33,6	35,1	36,7
Unweighted Average		41,1	42,2	43,4

Source: Schneider, 2004:19

⁶⁷ Schneider, 2004:9

As can be observed in the table above, Bolivia displays the largest informal sector with an astonishing two-thirds of the country's economic output emanating from the shadow economy. Conversely, Chile again proves to be the role model of the region with the lowest informal sector, estimated to about a fifth of national output. Finally, Brazil accounts for the median position of Latin America, with an informal sector of about 40% of GDP.

Of the three countries in this study Brazil and Bolivia have especially rigorous regulatory systems that make it attractive for business owners to avoid the official procedures of their respective country. Additionally, all three countries in this study have significant problems concerning corruption, and also large informal economies. This means that much of the generated income of business in these countries is untaxed and unaccounted for, distorting the social welfare system and national accounts.

If regulations are economically limiting, firms will try to avoid them by conducting business outside the legal system, thus expanding the informal economic sector. Although this saves the trouble of certain regulatory processes it also includes disadvantages such as the extra cost of bribes that must be paid in order to not be shut down for legal evasion, lack of support from the state and exclusion from (legal) international trade. There are “various policy variables that determine the costs and benefits of becoming and staying official [...]. This evidence is consistent with the generally accepted view that unofficial firms avoid paying taxes and adhering to regulations, but lose the access to public goods and other benefits of official status, such as external finance.”⁶⁸ Furthermore, avoiding the control of the state can be limiting to a company's growth and expansion since a large firm will have serious difficulties operating outside the law undetected. As long as the quality of regulation, or level of governance, is low, an increase in regulation will be conducive to the proliferation of the informal sector. A “number of countries in Latin America [...] exhibit characteristics consistent with a ‘bad equilibrium’: tax and regulatory discretion and burden on the firm is high, the rule of law is weak, and there is a high incidence of bribery and a relatively high share of activities in the unofficial

⁶⁸ La Porta and Shleifer, 2008:1

economy.”⁶⁹ However, if governance is good, the severity of regulation will not affect the size of the informal sector nearly as dramatically, and at a certain level of governance it will not have any effect at all; in fact, after this certain point, higher fiscal regulation will even decrease the size of the informal sector.⁷⁰ This paradoxical relationship makes sense simply because through high fiscal regulation the option of evasion is more attractive than conforming when excessive bureaucracy or governmental corruption is prevalent; however, when governance is good, fiscal regulation can succeed in the enforcement of tax compliance and thus offer improved public services.⁷¹

The relationship of high regulation leading to a large informal sector and in turn low economic growth is generally found in developing countries. According to Loayza et al, “if a typical developing country decreased its product-market regulation to the median of industrial countries while keeping its level of governance, then its informal sector would decrease by close to seven percentage points of GDP.”⁷² In addition, countries with high regulation and larger informal economies that increase consumer prices and hold back private investment tend to have higher corruption.⁷³ This can almost solely be attributed to the extremely high costs of business entry in most countries. Since this in no way ensures a higher quality of goods, private or public, it instead indicates that entry regulation primarily benefits politicians and bureaucrats, consistent with the tollbooth theory described previously. Thus, “In the absence of perfect monitoring and compliance, some firms will find it optimal - or simply necessary - to evade regulations and work outside the legal regime.”⁷⁴

⁶⁹Johnson, Kaufmann and Zoido-Lobaton 1998a:1, *quoted in* Schneider, 2004:11

⁷⁰ Loayza et al, 2007

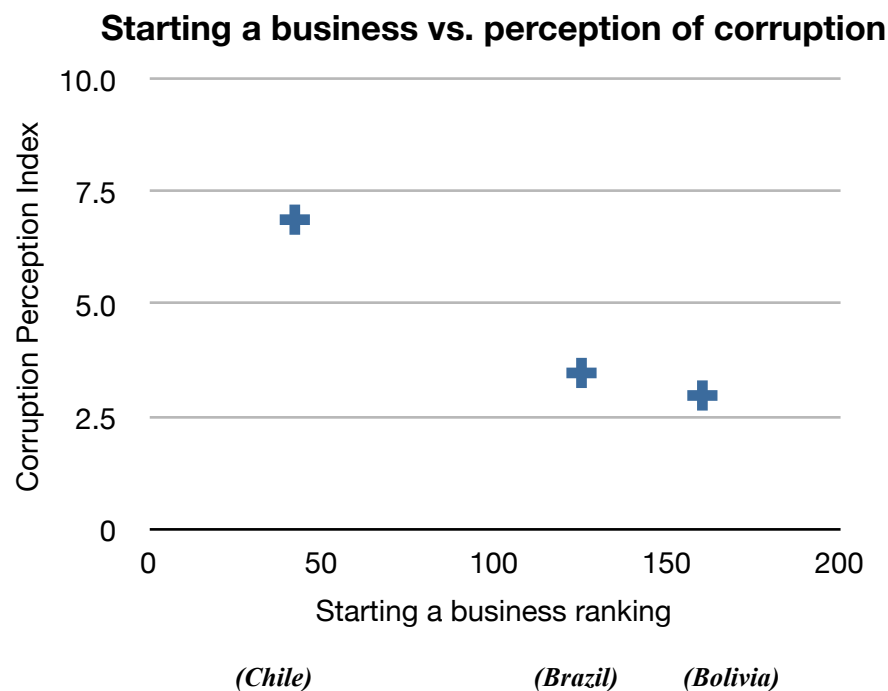
⁷¹ibid

⁷² 2007:142

⁷³ World Bank, 2006

⁷⁴ Loayza et al, 2007:122

Figure 4.4.2:



Sources: World Bank Doing Business database and the Transparency International Corruption Perception Index 2008

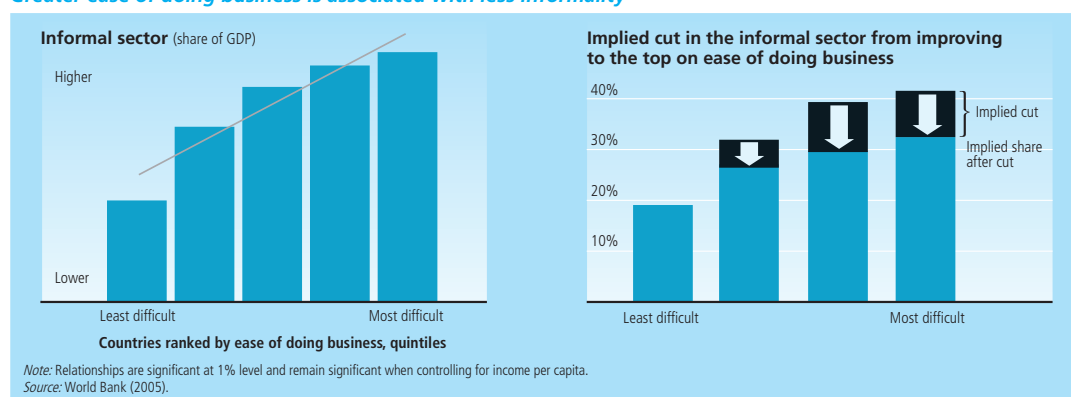
According to the Inter-American Development Bank (IADB),⁷⁵ the private sector in Latin America stands for about 90 percent of overall economic activity, out of which yet again 90 percent are comprised of microenterprises. “The prevalence of microenterprises contributes to the high degree of informality or large number of unregistered firms found in the region. ...the informal sector accounts for over half of economic activity.”⁷⁶ Figure 4.4.1 shows the perceived levels of corruption in Chile, Brazil and Bolivia, respectively, in relation to these countries’ ranking in the Doing Business Index for the ease of starting a new firm. Although this is of course a very limited sample, the data shows that it is easier to start a business when the perceived level of corruption is lower. A wider generalization of this finding is emphasized in the figure below from the Doing Business database.

⁷⁵ 2004:2

⁷⁶ *ibid*

Figure 4.4.3: *Doing Business vs. size of informal sector*

Greater ease of doing business is associated with less informality



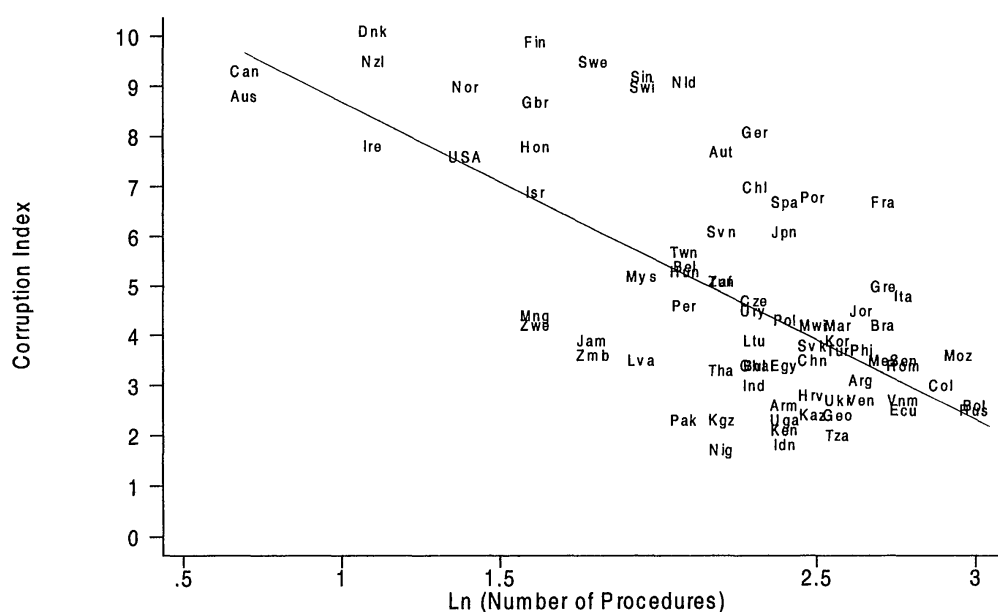
Source: *Doing Business Indicators*⁷⁷

In our context, bureaucratic corruption increases the expected number of bribes that are demanded in the business start-up process, making it increasingly difficult for an entrepreneur to establish a company. That, in turn, increases the entrepreneur's predisposition to turn to the informal market and operate the business illegally. Loayza et al⁷⁸ present a thorough cross-country analysis on the informal sector output in relation to governance quality for a large number of countries, which emphasizes our conclusions with a strong correlation (-0.78) between the variables in question. Additionally, the Doing Business team presents the following data correlation between corruption and number of procedures, providing further evidence for our postulate that increased regulation is consistent with higher corruption. Nonetheless, the direction of causality in this relationship is difficult to determine, i.e. whether corrupt officials promote extensive procedural requirements in order to extract rent from these, or that the prevalence of a high number of procedures induce corrupt behavior among regulators. Our belief is that this relationship is multidirectional, but in either case the emphasis should be placed on effectively reducing regulation in order to restrain opportunities for corrupt behaviour. Figure 4.4.4 below shows the correlation between the number of procedures necessary to start a business and index of corruption for a large sample of countries. As can be noted, Brazil and Bolivia fall into the lowest end, while Chile is somewhat higher up.

⁷⁷ World Bank, 2005

⁷⁸ 2007:136

Figure 4.4.4: Corruption vs. number of procedures required to start a business



Source: Djankov et al, 2002:26

4.5 Business regulation and economic growth

According to Johnson and Sheehy (1996)⁷⁹, the key to economic development is economic freedom. Although the notion that economic freedom is directly linked to economic growth is widely accepted, research on the precise relation between economic regulation and economic growth has proven difficult due to the diverse effects of varying types of regulations. Product market regulation, which is a combination of trade, entry, bankruptcy, financial markets and contract enforcement regulations, that all correlate similarly, as well as labour regulation, which measures the difficulty for firms to adjust their labour force, has shown a negative correlation to economic growth.⁸⁰

Brazil is a prime example of a country where the evasion of regulation is attractive. As indicated by the World Bank, it takes a total of 152 days to start a

⁷⁹ Discussed in Hanke and Walters, 1997

⁸⁰ Loayza et al, 2007

company in Brazil, one of the longest waiting periods of any country in the world, and the process entails 18 necessary official procedures. Yet, once a registered firm on the legal market, a Brazilian company is still in a fairly insecure situation with the country ranking at number two on the Legal Rights Index, making it one of the riskiest countries in Latin America for an entrepreneur to start his or her business in.⁸¹ Simultaneously, Brazil scores a mediocre 5.3 on the Good Governance Index, where New Zealand holds the highest ranking with 9.7.⁸² Judging from the state that Brazil is in, it seems they have not yet reached the level of governance where an increase in fiscal regulation would be beneficial. It may be advantageous for the Brazilian government to offer business owners a more dependable safety-net, thus spurring incentive to follow regulation, decrease the informal sector and reach the level of governance where increased fiscal regulation and established rule of law can improve the business climate and standard of living.

Chile, on the other hand, is a role model in this particular area with only nine necessary procedures to start a business, and a business start-up duration of only 27 days.⁸³ This makes it significantly easier for an entrepreneur to advance in Chile than in Brazil, where the income lost during the startup time alone is enough to thwart the establishment of new enterprises.

Bolivia has an entirely different factor that impedes economic development, namely the *cost* of starting a new business. Although Bolivia has 15 official procedures and the duration of 50 days for starting a business, which falls in between the figures for Chile and Brazil, its major setback is that it is remarkably expensive to start a business in Bolivia. As a percentage of GNI per capita it costs 7.5% to start a business in Chile, 8.2% in Brazil, and an abysmal 112.4% in Bolivia.⁸⁴ This makes it exceptionally difficult to finance a new business in Bolivia, severely disabling economic development.

Another variable that has an important influence on the efficiency of the

⁸¹ World Bank, 2008

⁸² *ibid*

⁸³ *ibid*

⁸⁴ *ibid*

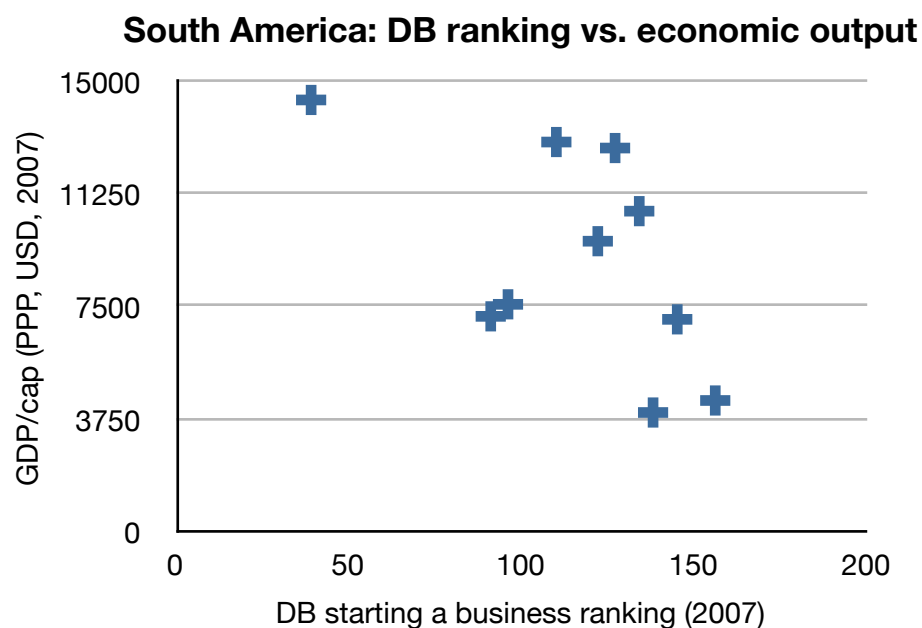
business environment is employment regulation. In Brazil and Bolivia the law makes it quite difficult to hire an employee, both countries ranking in the bottom quartile in the difficulty of hiring index (both at 78/100).⁸⁵ However, in Brazil there are no hinders at all (indexed 0/100) to firing employees, whereas Bolivian regulation makes it extremely difficult, in fact impossible, at an index rank of 100/100.⁸⁶ These circumstances make the labour market very rigid and creates a severe bottleneck in the efficient movement of capital and labour. In particular, regulation hindering the discharge of employees makes employers very reluctant to hiring new workers, in fear of the cost it will bring them when the market weakens or employee proves to be inefficient, which ultimately hurts the labour market at the aggregate level. In Chile it is relatively easy to hire and discharge a potential employee, even if the costs involved in firing someone still are rather significant (costs ranking at 52/100⁸⁷). Even if these types of regulation do not in effect make it harder to start a business, they are relevant factors in the decision to do so- taking the costs of employment into account. Furthermore, cumbersome regulation concerning the actual operation of the business give an incentive to avoid formal (official) registration.

⁸⁵ Doing Business database

⁸⁶ *ibid*

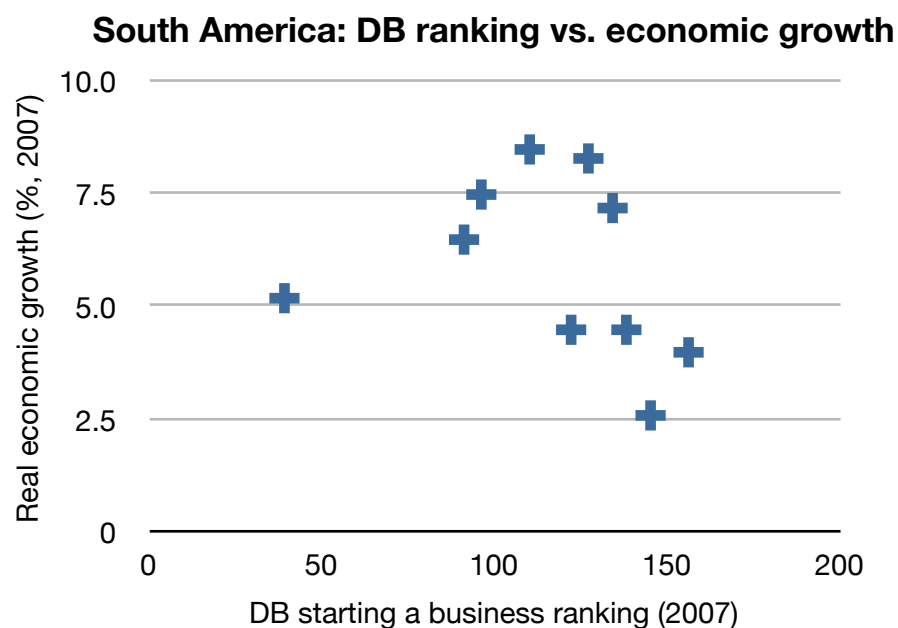
⁸⁷ *ibid*

Figure 4.5.1:



Sources: World Bank Doing Business database and the (US) CIA World Factbook⁸⁸

Figure 4.5.2:



Sources: World Bank Doing Business database and the (US) CIA World Factbook⁸⁹

⁸⁸ Country data specified in appendix 2. The very small economies of Guyana and Suriname (as well as the overseas department of French Guyana) have been omitted from the data presented on South America

⁸⁹ *ibid*

The figures above show the relation between economic performance and the ease of starting a business in South America during 2007. We have not specified each individual country in the comparison, but rather wish to give an overview of the region's situation in relation to our study, showing that there is a clearly positive relationship between the ease of starting a business (indicated by a low numerical rank) and strong economic performance. The IADB declares that "Private enterprises flourish when public policies, institutions, and activities provide an attractive and equitable environment for private activities."⁹⁰ This underlines our belief that good governance will lead to a better business climate. The relationship is made more apparent in conjunction with Loayza et al's research on the importance of reliable institutions, which provide the basis for enforcing "regulation in a transparent and even-handed manner, limiting the regulator's margin for arbitrariness and corruption that can place many firms at a disadvantage."⁹¹ The graphical data provided here on economic performance, together with that on perceived corruption presented above, provide some evidence on the state of different South American countries progress within the areas of business regulation and governmental reliability. Our data is not conclusive or all-encompassing, and we will not only acknowledge, but rather insist, that there is a very wide range of factors that determine economic development. Nonetheless, our analysis is indicative of the notion that bureaucratic transparency and efficiency provides the basis for economic growth, particularly for the formal private sector.

⁹⁰ IADB, 2004:5; see also OECD, 2004:18

⁹¹ 2007:123; see also OECD, 2004:6

5. Conclusion

We have studied the different effects that business regulation, primarily in starting a business, may have on the economic environment of a country. We found that the most important variables influenced by business regulation are informality, corruption and economic growth. Our sample is geographically limited to the Latin American region with Brazil, Chile and Bolivia as our focus group. After thorough data analysis we have come to the conclusion that it would be beneficial for the Latin American countries addressed in this study to revise their regulatory systems and improve governance so as to make an honest method of doing business a more attractive option than legal evasion, and by doing so, contribute to the national growth of the respective economy.

Our initial intention to have (formal) private sector growth as an overwhelming topic of discussion in this study was somewhat thwarted by the unavailability of specific information in this area. Our aim was to attain empirical data on private sector growth in order to construct cross-country and time-series analyses, but were astoundingly met short by all the sources we probed to acquire that particular information. Furthermore, the Doing Business researchers have modified their methodology in different ways since the introduction of the index in 2004,⁹² and therefore currently only providing an indexed ranking on starting a business for 2008 and 2009- obviously making a time-series comparison nonsensical. Also, the widespread economic meltdown following the financial crisis in 2008, would make an investigation of economic growth (in relation to regulation) very weak in the timeframe available.

Nevertheless, it turns out that this would lead our essay in another interesting direction, and consequently we examined a few other factors that appeared relevant for entrepreneurship, making use of information that may otherwise have been disregarded. Upon discovering the extent of corruption in struggling countries we

⁹² see, for example, <http://www.doingbusiness.org/MethodologySurveys/methodologynote.aspx>

were led to question whether the core problem could lie in a miscalculation or misinterpretation of the market, or if it in reality was the bureaucrats responsible for country regulations - and hold the power to make significant changes - that make up obstacles to economic growth. Further research on the extent and implications of corruption in the respective economies gave insight into the importance of this aspect in relation to business regulation. Subsequently, the study was redirected to include and emphasize the relevance of corruption and poor governance, especially in relation to the prevalence of informal economic activity. Furthermore, it became apparent that small business, i.e. microenterprise, made up the bulk of economic activity in the private sectors of South American countries, and are likely to be the main aspirants for legitimizing their operations, were it affordable under their existing regulatory systems. Even if La Porta and Shleifer's most recent study indicates that very few formal businesses have previously operated informally, evidence is provided in support of informal firms being inefficient and poorly managed.⁹³ Hence, the consequences are both socially and productively detrimental, to individual laborers as much as to the aggregate economy and its potential to redistribute resources to welfare. One should not be led to believe that it is simply in the best interest of informal business operators to act as they do. Instead, efforts should be made to spread awareness of the fact that the legal protection and social benefits involved in running a legitimate business, contingent on the prevalence of good public governance, provides a far better situation than the informal market ever can.

The possibility that reforms would in fact not lead to a general improvement in these countries should not be overlooked. As Djankov mentions, although it is evident that simplified entry regulation is beneficial for the business climate, "it could be that increased entry will also be accompanied by increased failure rates a few years later."⁹⁴ Unfortunately, this is difficult to predict, and studies that have been done on the subject of business entry and business regulation do not provide conclusive evidence on this specific matter.

⁹³ La Porta & Shleifer, 2008

⁹⁴ Djankov, 2008:29

Looking back at the introduction of the Doing Business Index and *The Regulation of Entry* (2002), Djankov has just recently published a discussion paper following up the previously mentioned work. Suffice it to say that the *Doing Business* project has been successful; since the introduction of this index, hundreds of reforms have been implemented across the world and many publications have followed the subject area.⁹⁵ Lamentably, Brazil is one out of only two countries in the Latin American region, together with Venezuela, that has not made any reforms in their business regulation policies.⁹⁶ Irrefutably, Latin American nations, specifically Brazil and Bolivia, have a difficult and bumpy road ahead of them. They will have to formulate and implement significant reforms within the regulatory system, so as to create a secure foundation and improve the economic environment for the private sector to expand and internalize the vast informal sector. “Transparent and predictable rules of the game, along with good governance, reduce risk. Simpler business regulations and improved access to infrastructure reduce the cost of doing business.”⁹⁷ And the number of bribes involved.

⁹⁵ See Djankov, 2008. Of course, an entirely different study would be necessary to ascertain how much of the said progress can be attributed to the *Doing Business* work, but it has surely played a role in the process

⁹⁶ Djankov, 2008:8

⁹⁷ OECD, 2004:22

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World Factbook, Central Intelligence Agency (USA), information retrieved through 2007 and 2008, www.cia.gov/library/publications/the-world-factbook

Appendix 1

Roughly 61% of Latin Americas private sector is made up of services, 31% of manufacturing and the rest by agriculture. These three combined are responsible for nearly 90% of Latin Americas overall economic activity. However, the prevalence of small enterprises greatly contributes to the number of unregistered firms and high level of informal economic activity. It is estimated that these informal businesses account for 10% of total business activity in most Latin American countries, as well as around 30% of private sector jobs.⁹⁸

The following tables show an overview of selected economic data for the country backgrounds covered in this study.⁹⁹

Chile

Year	2000	2005	2006	2007
GNI per capita, PPP (current international \$)	8930	11280	11660	12590
GDP (current US\$, billions)	75.78	118.18	146.44	163.92
Industry, value added (current US\$, billions)	28.8	49.6	70.3	-

⁹⁸ Inter-American Development Bank, Private Sector Development Strategy, 2004:2

⁹⁹ Source: World Bank development indicators, September 2008

Year	2000	2005	2006	2007
Services, etc., value added (current US\$, billions)	41.7	62.6	70.3	-
Agriculture (current US\$, billions)	4.5	4.7	5.9	-

Brazil

Year	2000	2005	2006	2007
GNI per capita, PPP (current international \$)	6840	8120	8700	9370
GDP (current US\$, billions)	644.5	882.5	1067.8	1314.1
Industry, value added (current US\$, billions)	180.5	264.75	331	407.4
Services, etc., value added (current US\$, billions)	431.8	564.8	683.4	841.1
Agriculture (current US\$, billions)	38.7	52.9	53.4	65.7

Bolivia

Year	2000	2005	2006	2007
GNI per capita, PPP (current international \$)	3080	3610	3840	4140
GDP (current US\$, billions)	8.4	9.6	11.5	13.1
Industry, value added (current US\$, billions)	2.5	3.1	3.8	4.2
Services, etc., value added (current US\$, billions)	4.6	5.2	6.1	7.1
Agriculture (current US\$, billions)	1.3	1.3	1.6	1.8

Appendix 2

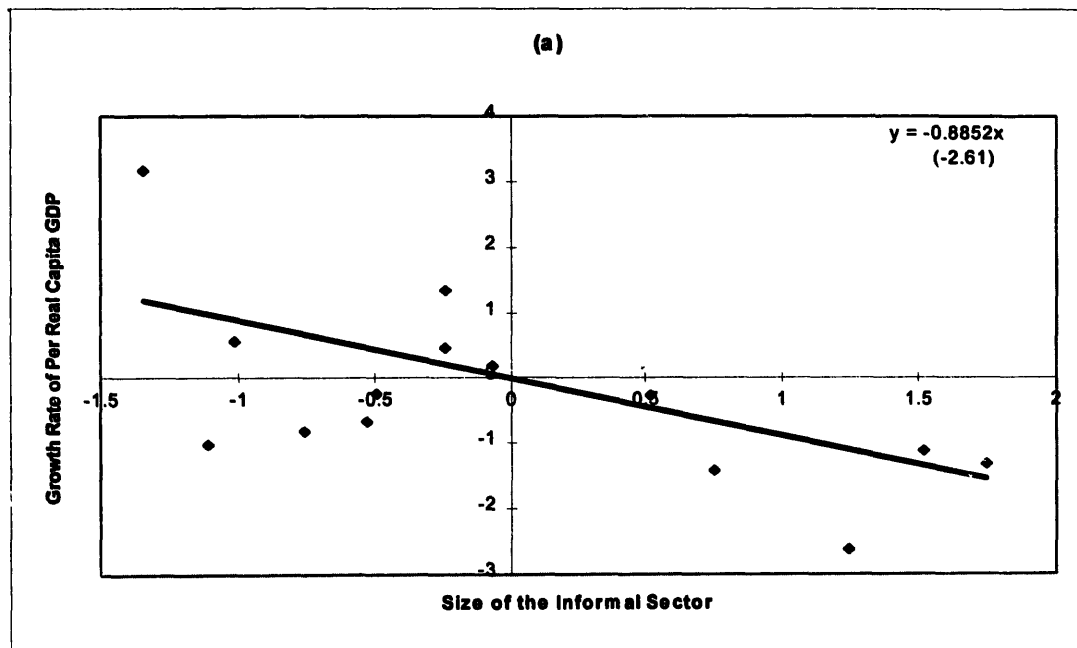
The following table contains the underlying data used in the graphs describing an overview of the South American countries presented in the analysis, based on 2007 figures.

	DB Start-Up Ranking	GDP/cap (PPP, USD)	GDP growth rate (%)
Chile	39	14400	5.2
Colombia	91	7200	6.5
Peru	96	7600	7.5
Argentina	110	13000	8.5
Brazil	122	9700	4.5
Venezuela	127	12800	8.3
Uruguay	134	10700	7.2
Paraguay	138	4000	4.5
Ecuador	145	7100	2.6
Bolivia	156	4400	4

Sources: World Bank Doing Business database and the (US) CIA World Factbook

Appendix 3

Economic growth in relation to the size of the informal sector, based on empirical evidence from Latin America



Source: Loayza, 1996:155