BOOK REVIEWS

Investment Climate around the World: Voices of the Firms from the World Business Environment Survey by Geeta Batra, Daniel Kaufmann, and Andrew H. W. Stone, Washington, D.C., World Bank, 2003, xvi + 154 pp.

I

It is well known that among some groups of people the World Bank is disliked very much. Those likely to have this feeling are people worried about the consequences of globalization and contraction policies on low-income countries that have suffered economic crises. However, even these people need to be mindful of the ideas that become the trends at the bank, if they want to work effectively and be influential within the field of international development. This is because the bank has an overwhelming presence not only in the lending of money but also in the publication and distribution of information, and consequently in determining the context of development strategies. An idea that is becoming the new trend at the bank, and which is the central theme of the book under review, is that of "investment climate."

Investment climate will be the central concept taken up in the *World Development Report 2005*. Behind this new trend are scholars who worry about the current neglect among international development economists and organizations of the contribution made by the production side of an economy to the long-run reduction of poverty. The creation of employment opportunities through the expansion of production, they say, has to be a key factor enabling the poor to extract themselves from destitution. At present, however, within the context of poverty reduction, the main emphasis has been on strengthening the supply side of the labor market through human capital accumulation, and the contribution to development of the demand side of the labor market has not been sufficiently taken into account. The concept of "investment climate" brings out more clearly the sort of business environment existing in an economy and how conducive it is to the entry of enterprises, their business operations and employment of workers. If an environment is not favorable, enterprises will not start up business with the result that there will be less employment for the poor. This was the argument that motivated the World Bank survey which ultimately led to the publication of the present book.

There are three aspects to the investment climate: the macroeconomy, institutions, and infrastructure. Typical macroeconomic factors affecting investment are inflation and fluctuation in exchange rate. Institutional factors are such things as corruption, anti-competitive practices, policy instability, crime, taxes, and regulations. The importance of infrastructure for investment needs no explanation.

The World Bank collected data on the investment climate in 80 countries and one territory in the late 1990s. It collected questionnaires from 10,032 enterprises in both developed and developing countries/regions. The book provides (1) the methodology used to collect the data, (2) the fundamental findings derived from the data, and (3) a simple analysis of investment climate on the performance of enterprises; this last was designed to provide basic information on the data set. The data should prove to be seminal because it has been made so readily accessible and because of the importance of investment climate for the long-run reduction of poverty. A CD-ROM containing the complete data set comes with the book making the data available to anyone. Researchers at the World Bank have already started using the data set and examining it.[1]

II

The book is organized as follows. Chapter 1, "Background, Approach, and Sampling," describes the intent and framework of data collection. The survey was titled the World Business Environment Survey (WBES) and was conducted by the World Bank in cooperation with the European Bank for Reconstruction and Development (EBRD), the International Development Bank, and Harvard University. A common questionnaire was used in all the 80 countries and one territory sampled so that all the data collected could be pooled and handled altogether. Of the 80 sampled countries, nine were developed; all the rest were developing countries. The median number of enterprises sampled per country was around 100, the maximum being 525 for Russia and the minimum 50 for Bangladesh and Belize. Interviews of enterprises engaged in manufacturing or services were undertaken for the most part by consulting firms hired for that purpose. In most cases sectoral composition, size, ownership (foreign or local), exporting, and location were taken into account for stratified random sampling. This seemed to avoid at least extreme disparities between sample and population in the composition of firms. There were basic questions that elicited subjective views while other questions focused on quantitative estimates of the costs of doing business, i.e., the amount paid for bribes, the number of business days lost because of power interruptions and strikes.

The above is followed by a description of the enterprises sampled in the chapter. Eighty percent of them were small and medium-sized enterprises with an almost equal proportion of small enterprises (50 or fewer employees) to medium-sized enterprises (51–500 employees). Roughly a third of the sampled firms were involved in exporting. Firm ownership was mainly domestic and private, although there were regional variations. An average of 18 percent of the sampled firms had holdings or operations in other countries (see Tables 1.4–1.6 of the book).

Chapters 2 and 3 describe the general characteristics of investment climate by region and firm size. The former deals with business environment constraints while the latter delves into the quality of public services.

One of the most interesting findings of the two chapters is that the major constraints that firms perceive on their business differ by region. Firms in relatively high-income regions, i.e., OECD countries, central and eastern Europe, the CIS, and Latin American and Caribbean countries, are likely to feel that taxes and regulations are the most serious constraints on business, whereas those in low-income regions, i.e., South Asia, sub-Saharan Africa, and

[1] See, among others, David Dollar, Mary Hallward-Driemeier, and Taye Mengistae, "Investment Climate and International Integration, Firm Performance in Developing Economies," mimeographed (Washington, D.C.: World Bank, 2003).

developing East Asian countries (excluding middle-income economies), are likely to cite corruption as a major constraint (see Table 2.1 of the book).[2] Chapter 2 examines the major types of constraints, such as “tax and regulation,” “financing,” “policy instability and uncertainty,” and “corruption.” The spectrum of constraints facing firms differs depending on the institutional and governmental environment and business practices. But of all the constraints discussed, corruption and its impact on firms receives the most extensive examination, not only as it is perceived by the firms themselves but also through an assemblage of quantitative data that was collected. For example, firms were asked the relative scale of their ”unofficial payments” to sales and the time delays they experienced at customs when importing items. The authors also draw attention to the influence that a firm can have on the content of national laws. This is a reversal of the usual form of corruption in the sense that the contents of a law may be altered to satisfy the demands of a firm. The authors call this type of corruption “state capture.” According to Table 2.14 of the book, about half of the sampled firms in developing East Asian countries and in South Asia think that they have a great influence on laws at the national level.

Chapter 3 briefly reviews the quality of public services. Firms were asked which areas of public services they consider “bad.” The worst area is public health followed by the parliament/national assembly, public works, the courts, the police, the central government, and customs. By contrast, the best category of public services is the postal service followed by the telephone service, power utilities, the central bank, water supply, and military. Again there are variations by region in the evaluation of public services.

Chapter 4 discusses various factors affecting investment climate that relate to the performance of firms. Two indicators are used to measure the performance of firms: (1) sales growth in the previous three years, and (2) investment growth in the previous three years. After controlling for firm characteristics, the results show that the rate of sales growth is likely to be low for firms which feel that financing is difficult, taxes are high, corruption is rampant, and the consulting of businesses regarding government policies is infrequent. Similar constraints along with the unpredictability of government policies (as opposed to infrequent consulting) are shown to be harmful to investment growth. The chapter goes on to explore the underreporting of revenues by sample firms. It also stresses the finding that firm size affects businesses in complex ways in that some indicators show that medium-sized firms suffer more severely than small or large firms probably because small firms may sometimes receive preferential treatment from the government while large firms may have the advantages of scale economies in one form or another.

Chapter 5 sets forth the book’s conclusions and their implications. It summarizes the study findings and stresses that this line of research needs to be pursued further and that more quantitative data needs to be collected. The questionnaire used for the survey and the basic figures of the raw data are provided in the appendices.

III

The foremost contribution of this new book is its detailed data set on the investment climate of 81 economies. This data set is surely seminal. As already mentioned, several research

[2] Financing is also seen as a major constraint by firms in all regions.

papers on international development which have used this data are about to be published. They will cite this book as the basis for their analyses on investment climate in developing countries. Scholars and policymakers who are concerned about corruption and interested in institutional and physical infrastructure will be keen to use the data set and consult this book for fundamental information on the set. There is no similar firm-level data set available enabling the comparison of investment climate in a large number of countries.[3] Clearly this is a great achievement on the part of the World Bank which will be useful worldwide.

This data will be important in the context of poverty alleviation. Poverty reduction has been approached largely from the standpoint of the household which has focused attention on the labor supply side of the poor. There has been only a limited amount of research that has examined poverty reduction from the labor demand side. However, if firms are not competitive and do not expand employment opportunities for the poor, there can be no reduction of poverty. Controlling corruption and providing institutional and physical infrastructure are key factors underpinning the competitiveness of firms enabling them to penetrate international markets.

A weakness in the data set is that the majority of questions in the questionnaire ask interviewees to give subjective evaluations. This makes it difficult to gauge the reliability of their information and to compare their answers with interviewees living in other regions of the world. Moreover, subjective variables may cause a measurement bias which is noted in Box 4.1 of the book (pp. 79–80). The authors call this bias the “kvetch factor” which comes from Yiddish, and they present some measures to compensate for it. However, there does not seem to be any clear-cut remedy for eliminating the measurement errors. For example, according to the data, firms in South Asia and sub-Sahara Africa are less likely to consider postal and telephone services as “bad” compared with public health services. Can we say from this that postal and telephone services are better in quality on average than public health services? Is “bad” for the health service of a country comparable to “bad” for its postal service? What if the standard for services in the mind of the interviewees differs? How bad or good a service is has to be measured in comparison with a standard. If the standard is not kept identical, the judgments and the answers of interviewees cannot be readily compared.

However, the authors recognize this obvious weakness, and it will be easily understood by readers. The advantages of the data set very much surpass its weakness. Users will be mindful of the weakness as they are with other subjective data sets like the Corruption Perception Index (CPI)[4] which was set up by Transparency International and is widely used to gauge the level of corruption in a country. (Tatsufumi Yamagata)

[3] The Japan External Trade Organization (JETRO) annually conducts its survey of investment-related costs in 26 cities in Asia for the benefit of prospective investors. This survey contains more practical data for investors than does the WBES. The JETRO survey can be found on the following website (http://www.jetro.go.jp/ec/e/stat/ surveys/cost_asia2002.pdf). However, the sampling method for the JETRO survey is rather ad hoc and not compatible with econometric methodology.

[4] The CPI is available on the website of Transparency International (http://www.transparency.org/).