South China Morning Post

Rankings that rankle

Steve Hanke November 1, 2013

The World Bank has been producing its annual "Doing Business" report since 2004 and its 2014 edition ranking Hong Kong second out of 189 economies surveyed, in contrast to mainland China's score of 96, hardly seems controversial.

Its rankings of 10 factors reflecting the ease with which entrepreneurs and businesses may conduct economic activity in a given economy offer an unbiased way of looking at business.

After all, with so much unreliable data coming out of official government statistics offices these days, it would appear to be a useful tool - not only for businesses, but for governments as well. Indeed, since 2005, a total of 1,940 reforms have been implemented by countries to improve their rankings.

As it turns out, however, a few countries (specifically those with low rankings) are none too happy about the report.

While some world leaders have viewed their countries' relatively low rankings as a challenge to institute economic reform, other countries - most notably China - have been pressuring the World Bank to scrap the rankings and weaken the analysis to the point of irrelevance.

Indeed, under pressure from China and others, World Bank president Jim Yong Kim commissioned a panel to "study" the Doing Business rankings and present recommendations for "improvement". Not surprisingly, the commission recommended doing away with the actual ordinal rankings, and switching to a less embarrassing evaluation of each country.

The panel's recommendations are nothing more than a thinly veiled attempt to gut the report. Stripping the ordinal rankings and "reforming" the report's methodology would have the effect of completely destroying its credibility and usefulness as a policy tool.

Fortunately, the Doing Business report has one very important ally - Kim himself. A campaign to save the report has also been mounted by the report's co-founder, former World Bank group vice-president Michael Klein.

These World Bank insiders recognise a simple fact - one which many businessmen, politicians, civil servants and economists, like myself, have long understood. The Doing Business report represents one of the few uniform, objective metrics available for measuring the progress of economic reform efforts over time.

Objective metrics like Doing Business are important, because as the late professor Oskar Morgenstern documented in his classic, "On the Accuracy of Economic Observations", the incompetence and wilful trickery of many governments often render official data less than reliable.

The solution to this problem is to develop unbiased statistics, using objective data. And, while official, macro-level data like GDP per capita is important, it must also be complemented with micro-level data on factors such as contract enforcement and access to electricity.

This is where the Doing Business report comes into play. Rather than rely on often dubious official statistics, the report uses data collected from more than 9,000 accountants, lawyers, engineers and other business professionals around the world. And the report provides vital data on the structural strengths and weakness of a given economy.

By "structural", I simply mean the "rules of the game" for small and medium-sized businesses - in short, the government-imposed regulatory costs of starting, running and closing a business in a given economy.

The case of China and its position on the Doing Business report is rather strange. After all, Chinese pragmatism holds the proverb of "seeking truth from facts" in high regard. Moreover, this mantra has worked in China for nearly four decades.

According to the late Nobel Prize-winning professor Ronald Coase and Professor Ning Wang in their recent book, *How China Became Capitalist*, this approach has produced multiple marginal revolutions that have brought back entrepreneurship and unleashed market forces outside the boundaries of socialism. In consequence, China has undergone one of the greatest economic transformations and sustained economic booms in history.

The key for China going forward will be to continue making marginal reforms that put more of the economy outside the grip of the dead hand of socialism - along the lines of the reforms proposed by the State Council's Development Research Centre, as well as China's own "Mr Market", Wu Jinglian.

The Doing Business report should be a cornerstone of this effort.

So long as Kim holds fast and preserves the report, as is, China will have access to a valuable policy framework for implementing further economic reforms and an objective benchmark for measuring their progress.

Rather than being embarrassed by its current Doing Business ranking, the Chinese government should view it as a challenge and a call for another marginal revolution or two.