CHAPTER 5

INVESTMENT CLIMATE

Summary

A sound investment climate is a prerequisite for robust private sector growth and job creation. Simple, clear, transparent regulations create a good level playing field and are key for creating a conducive environment for the private sector. Reducing regulatory barriers to business entry and competition, including inefficient tax administration, helps increase the number of firms that register and raise productivity, thereby creating jobs in the economy. Targeted investment climate reforms (such as special economic zones) can support job creation, if they are carefully planned and implemented. Regulatory simplification can also help create incentives for firms to move from the informal to the formal sector.

Getting the basics right

The very first step to set up an economy for growth and job creation is to get the basic enabling conditions right. Macroeconomic stability, clear and transparent regulations, and the rule of law, together form the fundamental operating environment within which the private sector makes its decisions to invest and create jobs. Investment climate reforms, including investment promotion efforts, spur economic growth that helps create jobs,[1] which is a principal way to escape poverty. Besides, investment climate reforms level the playing field and have the ability to positively affect the informal sector, where large proportions of poor people work in low-skilled jobs. The international community clearly underscored the importance of an enabling business climate for private investment and job creation, during the G-20 Mexico Summit in June 2012. Therefore any effort to create jobs in an economy needs to begin by ensuring that the investment climate in which the private sector operates is clear, simple and streamlined. This chapter focuses specifically on the legal and regulatory framework and its implementation. Other aspects of the operating environment for private enterprises—such as infrastructure and access to finance—are covered elsewhere in this report.

Examples from Africa illustrate the critical role that investment climate can play in creating jobs. Four evaluations conducted for IFC-supported investment climate reforms in Burkina Faso, Liberia, Rwanda, and Sierra Leone estimate that approximately 50,000 jobs had been created in those four countries in 2008–2010 (Table 5.1 and Box 5.1).[2] This is roughly equivalent to about 0.3 percent of the total labor force in the four countries. While these programs were multipronged, not simple undertakings, the pay-offs of these types of efforts can be far-reaching. In each of these countries, the reforms helped generate in two years: i) about US$1 million to $5 million in cost savings for the private sector; ii) US$5 million to $51 million in savings for the private sector companies; and iii) an additional 23,000 enterprises registered, of which about 10,000 were informal but chose to register and formalize as a result of the improvement in business regulations.[3]

Importantly, three of these countries incorporated a "public-private dialogue' (PPD) mechanism to effectively work with a broad range of stakeholders. Especially useful in countries with a disenfranchised or underdeveloped private sector, PPDs help ensure the participation of such groups as micro, small, and medium enterprises (MSMEs), women, minorities, and the broader civil society.

Table 5.1 Comprehensive investment climate reforms led to approx. 50,000 jobs in four countries

Summary of Four-country Investment Climate Interventions

		Burkina Faso	Liberia	Rwanda	Sierra Leone
Reform impact	Number of Jobs created (estimates) 2008-2010	1,700 - 2,000[1]	16,300 - 20,400	15,000 - 17,600	13,500 - 16,800
	Approx. Private sector cost savings	US$2.7m (2007-2010)	US$4.7m (2008-2010)	US$5.1m (2008-2010)	US$0.9m (2008-2010)
	Private sector investment generated, 2008-2010[2]	US$5-6m[3]	US$11-13m	US$44-51M	US$15-20m[4]
	Approx. number of new business registered, 2008-2010	1,200	8,200	8,000	5,600
	Within, formalized from informality	250-300	3,300-4,100	4,400-5,200	2,250-2,800
Investment Climate Interventions	Access to Business Land			X	
	Business Entry	X	X		X
	Business Exit	X			
	Business Licensing			X	
	Contruction Permits	X			
	Contract Enforcement	X			
	Doing Business Reforms[5]		X	X	X
	Investment Promotion		X	X	X
	Labor Regulation	X			
	Property Registration	X			
	Public Private Dialogue		X	X	X
	Special Economic Zones		X		
	Taxation	X		X	X
	Tourism Development				X
	Trade Logistics	X		X	
Program preparation and implementation duration (IFC assistance provided)		57 months (Mar 2006~)	51 months (Oct 2006~)	35 months (Jan 2008~)	31 months (Dec 2008~)
IFC's project expenditure (incl. others' funding)		US$2.8m	US$8.9m	US$3.3m	US$8.5m
Country Data	Per Capita GDP in current US$ (2011), WDI	US$600	US$281	US$583	US$374
	Population (2011), WDI	16,967,845	4,128,572	10,942,950	5,997,486
	Official unemployment rate, WDI	3.3% (2007)	3.7% (2010)	n.a.	3.4% (2004)
	Total labor force (2010), WDI	7,544,166	1,374,476	5,228,059	2,260,968
	Informal economy % GDP[6]	40.5	44.2	40.1	45.6

Source: Based on 4 case studies conducted by Economisti Associati

1. No impact could be detected in the case of Labor Law reform.
2. Generally these programs contributed to 3-4% of total private investment.
3. The reform program is believed to have contributed to economy's investment climate and thus overall investment increase, including large FDIs not included in this impact evaluation.
4. Improved institutional capacity resulted from the program is estimated to generate $150m in private investment for 2011-2013.
5. The component specifically focuses on the investment climate measured by WBG's Doing Business Report.
6. Friedrich Schneider, Andreas Buehn, Claudio E. Montenegro 2010, based on the definition of "all market-based legal production of goods and services that are deliberately concealed from public authorities to avoid payment of income, value added or other taxes, to avoid payment of social security contributions, to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, etc., and to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms.

This chapter is divided into ***three main sections***:

The ***first section*** illustrates examples of economy-wide business regulations that facilitate a level playing field through clear, consistent and simple standards, processes, and regulations. The ***second section*** consists of targeted interventions that proactively attempt to attract private sector investment, often through investment promotion policies, special economic zones or industry-specific policies. These complement the above-mentioned business regulations. The ***third section*** is a discussion on informality and jobs. Informality can be a direct outcome of a poor investment climate, and is often associated with poverty, lower wages, and poor working conditions.

1. Regulatory Simplification: Creating a level playing field

As shown in Figure 4.6, various investment climate factors, taken together, account for about half of the top constraints for formal private enterprises. These constraints, led by informality, tax rates, and corruption, tend to mutually reinforce one another. Hence, investment climate reforms should attempt to remove or reduce such constraints by leveling the playing field for all enterprises, and strengthening governance and enforcement of law in a country.

Having a set of simple, clear, transparent rules to register a business or close a business, or pay taxes, can go a long way in creating a conducive environment for the private sector. Such conditions encourage more entrepreneurs to set up a business, operate in the formal sector, and also encourage existing firms to expand and grow - all of which stimulates investment and job creation. As examples, this section will discuss seven types of regulatory simplification reforms that help create an encouraging investment climate.

1. Business entry
2. Competition policy
3. Taxation
4. Secured transactions and collateral registries
5. Inspections
6. Business licenses and permits (for registered firms)
7. Trade logistics

1.1 Business entry reforms

A business entry reform is a legal or regulatory change in which required processes and procedures to register a new or existing, unregistered business are rationalized, simplified and modernized. Such a reform results in reduced time, costs, and procedures to start a business. Less bureaucracy and lower costs to register a business encourage more firms to register and operate in the formal sector. This increase in firms stimulates job opportunities in the formal sector, which tends to offer better quality jobs. Abolishment of License Raj in India that involved cutting down procedures to register a business led to a 6 percent increase in the number of registered firms (after controlling for other effects).[4]

In 2002, the Mexican government passed a federal law to reduce the number of procedures required to start a business from 15 to 2, thus reducing the time it took a business to register from 67 days to 72 hours. In the next four years the country built a modern, efficient regulatory system for opening a business – Rapid Business Opening System (SARE) – in most of its urban municipalities. SARE was successful in rationalizing business entry procedures. An evaluation of the business entry reforms

Box 5.1: Reforms in investment climate helped create about 15,000 new jobs in Rwanda

Rwanda recently implemented a comprehensive reform program to improve its investment climate and boost private sector investment.

According to an external evaluation, within 2 years of implementing these reforms the country saw positive impact in terms of:

- $5 million in time and cost savings to the private sector
- 8,000 new and "formalized" enterprises
- 15,000 – 17,600 new jobs created and
- Approximately $50 million in new investment generated

Rwanda now ranks 45th in Doing Business 2012—an improvement of 113 ranks from the start of the program. With more than a dozen major pieces of legislation were passed that included reforms in business registration, issuance of construction permits, procedures for paying taxes and trade logistics involved in exporting or importing goods. The government showed commitment to creating a more efficient, and transparent business climate, and as a result Rwandan businesses have already begun to reap the rewards. The program also included investment promotion intervention and showed that emphasizing continuous dialogue with public and private stakeholders (through the Public-Private Dialogue mechanism) helped the government respond better to the business needs.

found that there was a *5 percent increase in the number of registered businesses* in the eligible industrial sectors. The reform also helped *total employment to increase in the eligible industries by 2.8 percent* from the pre-reform level within one year (after controlling for other factors).[5] While there were also job losses in non-eligible industries, people who were previously unemployed or out of the labor force were more likely to obtain jobs after the reform. This study clearly links reforms in the business registration processes to employment creation.[6] A similar study in Colombia found that business entry reforms in Colombia facilitated a 5.2 percent increase in the registration of new firms.[7]

1.1.1 Do these newly created firms survive?

A Portuguese business registration reform in 2005 led to a 22 percent increase in employment. The reform was primarily to simplify the lengthy and burdensome process of starting a business through an "On the Spot Firm" program. Jobs created were primarily in the agricultural, retail trade and construction sectors, and the start-up businesses are relatively smaller. Interestingly, firms that entered the market after the reform were about 4 percent less likely to survive their first two years than comparable incumbent firms having entered prior to the reform.[8] This is presumably due to increased competition in the market with more entrants, paired with eased market entry. Nevertheless, at a 17 percent increase in registered firms, the net effect on new business creation is positive. While survival rates of newly created firms is an important dynamic to take into account, one can generally expect there to be a positive and sustainable job growth as a result of reforms because job growth in surviving firms generally makes up for jobs lost in exiting firms.[9] In addition, even though some firms leave the market after the reform, this tends to be a positive market mechanism to reallocate resources to more efficient players in the economy.[10] Low aggregate productivity in developing countries is in part due to misallocation of resources across firms and that complex regulation is one factor that contributes to this misallocation.[11]

1.1.2 Business Entry reforms work best when complemented with other investment climate reforms

There is evidence from various studies that reforming the business entry processes works most effectively when such reforms are part of a package of reforms.[12] However, introducing multiple reforms at the same time is generally more challenging in terms of implementation.

1.2 Competition policy

Policies that help open markets and remove barriers promote competition, typically resulting in lower prices and better deals for consumers. They tend to stimulate innovation, productivity and economic growth.[13] This economic growth then helps create jobs. For example, a study based on OECD countries found that reducing pronounced state controls and barriers to competition would increase long-run employment rates by 2.5 to 5 percent.[14] Another study illustrates that removing anti-competitive regulation in energy, telecommunications, and transport in Croatia would increase GDP per capita by about 1.4–3 percent, as it would provide firms with incentives to reallocate resources to more productive activities, and increase innovation and technological diffusion.[15] Besides, less restrictive regulations may positively affect employment by reducing the rents that some firms extract from overregulation.[16] Another example—deregulation of shop opening hours in the US—resulted in an increase in employment by about 5 percent.[17] All these studies confirm that increasing competition and opening up markets help stimulate growth and job creation.

1.2.1 Encouraging competition raises productivity

Competition drives productivity growth through two key mechanisms: (a) it shifts market share toward more efficient producers; for example, the removal of price floors and advertising ban in the legal profession in Italy led to a market correction where more productive lawyers are more likely to stay in the profession;[18] and (b) it induces firms to become more efficient in order to survive; for example, land reforms that helped Vietnam move from community-based to market-driven production led to a large increase in total factor productivity in main rice-growing regions.[19] The efficiency gains from increased competition and liberalization in gas, water, and electricity in the United Kingdom resulted in an increase in productivity growth of more than 10 percent.[20] Although the relationship between productivity and employment is complex, the effect of an increase in productivity on employment is generally positive, as discussed in an earlier chapter.

1.2.2 Regulatory barriers to competition hurt employment

An interesting study on the French retail industry highlights how restrictive zoning regulation in France impacted employment negatively. A 1973 legislation of the French parliament introduced measures to protect small shopkeepers and craftsmen in the French retail industry in the face of a rapidly evolving large distribution market. This regulation implied that creation of any new large store had to be first approved by a regional zoning board. The study found that these barriers to entry had a negative impact on employment; retail employment could have been more than 10 percent higher at the time of the study (2002), had this entry regulation not been introduced.[21]

1.3 Taxation

A tax regulation reform may adjust different tax rates for companies, or it may modernize and rationalize the tax system and administration, including adoption of electronic tax payment portals. High tax rates, or taxes that are perceived to be unjustified, result in some firms preferring to operate informally without registering the company. Firms identify the tax system as one of the most important parameters in making an investment decision. Cumbersome tax structures are a drain on investor time and resources and act as a disincentive to participation in the formal economy. A streamlined tax system can increase the number of firms in the formal economy, facilitate investment, widen the tax base, and rationalize a company's tax compliance cost—and it need not decrease tax revenues (Box 5.2). A poorly designed or executed tax system negatively impacts investment, and economic growth suffers.[22]

Box 5.2: Reforming the tax system leads to a 12 percent increase in employment in Brazil

In 1996, Brazil introduced a business tax reduction and simplification scheme (SIMPLES) for micro and small firms. The program aimed at enabling small, unskilled labor-intensive firms to compete more effectively with larger enterprises and hence excluded from eligibility all activities that require the employment of professionals with regulated occupations, such as manufacturing of chemical products, machinery and equipment, education and health services, and incorporated companies.

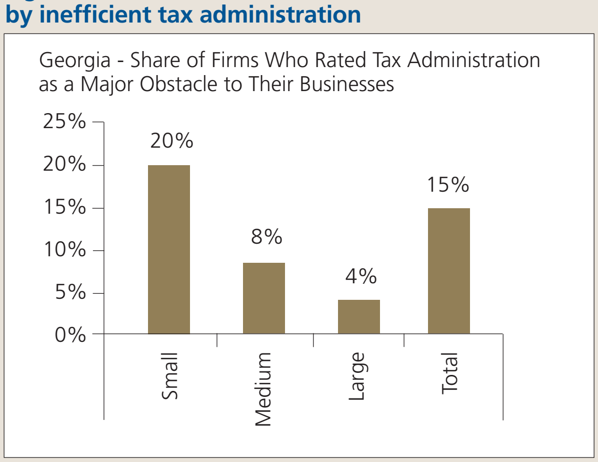
This reform had several positive effects:[23]

- It reduced the tax burden by about 8 percent for eligible firms.
- It led to a substantial reduction in labor costs (by replacing a fixed cost with a standard payroll contribution), and hence created a strong incentive to hire new employees and legalize already existing labor relationships.
- It led to an increase in formality.
- Newly created firms that opted to operate in the formal sector had higher revenues and profits, and employed more workers.
- *Employment increased by 12 percent.*

1.3.1 An inefficient tax administration imposes a significant constraint on private sector

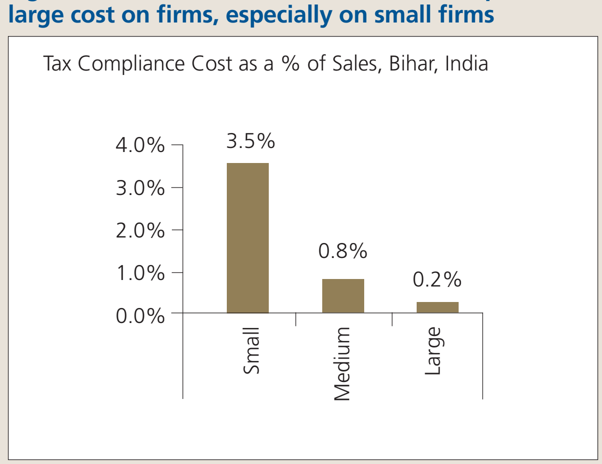
Feedback from the World Bank Group Enterprise Surveys shows that tax administration and tax rates constitute serious constraints for business, in particular for SMEs. As significant drivers of informality, high tax rates are primarily a result of multiple taxes, in some cases over the same base and across different layers of governments. The burden of tax administration is due to procedures that taxpayers need to comply with, such as tax filing and tax inspections. In most cases, these procedures are excessive, imposing a significant cost of compliance of businesses, especially for SMEs, which are typically more burdened.

Figure 5.2: Small firms are most affected by inefficient tax administration



Source: Enterprise Survey 2008

Figure 5.3: Inefficient tax administration imposes a large cost on firms, especially on small firms



Source: World Bank Group

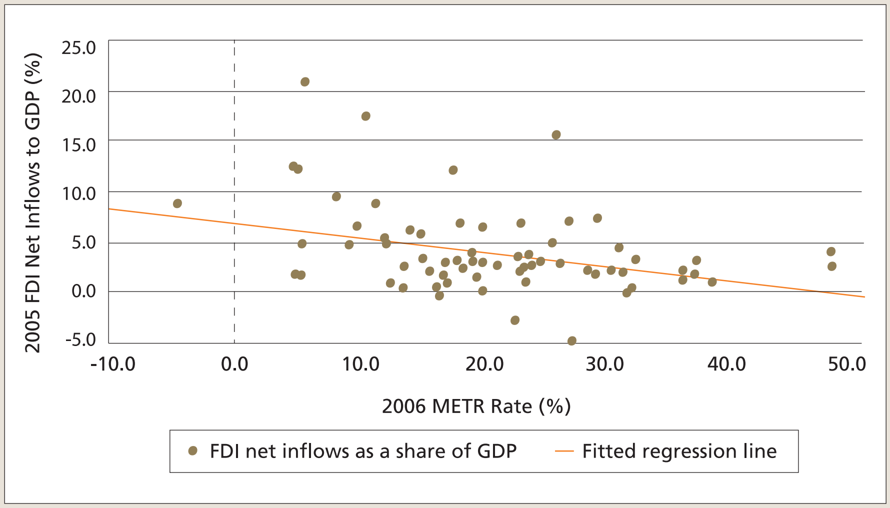
In Georgia, for example, 20 percent of small businesses identified tax administration as their main obstacle to doing business, as compared to 8 percent for medium-size businesses and 4 percent for large businesses (see Figure 5.2). Similarly, in the state of Bihar in India, the cost of complying with the tax system is equivalent to a 3.5 percent tax on sales for small businesses (Figure 5.3).[24]

1.3.2 Tax rates affect Foreign Direct Investment flows

Most studies on the relation between tax and investment have been on OECD countries. While some studies show that tax policy has little effect on investment when macroeconomic data are used,[25] other studies find that taxes do affect the volume and destination of FDI.[26] A meta-study of the literature concluded that, on average, a 1 percentage point increase in the tax rate reduced FDI by 3.3 percent.[27] However, most of these studies were in OECD countries.

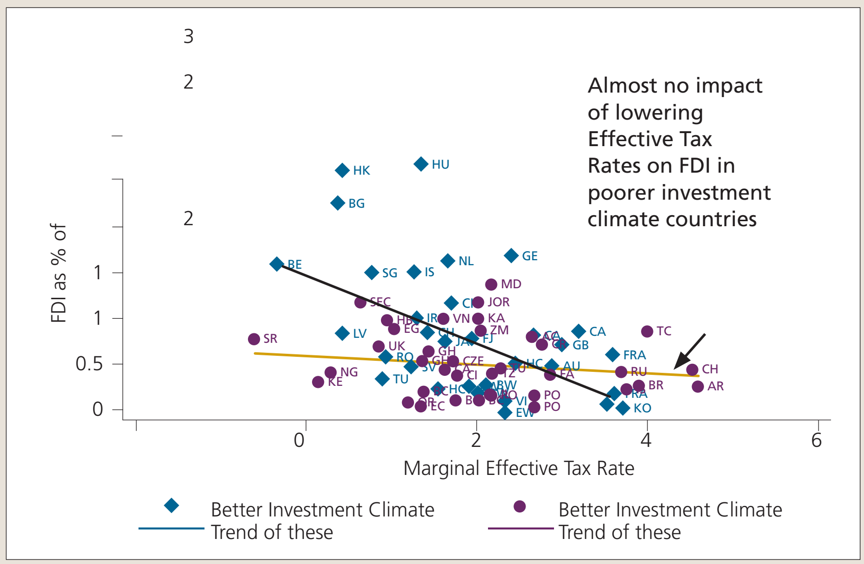
Recent research by the World Bank Group and the International Monetary Fund (IMF) has tried to extend the OECD-based studies to developing countries. The IMF conducted a study on how corporate tax rates and tax incentives affected FDI in 40 Latin American, Caribbean, and African countries during 1985–2004. The studies had findings similar to those of the OECD studies, although the impact of tax rates on investment is considerably smaller. A 10 percentage increase in the corporate income tax rate lowers FDI by 0.45 percentage of GDP.[28] Another study found that a 10 percentage point drop in the marginal effective tax rate (METR) caused FDI to rise by 3 percentage points of GDP in a sample of 69 countries, including several developing ones.[29]

Figure 5.4: Higher FDI is linked to lower effective tax rates



Source: International Monetary Fund; calculations by Andrew Tarasov.

Figure 5.5: The relationship between higher FDI and lower tax rates is weaker in countries with poorer investment climate



Source: James and Van Parys (2010)

One reason why the relationship between tax rates and investment is stronger in OECD countries than in developing countries is because of the investment climate. For countries with a weak investment climate, a lower METR has limited impact on FDI (Figure 5.4).[30] For example, having an METR of 20 percent instead of 40 percent raises FDI by 1 percent of GDP for countries ranked in the bottom half in terms of investment climate—while the same difference in the METR has an effect eight times greater for countries in the top half.[31] This finding implies that tax policy is far less effective in attracting FDI in countries with weaker investment climate than those where investment climate is more favorable. Other regional studies also support the conclusion that tax incentives have been much less effective in attracting FDI in West and Central Africa[32] than in the Caribbean countries.[33]

1.3.3 FDI plays an important role in quantity and quality of jobs

For many developing countries, foreign direct investment provides an opportunity to augment scarce internal resources in terms of capital, skills, and technology. Moreover, in the last decade, the rate of growth of FDI-related employment (28 percent) has far outpaced growth of the global labor force overall (16 percent), indicating a deepening importance of FDI in job creation. Therefore FDI has job creation implications that developing countries cannot ignore. FDI helps direct and indirect generation of jobs, generally creating higher paid jobs than domestically generated jobs, and leads to enhanced productivity of the host country labor force.[34] In 1997, US$488 billion in global FDI inflows had an employment effect of 26 million direct jobs and 42 million indirect jobs, or one job for about every US$68,000 in FDI.[35] Moreover, workers in foreign-owned firms tend to receive a wage premium over domestic-owned firms, especially in developing countries. For example, a study of Mexico and Venezuela estimated this wage difference at 30 percent, controlling for other factors.[36] In addition, FDI has been found to have a positive spillover effect on the productivity of the host country labor force. A study of firms across Europe regions found productivity gains of up to 40 percent, while increasing (not decreasing) labor demand in the long run.[37]

1.3.4 Investment promotion intermediaries can help attract FDI and create domestic jobs

Besides reforming the investment climate in general, some countries make special policies to attract FDI by creating investment promotion intermediaries (IPIs) to appeal to foreign investors. Policy advocacy to reform the investment climate was the investment promotion activity with the largest return for expenditure.[38] A recent study has shown that on average, one dollar spent on investment promotion was associated with an increase in FDI inflows by 189 dollars, and that 78 dollars spent on investment promotion helped create an additional job by a foreign affiliate.[39] However, one has to be careful attributing all the effects to investment promotion expenditures, since those governments spending money on investment promotion may also be the ones that are generally more welcoming toward private investment. Nevertheless, agencies that promote FDI help address information asymmetries and overcome burdensome bureaucratic procedures.[40] In a recent survey of executives with site selection responsibilities, 47 percent indicated a strong likelihood that they would use the IPI website, and 83 percent responded that they would make direct inquiries with IPIs during the site selection process.[41] A well-functioning investment promotion intermediary can provide valuable customer service to a foreign investor looking for investment opportunities, and can therefore help increase FDI inflows into a country (Box 5.3). A study found that on average, a 10 percent increase in IPI budget was associated with a 2.5 percent increase in a country's FDI inflows.[42] An analysis of 30,000 high value-added FDI projects shows that government-provided information and assistance significantly influenced investor decisions to locate in one economy or another.[43] According to another recent study of 156 countries, there is a strong positive correlation between a country's investment facilitation performances—based on the IFC Global Investment Promotion Best Practices (GIPB) framework—and its FDI inflows. It compares each country's average annual FDI inflows from 2000 to 2010 with its average performance in the three GIPB reviews.[44] The study found that a 1 percentage point increase in performance was associated with a 1.5 percentage point increase in FDI inflows (controlling for other factors).

Box 5.3: An effective investment promotion intermediary agency helps attract FDI, generate jobs, and empower women in Nicaragua[45]

ProNicaragua, an official Investment Promotion Intermediary (IPI) for Nicaragua, was set up in 2002 as the public-private, non-profit agency, with support from the World Bank Group. It has been featured amongst the top performers on Global Investment Promotion Best Practices (GIPB) 2008 and 2012 and recognized favorably by evaluations.

At just three years of operation, ProNicaragua:

- Contributed to the creation of 22,996 jobs by attracting FDI in the labor-intensive apparel and textile sector, becoming the champion of job creation in the Central American region since 2005.[46]
- Contributed to higher household income and consumption.
- Helped women's economic empowerment- those jobs paid higher wages to women.[47] It has enabled women to formally enter the workforce, contributing to their higher self-esteem and household consumption levels.
- Helped attract over 130 foreign investors representing $830 million in FDI.

1.4 Secured transactions and collateral registry

Secured transactions or secured lending generally refers to lending based collateral provided by movable assets such as inventory, account receivables, livestock, equipment, and machinery. Secured transactions reforms unleash credit potential in the economy, especially for smaller enterprises (discussed in the Chapter Access to Finance) (Box 5.4). An independent evaluation of a reform of China's secured transactions law found that the surveyed SMEs that received accounts receivable financing clearly increased their workforce. The evaluation found that 21 percent of the SMEs surveyed confirmed the reform impact on job creation for their businesses.[48]

Box 5.4: Reforming secured transactions law helps increase employment in China

China's comprehensive Property Rights Law went into effect in October 2007. With IFC's assistance, China successfully developed a modern secured transactions law and a security interest registry. The law covers the creation of security interests on various types of property and recognizes and protects private property rights with respect to certain property types, such as immovable or real property. It also enabled establishing security interests in movable assets, such as account receivable and inventory, promoting access to finance using those assets as collaterals.

The outcomes were impressive.[49]

- Over 250,000 loans were secured by accounts receivable in 3 years.
- The reform fundamentally changed the credit market structure, enabling significant innovation and growth of movables financing, particularly in accounts receivable financing.
- SME finance was facilitated and the increased access to finance was highly valued by entrepreneurs leading SMEs. Female entrepreneurs are among the key beneficiaries of the reform.
- SMEs that received accounts receivable financing clearly increased their workforce in 2011.

1.5 Inspections

Inspections are government mechanisms to ensure compliance in key areas such as health, safety, and the environment. Such inspections typically involve visits by government-appointed officials to private sector facilities. Inspections can also be a time-consuming and expensive burden, affecting business productivity and deterring owners from joining the formal economy.[50] Poorly written, complex inspection regulation could lead to corruption, as it leaves room for inspectors to demand bribes.[51] Improvements in a business inspections framework and practices are expected to lead to more companies operating as registered entities (promoting formalization) and, through compliance, more sustainable labor, environmental and social conditions.

Although there are no formal studies on the job creation impact of inspection reforms, one could expect that a reformed inspection mechanism would encourage job creation by 1) cost savings for the private sector, which could be used for more productive purposes (Box 5.5); and 2) increased investment because of risk reduction with improved compliance (more discussion follows in the chapter on quality of jobs).

Box 5.5: Inspection Reform in Jordan generated savings for the private sector[52]

The Jordan government introduced inspection reform with IFC's advisory engagement, which involved developing a management system, an inspection organization structure, and a comprehensive operations manual. As part of the implementation, inspectors were trained to gain updated inspection skills and knowledge on procedures, management systems, and communication. As a result of reform, incidence of non-compliance decreased and the number of worker complaints increased over time (indicating improved awareness among workers of their rights). It also hired additional inspectors, including more female field inspectors to address gender issues.

The reform led to:

- Increased efficiency of inspectorates
- Increased transparency of inspection operations
- Improved implementation of regulations
- Expected private sector savings of $2 million per annum which would enable more output and employment.

1.6 Business licensing and permits

A license simplification reform that was launched in January 2006 in Lima, Peru simplified and reduced business licensing procedures, the time to obtain business licenses, and the average number of inspections. This set of efforts helped reduce the time taken to obtain a business license from two months to 6 days, reducing the cost by about 60 percent. In the first six months after the implementation of this reform, there was a 263 percent increase in the number of firms in operation that applied for a license. The impact evaluation, however, did not find statistically significant evidence on firm performance indicators, such as income, profit per worker, investment in machinery, number of employees, and access to credit. This finding is consistent with the emerging picture where growth-oriented micro enterprises generally seek a business license to avoid risks, not necessarily to improve firm performance.[53] However, it is possible that a medium- to long-term evaluation may show effects on business growth and job creation.

1.7 Trade logistics

Faster, leaner, more efficient trade logistics systems are essential for businesses to survive in competitive global markets. Firms increasingly use global sourcing strategies that require flexible, speedy, and cost-effective solutions. Improving trade logistics services is therefore an important reform for promoting not only trade, but indeed, economic growth, private sector investment, and jobs. An improved trade logistics system usually includes simplifying and harmonizing procedures and documentation, implementing electronic processing, automation, and "single window" systems, and introducing risk management in border inspections and clearance.

Colombia implemented a trade logistics reform in 2008. With the passage of over 15 pieces of legislation, various improvements were effected from an online registry for trade transactions to streamlined physical inspections. Since 2008, the time to import and export goods decreased from 20 and 24 days, respectively, to 14 days in 2010 for both. A 10 percent reduction in the time to trade implies an increase in trade by roughly $780 million for Colombia.[54] Traders witnessed a 30 percent decrease in the time to obtain transaction approvals through the single window system. While a direct quantitative link between trade reforms and jobs was not established in most studies, one can assume that a reduction in the time and cost for the private sector to trade would positively affect the output of firms, and hence job creation.

2. Targeted investment climate reforms

Realizing the importance of investment climate in attracting investments for growth and employment, many governments proactively promote and facilitate investments in certain targeted sectors of strategic interest or regions in the economy. Instruments used include setting up special economic zones, or formulating targeted investment policies for specific sectors such as tourism, for example. These two specific instruments (and their role in employment creation) are discussed below in this section. These instruments become even more effective when used in complementary ways as part of an overall investment climate reform package, as shown by the experience of Panama, where targeted investment generation reforms has led to the creation of 4,800 jobs (Box 5.6).

2.1 Special Economic Zones

A Special Economic Zone[58] is a piece of serviced land (typically industrial) with good connectivity and infrastructure, governed by a comprehensive and integrated set of laws and regulations often compatible with international trade agreements. For developing countries, SEZs have traditionally attempted to create a good investment climate policy environment along with providing good quality, reliable infrastructure in a specific area to potential investors (the importance of good quality infrastructure in attracting private sector investment is discussed in Chapter 6). Through SEZs, governments aim to develop and diversify exports, support local industry and clusters, attract FDI, create jobs, and pilot new policies and approaches to create jobs—particularly those removing or reducing key administrative barriers, regulatory difficulties, and land-rights issues. SEZs also provide improved physical infrastructure and services to investors in a sustainable and environmentally friendly manner, and allow for more efficient government supervision of enterprises, provision of off-site infrastructure, and environmental controls.[59]

2.1.1 SEZs can support employment creation

While SEZs represent less than 1 percent of global employment, they can be an important source of employment in some countries, especially smaller ones. The impact of these jobs in countries with high rates of unemployment and underemployment

Box 5.6: A targeted investment climate instrument creates 4,800 jobs in Panama[55]

The Panama Pacifico project is a good example of multifaceted investment facilitation efforts to achieve growth and create jobs. This project involved establishment of a Special Economic Zone (SEZ) managed in the form of a public-private partnership (PPP).[56]

In early 2000, the Panama government sought to convert the former 2,500-hectare Howard U.S. Air Force Base into a hub for international trade, logistics, services, commerce, and industry. Panama, a Central American country of about 2 million people, has a significant comparative advantage in world trade logistics. However, it recognized that the significant regulatory barriers were too difficult to solve at a national level.

Since June 2001, the government of Panama, with support from the World Bank Group, established a modern SEZ regulatory framework conducive to business and FDI, drawing on experiences of other countries such as the Philippines, Malaysia, and Singapore. They established a dedicated agency structured as a true one-stop shop on site, and then launched an SEZ development tender process under a PPP approach. The master plan development contract was awarded to an international private agency. The area has now developed into a platform for economic growth that has generated over 4,800 jobs.[57] It has attracted international corporations like 3M, BASF, Dell, 3PL, and Cable & Wireless. Over the next 20 years, the SEZ is expected to create another 20,000 high-value jobs and bring about $3 billion of FDI into Panama.

This successful experiment is now being used in other countries like Democratic Republic of Congo, Kenya, and Haiti to attract investment and create jobs.

are significant.[60] It is estimated that in 1975, there were 79 zones in 25 countries, employing about 800,000 people. Today, it is estimated that 3,500 SEZs operate in 130 countries. Of these, there are more than 2,300 zones in 119 developing and transition countries, mainly in Asia and the Pacific and the Americas, employing 66 million. For some countries, such as China, Korea, Mexico, Malaysia, and Mauritius, SEZs have been transformational.

Through SEZs (or Export Processing Zones, or EPZs), Bangladesh has generated $2.4 billion cumulative in investments and a total of 340,000 gross jobs (in its eight EPZs) since 1983 (see Box 5.7), while Panama has seen 4,800 jobs created (as noted previously). Although such estimates only capture the number of direct jobs created, SEZs also help generate indirect jobs and other spillover benefits within the entire economy.

2.1.2 SEZs can affect quality of jobs

Another advantage of SEZs is that they enable job creation in the formal sector, as companies within the SEZ need to be legally established in the country and are typically subject to stricter regulatory compliance. Formality and better compliance with labor, social, environmental, health and security standards, and typically better enforcement within SEZs, tend to elevate the quality of these jobs in comparison to those in the rest of the economy.[61]

2.1.3 SEZs can help create jobs for women

SEZs have been especially effective in generating jobs for women in the formal labor market.[62] Worldwide, 60 to 70 percent of SEZ employees are women, who tend to be engaged in labor-intensive, assembly-orientated activities requiring manual dexterity, such as production of garments, textiles, and electrical and electronic goods. In Bangladesh, women represent about 64 percent of over 200,000 total workers, and the share increases to 75 percent in fully foreign-owned garment firms.

However, it has been observed that jobs for women tend to be concentrated in lower-paid production, while men dominate in supervisory and skilled positions. Concerns about women's low wage levels, lack of training, and suppression of labor standards and rights have been raised even within the zones, especially among the least developed countries. However, such issues can usually also be addressed more easily within the zones, as is being piloted in Bangladesh.

Box 5.7: An EPZ helps generate investment, create jobs, improve productivity, and increase women's economic participation in Bangladesh[63]

The development of a special economic zone is usually a significant undertaking. With its first SEZ (an EPZ) in Chittagong, the Bangladesh Export Processing Zones Authority (BEPZA) zone program started in 1983. Today, there are eight EPZs in the country that together account for US$2.4 billion of cumulative investment, US$4.3 billion of annual exports (2012-13), and employ more than 340,000 people on a gross basis.

With the assistance of FIAS and IFC since 2004, and funding support from the UK government and the EU since 2007, BEPZA has benefited from strong private sector engagement, technical feasibility studies, on-site infrastructure development in the form of public-private partnerships, better environmental and other regulatory standards, stakeholder analysis, and investment promotion capacity building. In addition, a major accomplishment has been the enacting of the Economic Zone Act of 2010, which allows the private sector to develop new economic zones—to scale up the benefit.

2.1.4 However, the SEZ experience has been mixed across the globe

Global experience with respect to SEZs has not been uniformly successful. Successes in East Asia and Latin America have been difficult to replicate, particularly in Africa. In some cases, the special status accorded to SEZs gave rise to corruption opportunities. Other reasons for mixed outcomes have been poor strategic planning, mismatch of comparative advantages, and lack of financial viability. There is also ongoing debate on the effectiveness of using SEZs at an economy-wide level. Ideally, all investors should have the same transparent regulatory conditions to be competitive, irrespective of where they locate in a country. However, this is far from the reality in most parts of the developing world, and even less in low-income countries or fragile and conflict-affected states. In such situations, SEZ could be used as an instrument to strengthen the investment climate in a smaller targeted area to pilot reforms before scaling them up to the national level. China's economic zones grew in a phased way. Some post-conflict countries like Rwanda,[64] Iraq, Nicaragua, and El Salvador are now successfully using SEZs or other types of economic zones to further achieve their peace-building efforts.

One way to mitigate the risks of implementing poorly designed SEZs is to follow an approach based on private sector principles, i.e., to be careful in designing an SEZ that is responsive to local, regional, and global market demand and that is consistent with the country's comparative and competitive advantages. By offering turnkey connection points with simplified business processes, better infrastructure, and quick access to markets, without the usual burden of land acquisition, utility connections, etc., SEZs could be effectively used for generating growth, investment, and jobs in an economy.

2.2 Industry-specific investment climate policies

While economy-wide reforms are often required to level the playing field for competition among businesses, sector-specific initiatives could help address certain regulatory constraints that inhibit specific industries.

Taking the example of tourism, several economies strongly rely on this sector for growth and jobs (see Boxes 5.8 and 5.9). The travel and tourism industry currently generates 234 million direct and indirect jobs (approximately one in twelve jobs) worldwide.[65] The jobs that tourism helps create are particularly valuable, as they are often in remote locations where other employment opportunities may be limited. Tourism is a labor-intensive industry and employs a high share of unskilled or medium-skilled youth and women workers—maximizing its potential impact for the poor and marginalized. The generation of earnings among local people directly or indirectly (through the local supply chain) involved with the industry, in turn, stimulates spending in the local economy, thus creating induced jobs. For example, targeted investment climate interventions by the governments of Mozambique and Sierra Leone (described below) are expected to generate investment that would create 60 and 400 jobs, respectively, along with positive spillovers of the tax revenues that are generated. However, maximizing development returns from the tourism sector needs careful planning and stakeholder engagement.[66]

While industry-specific efforts could be effective, they require very careful diagnostics on country-specific competitive advantages and growth barriers. Such a diagnosis further requires detailed information and also strong government capacity to make objective choices.[67] The specific risks associated with such targeted investment reform decisions are that preferential policies toward any sector have distributional implications that could affect other stakeholders, sometimes unintentionally.

Box 5.8: Tourism helps spur local growth and create jobs in Mozambique[68]

Mozambique launched the development of a $3 million eco-lodge, Maputo Special Reserve, in a 70,000-hectare prime protected area. Bordering the Indian Ocean, the reserve offers tourists a variety of beaches, bays, coral reefs, forests, lakes, rivers, and a host of wildlife including an estimated 350 elephants. Co-financed by Switzerland and other donors through the World Bank Group, the Maputo Special Reserve in Mozambique was implemented through a concession to attract qualified eco-tourism investors.

A joint venture between a local community association, A Hi Zameni Chemucane, and a private investor, the Bell Foundation, was set up to build and operate a 36-bed lodge at Ponta Chemucane in the reserve. It is Mozambique's first agreement granting a community long-term concession rights for a tourist area within one of the country's leading national parks. The lodge is expected to create 60 full-time jobs and help spur local growth in an area that has few opportunities for formal employment, a positive externality of tourism projects like this. In addition, annual concession fees to be paid to the government will be used for park and longer term conservation management.

Following investment in the Maputo reserve, a standardized set of procedures was compiled and a toolkit developed for future use by Mozambican authorities. The Maputo model has been replicated to attract a $30 million investment for a 200-bed eco-lodge in Mozambique's Zambézia Province. It is also assisting in sustainable tourism development. Through new investment zone regulations, for example, the government can reserve land with unique natural, cultural, or historic attributes for tourism development. As a result, the Inhassoro and Crusse-Jamali sites along Mozambique's coasts have been declared the country's first tourism investment zones, securing over 4,500 hectares.

Box 5.9: The right regulatory approach helps attract good quality investors in tourism and create jobs in Sierra Leone[69]

The government of Sierra Leone was in search of a credible investor for the Cape Sierra Hotel, an abandoned 100-room hotel in a suburb of Freetown. At the time, there were no international hotel brands in Freetown, and the existing three hotels offered about 120 rooms, well below the demand, estimated at 400 rooms. The government needed to attract a branded hotel operator as a strategic investor to redevelop the Cape Sierra into an international first-class hotel.

The government decided to establish a PPP structure and engage in efforts to improve the sector business environment in tourism with a strengthened regulatory framework. It proceeded with the tender on the basis of structuring a concession and sublease agreement, supported by the World Bank Group

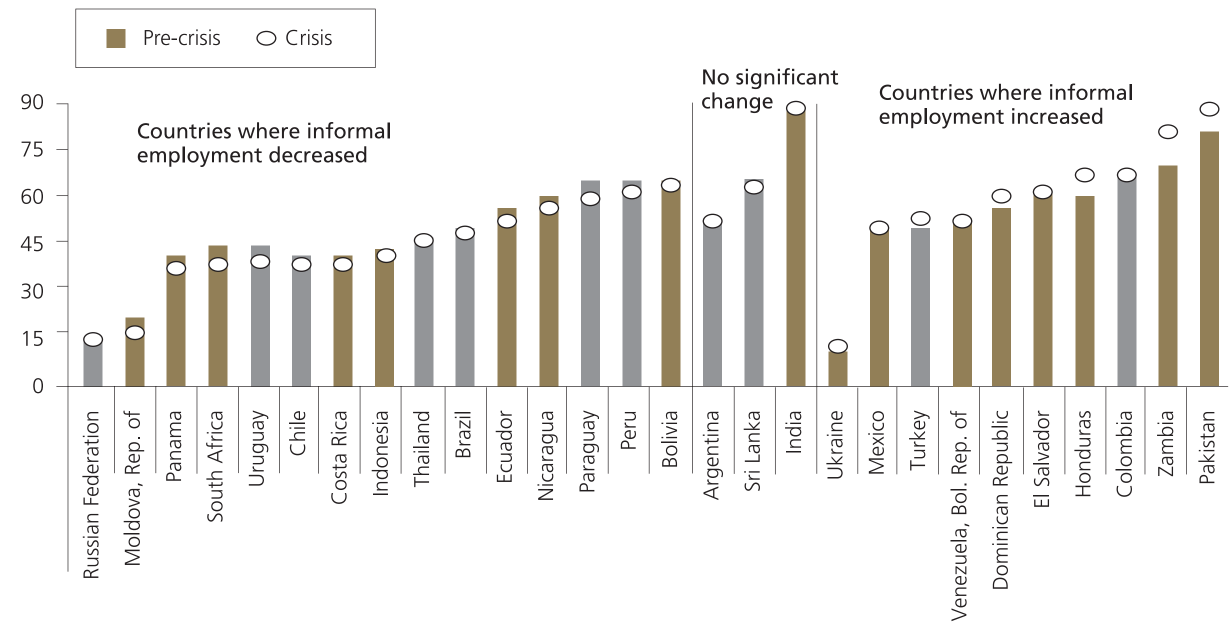
IDEA UK and Hilton International were selected as the highest-ranked bidder to completely redevelop the Cape Sierra into a 200-room hotel (at a cost of about $40 million). The hotel is expected to create more than 400 jobs.

3. Informality and jobs

A poor investment climate, in the form of cumbersome regulations as well as their weak enforcement, usually results in a large informal sector. Firms often find that formalizing imposes excessive costs and time and is often not commensurate with the potential benefits, which is why they prefer to operate under the radar screen as informal initiatives. Hence the informal sector is often a direct outcome of poor regulatory frameworks. Therefore, any reforms in investment climate that ease regulatory barriers would make it more attractive for firms to formalize.

In developing countries, informal employment accounts for over 40 percent of non-agricultural employment (Figure 5.6).[70] Typically, high-income countries are associated with a proportionally small informal economy, with Switzerland at 8.5 percent of GDP, whereas lower-income countries typically have a much larger informal economy, even exceeding 60 percent of GDP (e.g., Bolivia, Georgia, and Panama).[71]

Figure 5.6: Informal employment in developing economies (percentage of total non-agricultural employment)



Note: For Pakistan, Russian Federation, Turkey, and Ukraine, the figures represent only employment in the informal sector (it excludes workers with no proper contracts in the formal sector) and for all other countries, the figures are estimates of informal employment.

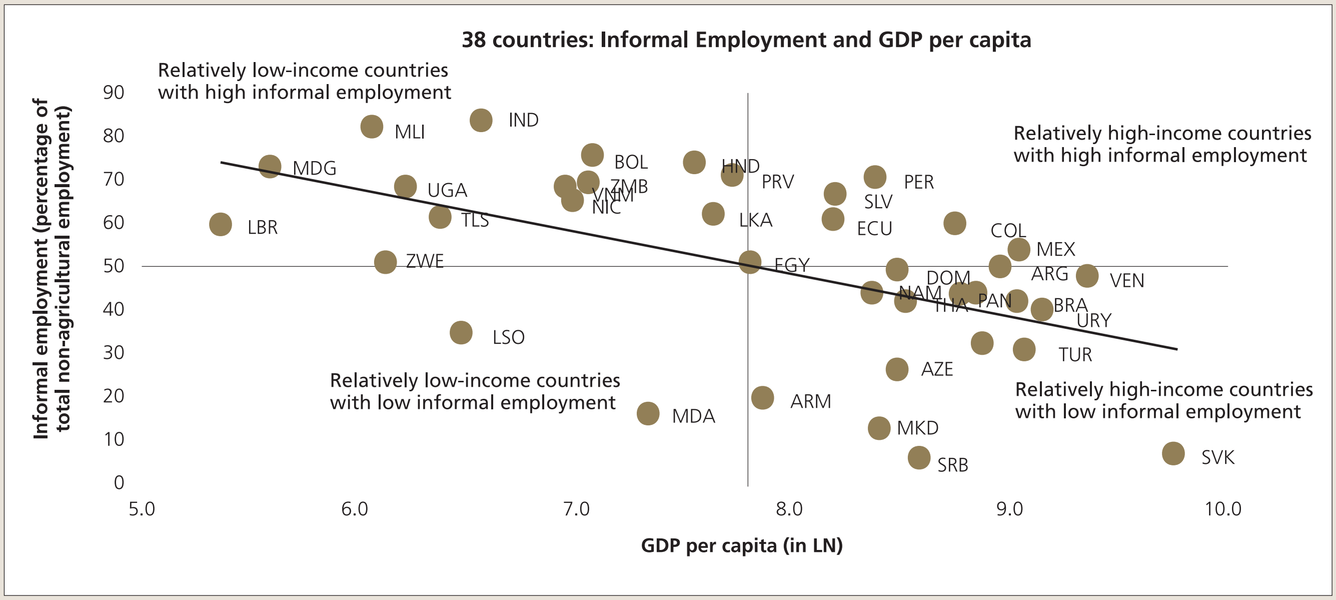
Grey bar denotes countries where employment rates increased.

Source: The estimates for Latin American countries are from Panorama Laboral (2011); data for Zambia, South Africa, Turkey, Republic of Moldova, Russian Federation, Ukraine, Sri Lanka, and Thailand were compiled by the ILO Statistics Department and are published in Vanek et al. (forthcoming). Data for India, Indonesia, and Pakistan are estimates by IILS from national sources.

Source: ILO World of Work 2012: Better jobs for a better economy

The informal sector generally includes informal companies engaged in economic activities, individuals carrying out unregistered economic activities, or formal companies engaged in informal economic activities to make money. Their activities do not contribute to the officially calculated GNP.[72] These activities generally include subsistence-type activities that people use for survival or business activities that are carried out without formal compliance of regulations (such as tax evasion, avoidance of labor regulation, or not registering the business).[73] While most of such survival, subsistence-type informal economic activities may pose unfair competition to formal players by not being subject to certain cost and compliance requirements, people who live on these informal activities are largely trying to make ends meet. They are typically those who were unable to find wage jobs in the formal sector. Often such persons prefer to operate informally to avoid costs of formalization or burdensome regulations.[74]

Figure 5.7: Informal employment tends to be higher at lower levels of development



Source: ILO, IMF, World Economic Outlook.

3.1 How informality affects different stakeholders

- Government: Having a large proportion of economic activities outside the formal sector implies lost tax revenue, which further limits the ability of the government to provide services or shape macroeconomic outcomes through policies (as a large portion of activities are outside the zone of influence of a policy). This undermines the "fiscal-social contract" between the state, business, and citizen, represented by the exchange of regulatory compliance and tax on the one hand and for services and the rule of law on the other, and further undermines democracy and the emergence of effective states.[75] It limits a country's capacity to grow.[76]
- Private Sector: Operating informally restricts a company's potential to grow. The absence of predictable, enforceable rules increases risks and corruption.[77] Informal firms are typically small and less productive compared even to small formal firms, and especially relative to larger formal firms.[78] This is partly due to formal firms generally being run by better educated managers, who are able use opportunities like advertisement and access to finance that can only be available to formal firms.[79]
- Workers: The informal sector provides the last-resort opportunities for some to obtain income, skills and experience—usually of low quality compared to the formal sector jobs. There is a much higher concentration of lower-skilled workers in the informal economy than intermediate- and higher-skilled workers (Figure 5.8). As also discussed in the chapter on Quality of Jobs, informal jobs tend to be lower in quality, often paying lower wages and lacking labor safeguards. Informal workers generally receive no overtime compensation or benefits such as health insurance or retirement savings. Work can be discontinued at any time without severance. This is due to the fact that informal employers are not bound by labor and other standards to protect workers. Formal firms tend to provide safer working conditions than informal firms. Having proof of employment often brings additional benefits for workers, such as eligibility for loans and leases, and certain social status.

3.2 Informal jobs are often associated with poverty

Although informal jobs help make ends meet, they tend to be suboptimal solutions that could further perpetuate rather than reduce poverty. Many of the 4 billion people estimated to be at the Base of Pyramid (BoP) depend on informal sector activities, which can act as poverty traps.[80] Workers belonging to this sector cannot advance in their economic status, and often remain in poverty.[81] There is also a strong negative correlation between the size of the informal economy and income per capita.[82] Figure 5.9 points to a relationship where a larger informal economy is generally associated with a larger degree of poverty.[83] Women are three times more likely than men to be hired informally[84] and are much more likely to be unpaid workers who contribute to the family's business than are men.[85]

3.3 Easing regulatory costs and constraints will help incentivize some firms to formalize

The operation of a large proportion of economic and potentially productive activities in the informal sector represents a suboptimal situation for all stakeholders concerned. Formalization of companies and jobs could potentially provide more security and stability to individual workers and also be beneficial for companies that could use opportunities associated with the formal sector, such as access to finance, in order to grow. Yet informality cannot be easily addressed through a few simple quick-fix measures.

One obvious policy approach is the one many countries are trying—that is, easing regulatory constraints and reducing costs that prevent firms from formalizing. A study in Sri Lanka found that modest increases in the perceived benefits of being formal could lead to a potentially large increase in demand to formalize among informal firms (Box 5.10).

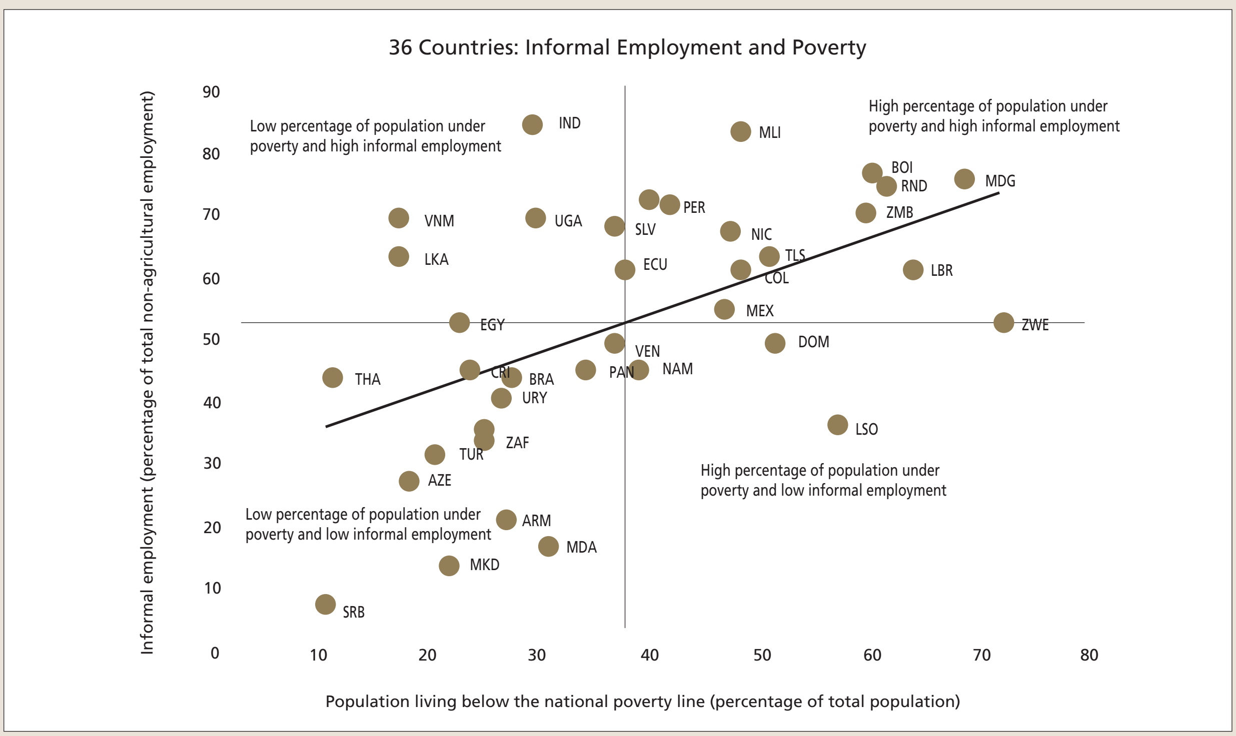
Figure 5.8: Low skilled workers tend to be concentrated in the informal sector

Source: IILS estimates based on the IILS Informality Database, Economic Commission for Latin America and the Caribbean (ECLAC).

Note: The figure displays the share of informally employed workers as a percentage of total employment by skill level. Informality covers salaried workers in small firms, non-professional self-employed and zero-income workers. Countries included: Argentina, Brazil, Chile, Costa Rica, Ecuador, Mexico, Panama, Paraguay, Uruguay, and Venezuela.

An insight from a study in Mexico[87] is that business entry reforms alone may not be enough to incentivize all firms to formalize. The business entry reform in Mexico did lead to the creation of new businesses. However, a large number of firms

Figure 5.9: Informal employment is positively associated with poverty



Source: ILO, IMF, World Economic Outlook.

Box 5.10: Experiment to move from informality to formality in Sri Lanka[86]

This study conducted a field experiment in Sri Lanka that provided incentives for informal firms to formalize as follows: The first group was offered only information about the registration process and reimbursement for direct registration costs; no firm ended up registering. The second group was offered payments equivalent to one-half to one month's profits for the median firm, and around one-fifth of firms registered. The third group was offered a larger payment equivalent to two months' median profits and about half of the firms registered. While not the primary focus on the study, the experiment demonstrated that modest increases in the perceived benefits of being formal could lead to potentially large increase in demand to formalize among informal firms. One-third of those who didn't register despite being offered incentives reported problems, such as land issues, which would significantly increase their costs for registration. Other concerns included facing labor taxes in the future and bureaucracy in the registration process.

While the authors overall found little evidence for hypothesized benefits of formalization (such as access to credit and formal contracts and programs), formalized firms were found to advertise more and use receipt books. In interviews, owners of formalized firms expressed that the formalization established more legitimacy of their businesses and a large increase in trust in the government.

continue to operate informally even after the entry reform.[88] Informal business owners who wanted to be business owners ("entrepreneurs out of aspiration") but found the business registration too cumbersome were 14.3 percent more likely to register their business after the reform. In contrast, informal business owners who run informal business to make ends meet while looking for a wage job ("entrepreneurs out of desperation") are less likely to register their businesses after the reform, but they are 20.4 percent more likely to become wage workers as job opportunities increase. This suggests that it is difficult to draw simplistic conclusions about a direct and clear effect of business entry reforms on the informal economy. Only 14 percent of informal companies that were previously unregistered due to high regulatory barriers did formalize their businesses after the reform. Similarly, only 6 percent of informal business owners who had wanted to be wage workers did become wage workers. The study suggests that policy interventions that seek to reduce the size of the informal sector may need to take a dual-pronged approach, targeting both firm formalization and job creation (as was done in Mexico's SARE process). Another lesson is that bringing a larger fraction of informal enterprises into the formal sector and creating additional jobs would require other reforms as well, such as a tax reform.

A review of the Brazilian experience suggests that the intervention to incentivize informal enterprises to formalize could be timed strategically to capitalize on the favorable economic environment.[89]

Although not the main focus of this section, another aspect of informality is the illegal shadow economy activities of companies that choose to operate informally in exchange for financial benefits or profits by avoiding costs through or carrying out criminal operations. In this case, policies need to focus on stronger governance and enforcement capability to complement improved policy and regulatory framework to close loopholes.[90] In general, informality, poor governance, and corruption reinforce one another in many developing countries.[91] Therefore, along with improving the quality of the regulatory framework, it is also important to strengthen institutions and to improve governance and the enforcement of regulations in order to discourage illegal and criminal activities and encourage a rule of law.

Conclusions

- A good quality investment climate is a prerequisite for an economy that wants to grow and create jobs.
- Simplifying and streamlining regulations create a good level playing field within which the private sector can operate productively and help create jobs. Complex, poorly written regulations could lead to corruption.
- Reducing regulatory barriers to entry incentivizes more firms to register and helps create jobs.
- Investment climate reforms work better when they are comprehensive and planned as a package, rather than standalone reforms. The specific components of an ideal investment climate reform package that would be comprehensive and effective would depend on the country context.
- Encouraging competition raises productivity and helps create jobs in the economy.
- Inefficient tax administration imposes a significant constraint on the private sector.
- FDI inflows generally help create more and better quality jobs. A well-functioning investment promotion intermediary can help attract crucial FDI, which would, in turn, help create jobs.

- Targeted investment climate reforms like SEZs can support job creation, although the experience has been mixed across the globe. SEZs work best when they are based on market demand and the competitive advantage of the region or country.
- Formal enterprises perceive the informal sector as presenting unfair competition. Simplifying and streamlining regulatory barriers through a good investment climate can help incentivize firms to formalize, although the issue of informality is more complex, and one cannot assume that business entry reforms will automatically cause all firms to formalize.

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[3] The external evaluations did not involve developing a proper counter factual, and only simple before-and-after frameworks were applied. Nonetheless, considering the scarcity of available wage jobs in these economies, the evaluation gives us an estimate of the importance of such reforms for employment generation and growth.

[4] Aghion, Burgess, Redding, and Zilibotti (2008).

[5] David Kaplan et al. (2007) also confirmed that SARE helped increase the number of registered firms. However, presumably due to the use of Mexican Social Security data for employment counts, which excludes self-employed workers, the increase was 7 times smaller than Miriam Bruhn's finding. Bruhn's study also indicates that the employment increase in wage workers only (excluding self-employed business owners) was 2.2 percent.

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[25] Hassett and Hubbard (2002).

[26] Hines (1997).

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[28] Klemm and Van Parys (2009).

[29] Mintz, Jack M. 2007

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[31] James and Van Parys (2010a).

[32] James and Van Parys (2010b).

[33] James and Van Parys (2010c).

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[35] Aaron (1999).

[36] Aitken, Harrison, and Lipsey (1996).

[37] Blomstrom et al. (2006).

[38] Morisset and Andrews-Johnson (2004).

[39] Harding and Javorcik (2011).

[40] Ibid.

41 Development Counsellors International (2011).

42 Morisset and Andrews-Johnson (2004).

43 Hornberger, Battat, and Kusek (2011).

44 Javorcik and Harding (forthcoming).

45 Sourced from: i) ProNicaragua, Institutional Presentation (2012); ii) Zanias, George P. (2008): iii) Dexis Consulting Group (2007).

46 Zanias (2008).

47 Dexis Consulting Group (2007).

48 Dalberg Global Development Advisors (2012).

49 Ibid.

50 Aranki and Shalan (2012).

51 Based on a comment provided by an SME business owner in Mozambique.

52 Aranki and Shalan (2012).

53 Alcazar, Lorena and Miguel Jaramillo (2011).

54 Internal study.

55 Sourced from: i) Marques De Sa and Manchanda (2009); ii) IFC Success Stories – Infrastructure Advisory (2009); iii) Interview with London and Regional, Panama Pacifico SEZ operator, by Armando Heilbron, July 2011 and September 2012; iv) Interview with Sebastian Arango, London & Regional, Panama, September 2012; and v) World Bank, International Trade Department BBL Series, March 2011

56 With IFC as the principal advisor, global coordinator, and lead negotiator, the World Bank Group coordinated policy advice and quality control of legislation and regulations and supported targeted investment promotion.

57 Interview with Sebastian Arango, London Regional Properties, Panama. The actual job figures are based on Social Security records.

58 A "Special Economic Zone" is a commonly used term for this type of zone described in this section, but other terms, such as "Export Processing Zone" or "Special Industrial Zone," are also used.

59 World Bank Group Investment Climate website (www.wbginvestmentclimate.org).

60 FIAS (2008).

61 World Bank (2011).

62 World Bank (2010).

63 Sourced from i) BEPZA's website: www.epzbangladesh.org.bd; and ii) internal source.

64 In post-conflict Rwanda, the government is employing IEZs as a policy tool to effect needed reforms to attract investment and create jobs in such targeted sectors as agriculture, tourism, high-technology, manufacturing, social infrastructure, labor housing, and hospital and school developments.

65 World Travel and Tourism Council.

66 World Bank and IFC (2012).

67 World Bank (2012).

68 FIAS (2011), *2011 Annual Review*, Washington, DC.

69 Lee et al. (2012).

70 ILO (2012), World of Work Report (2012).

71 Schneider, Buehn, and Montenegro (2010).

72 Ibid. This also introduces two other definitions: "Market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of GDP" by Smith (1994), "Assessing the Size of the Underground Economy: The Statistics Canada Perspectives, *Canadian Economic Observer*; and "Those economic activities and the income derived from them that circumvent or otherwise avoid government regulations, taxation or observation" by Dell'Anno (2003), Dell'Anno and Schneider (2004), and Freige (1989). Another study by Flodman, *The Informal Economy*, Sida (2004) describes informality generally as businesses completely or partially avoiding tax payment, which are not accounted for in the economy's total income and are not supervised by any public institution.

73 "World Bank Group Concept of Informal Sector, http://lnweb90.worldbank.org/eca/eca.nsf/1f3aa35cab9dea4f85256a77004e4ef4/2e4ede543787a0c085256a940073f4e4?OpenDocument

In this particular definition, corruption, the third top perceived constraint in investment climate business regulations by surveyed formal companies is basically a type of informal sector activities. Also see: Donor Committee for Enterprise Development (DCED), 2009 Business Environment Reforms and the Informal Economy, Table 2.1: "A simplified typology of the degree of enterprise informality Characteristic"

74 Unofficial business activities, like money laundering and corruption, are also classified informal but are not the focus of this chapter.

75 Donor Committee for Enterprise Development (2009).

76 La Porta and Shleifer (2008).

77 Donor Committee for Enterprise Development (2009).

78 La Porta and Shleifer (2008).

79 Ibid.

80 Hammond, Kramer, Katz, Tran, and Walker (2007).

81 http://www.ilo.org/global/topics/employment-promotion/informal-economy/lang--en/index.htm

82 It indicates GDP per capita as the most robust predictor of the size of the informal economy, which is interpreted as a manifestation of underdevelopment.

83 Internal source.

84 World Bank and IFC (2006).

85 World Bank (2010).

86 de Mel, McKenzie, and Woodruff (2012).

87 Bruhn (2012).

88 The author cites other literature suggesting evidence from Bolivia and Indonesia that not all informal firms benefit equally from registering, and that for some firms in Bolivia, formalization lowers profits (McKenzie and Sakho, 2010, McCulocu, Schulze and Voss, 2010, Perry et al. 2007)

89 Internal source.

90 Donor Committee for Enterprise Development (2009).

91 Internal source.