

# CEES

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## **Doing business**

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## **Content**

1. Introduction .....	3
2. Theoretical and methodological basis for assessing regulatory quality .....	3
3. Factors and significance of regulatory quality .....	5
4. Conditions for doing business in the Czech Republic .....	10
5. Comparison of the EU-8 and EU-14 countries .....	18
6. Conclusion .....	19
References .....	20
Annex .....	22

## 1. Introduction

Conditions for doing business significantly and directly influence the execution and productivity of entrepreneurial activities and subsequently have impact on the overall economic productivity. Results of their quality assessment help to identify the impact of enterprise regulation on the economic and social characteristics of productivity and the related institutional characteristics (such as motivation to engage in corrupt practices). On the other hand, assessment of conditions for doing business helps in planning and implementing related (individual and comprehensive) reforms, which may contribute to increased competitiveness of a country through improving the quality of its institutional environment and boosting incentives to invest and employ. However, this does not mean that better evaluation of conditions for doing business is a reflection of no regulation. For example creating an adequate information system or ensuring enforceability of parties' rights often requires an advanced regulatory framework and significant expenses. Nonetheless, regulation in countries with favourable conditions for doing business represents a smaller administrative and financial burden for companies and makes their operation easier. Higher tax rates in these countries may be connected with a higher quality of public services, which apart from a minimal regulatory burden is also reflected for example in the quality of infrastructure, higher human development index values and a lower degree of corruption.

This chapter assesses the conditions for doing business (regulatory quality) in the Czech Republic within the European Union, using findings of the World Bank (WB) research for 2005 carried out within the *Doing Business* project (with data valid in January of the relevant year). Comments on the Czech regulatory practice and suggestions for their future use in an economic analysis are presented. The WB project assesses the conditions for doing business or the quality of regulation of entrepreneurial activities in 155 countries, including 22 European Union member states (excluding Luxembourg, Cyprus and Malta). Conditions for doing business are evaluated especially according to the characteristics and impact of the regulatory burden. The range of monitored indicators is gradually extended (ten indicators were monitored in 2005) and their methodology changes slightly, resulting in somewhat limited comparability of results in time (data for a period starting from 2003 available). The wide span of the project with regard to the number of countries allows extensive international comparisons for groups of countries at various levels of economic and institutional development. The study is structured to examine ten indicators of conditions for doing business, i.e. starting and closing business, granting licenses, enforcing contracts, protecting investors, registering property, getting credit, hiring and firing workers, trading across borders and paying taxes.

## 2. Theoretical and methodological basis for assessing regulatory quality

Leading modern **theoretical approaches** to regulation follow Pigou's concept of regulation as public interest, Coase's contractual solution theory and Stigler's theory of regulatory capture (see WB, 2003, p. 90–92). According to the public interest regulation theory, markets demonstrate frequent failures and governments striving for societal effectiveness are responsible for correcting these failures. Stiglitz draws attention to increased incidence of market failures in less developed countries requiring more extensive regulation. This concept of the need for regulation is criticized from a number of aspects. Firstly, the expected extent of market failures and the inability of the competitive environment to solve the majority of alleged prob-

lems without regulatory intervention are considered excessive. Private arrangements are often capable of solving this problem even in the case of insufficient effectiveness of competitive forces. If this is not the case, impartial courts may serve this purpose, provided that they are able to effectively enforce adherence to proprietary rights and contractual provisions. Finally, the critics of regulation point out the assumption of competence and good intentions of the government as the regulator as erroneous. According to this concept, regulation is abused for the benefit of entities capable of influencing it. State intervention cannot increase the welfare of the society; on the contrary it contributes to its decrease. Regulation increases corruption in the environment and transaction costs.

Nonetheless, a certain level of regulation is necessary in the real world of market economies and this regulation increases the quality of life and the economic productivity. The enforcement theory (see Djankov et al., 2003) that compares two types of social costs – private damage costs and state intervention costs – represents an attempt to define the optimal extent of regulation. Private damage occurs as a result of private actors' ability to harm other entities, for example by theft, fraud, overcharging or creating external costs. State intervention is a manifestation of the public servants' ability to harm private entities through bureaucratic bullying or expropriation. As solutions progress from private arrangements within the market discipline to private judicial settlement, regulation and state ownership, the government's decision-making power increases, the authority of private actors decreases, social loss due to private damage reduces and social loss due to state intervention rises. Adequate forms of governmental intervention will depend on the type of activity and specific conditions in the relevant country, such as the productivity of the public administration and courts. Minimizing the cost of regulation triggered by its misuse for private gain requires a certain system for supervising regulators.

Two basic principles should apply in enterprise regulation – regulation is only necessary if private solutions cannot prevent harmful acts and feasible if it can be enforced effectively (i.e. when its misuse can be prevented). Countries achieving positive results in conditions for doing business typically simplify and deregulate competitive markets and thus increase their ability to generate private and social optimum without the need for external intervention. When regulation is considered necessary, maximum effort must be made to simplify it as much as possible. Strengthening property rights and ensuring their enforceability must be the key aspect of regulation. An efficient judicial system significantly reduces opportunities for breaching contractual obligations. Wider use of information and communication technologies increases the effectiveness and reduces the burden of administrative procedures, minimizes personal contact with public servants and thus reduces opportunities for demanding bribes, and improves the access to information for parties involved, thus decreasing their transaction costs.

Decreasing regulatory burden, especially the time demands and the cost of regulation, is significantly supported by limiting participation of courts in business matters to cases that cannot be solved by extrajudicial settlement or replacing judicial procedures with administrative procedures. Effective improvement in the quality of conditions depends on the consistency of reforming efforts. Many countries have recently introduced regulatory impact assessment for proposals of new regulatory measures. The requirement for analyzing the cost and benefit effectively helps to remove superfluous and burdening regulatory measures.

**Box 1 - Quality of regulation (institutional environment) and economic performance**

Analyses of the relationship between the regulatory quality and economic performance on the micro and macroeconomic levels are comprehensive, i.e. including various aspects of the regulatory quality, or focus on its individual aspects (such as the labour market, credit markets, etc.). **Eifert, Gelb and Ramachandran** (2005) use microeconomic data obtained from the investment climate research carried out within the World Bank project (World Bank, 2004) to demonstrate the impact of a low corporate environment quality on the overall factor productivity in African countries (in a wider international comparison). The related high regulation costs reduce the labour factor revenue and thus decrease the demand for labour and real wages. **Love and Mylenko** (2003) use the World Bank research data on the quality of corporate environment to assess the importance of public and private credit registers for reduction of financing restrictions and increase in the share of financing through external (bank) resources. This relationship is apparent in the case of private registers (the impact of public registers is insignificant mainly due to their lower information value) and reflects especially in the availability of financing for small and medium-size enterprises. **Arrunada, González-Díaz and Fernández** (2004) explain the differences between European and American forms of organisation (volume structures) and ownership in motor freight transport by institutional differences in labour regulation and taxation laws, which increase the cost of vertical integration in Europe compared to the USA. **Hoang Lan Ha** (2003) presents a (statistically significant) positive relationship between efficiency of judicial systems and development of credit markets in a wider international comparison. Judicial system efficiency is measured according to the speed and simplicity of the system. Countries with better contract enforcement systems exhibit more developed credit markets, greater banking sector volumes and higher shares of credit provided to the private sector. **Pierre and Scarpetta** (2004) demonstrate the perception of regulation on the part of employers and their response to situations when regulation is seen as restricting company operation. The company research results are compared to the actual labour legislation valid in the monitored countries. As a rule, stronger regulation reflects in more intense perception of regulation as a limiting factor on the part of firms. However, there are significant differences between enterprises in adverse effects of this regulation – medium-size and innovative firms tend to feel the impact more intensely. Small firms address the regulatory pressure (which increases the cost of hiring and firing employees) through larger numbers of definite term contracts, while medium-size, large and innovative companies increase their investments into education at a workplace. **Pica and Mora** (2004) present the impact of similarity/difference in regulation between individual countries on their bilateral flow of foreign direct investment. This impact is significant and negative. Implementation of FDI is associated with additional fixed costs, which include the cost of managing different regulation. Similar levels of regulation support FDI, and increase wages, output and productivity. Higher productivity is a result of forcing out less efficient local entrepreneurs by foreign entities supported by more efficient allocation of resources. **Loayza, Oviedo and Servén** (2005) explore the impact of regulation on economic growth and relative volume of the informal sector. Regulation (especially on product and labour markets) influences macroeconomic and especially growth performance by stimulating transfer of resources to grey economy whenever it is excessively intense. The negative impact of the degree of regulation on economic growth is reduced or even eliminated by a high institutional quality. At the microeconomic level the authors focus on a mechanism through which dissimilar forms of regulating firms' input and output (negatively) influence growth of productivity. Interventions on the product and labour markets and fiscal regulation complicate input and output and thus negatively affect the Schumpeterian process of creative destruction as a condition for constructive corporate dynamics. **Bolaky and Freund** (2004) study the relationship between openness of economies, economic growth and regulation, concluding that greater openness of economies in countries with high regulation does not have a significant impact on economic growth, while a positive relationship between growth and openness of economies can be observed in countries with less intense regulation. In view of the effect of regulation, the relationship between openness and growth appears stronger compared to the previous studies.

**3. Factors and significance of regulatory quality**

The regulatory quality is affected by a number of factors and it is a consequence of local choice or efforts to achieve higher regulatory efficiency to a limited extent only (WB 2003, p. 84-85). In a wider international comparison, countries with more developed

economies on average regulate less and more consistently than less developed countries. Differences in regulation between developed countries are influenced by their history and these differences were previously also reflected in institutional structure of their former colonies. Anglo-American common law was typical for independent judges and juries, low weight of regulation and preference of private settlement of disputes. France developed a tradition of civil law based on the Roman law with state judges, emphasis on codes of law and procedures and preference of state regulation over private solution. Germany and Nordic countries developed their own versions of the civil law also based on the Roman law. Nordic countries and countries with Anglo-American legal systems exhibit the lowest regulation, while regulation is the most intense in countries with the French civil law system.<sup>1</sup> Levels of economic development and legal system heritage explain 60 % of differences in the degree of regulation between countries included in the World Bank survey in 2003 (WB 2003, p. 76). The impact of the remaining factors is less prominent and systemic. Political systems play a specific role. In countries with representative government systems, the aim of regulation is mainly to correct market failures, while the tendency towards exploiting regulation by narrow lobby groups is manifested in less democratic regimes. Regulation is less intense in countries with a greater degree of political freedom.

**Table 1: Country ranking according to the business conditions indicators, 2005**

	<b>Over-all ranking</b>	(1) Start-ing busi-ness	(2) Grant-ing li-cences	(3) Hiring/firing work-ers	(4) Regis-tering prop-erty	(5) Obtain-ing credit	(6) Pro-protecting inves-tors	(7) Paying taxes	(8) Trad-ing across borders	(9) Enforc-ing con-tracts	(10) Clos-ing busi-ness
DK	<b>8</b>	15	6	17	31	47	22	61	1	2	41
UK	<b>9</b>	9	29	15	23	3	9	81	21	30	12
IE	<b>11</b>	13	14	59	69	7	10	21	18	32	13
FI	<b>13</b>	18	19	84	16	39	46	67	4	23	6
SE	<b>14</b>	20	13	86	8	15	70	38	2	14	23
LT	<b>15</b>	37	16	93	2	40	61	31	31	7	17
EE	<b>16</b>	43	9	111	29	61	34	18	14	18	43
BE	<b>18</b>	34	31	43	141	41	11	33	9	17	7
DE	<b>19</b>	47	20	131	33	2	48	54	3	24	21
NL	<b>24</b>	42	66	70	20	12	112	120	5	20	10
LV	<b>26</b>	26	47	103	88	48	43	83	62	15	9
SP	<b>30</b>	86	50	150	37	14	79	25	10	25	22
AT	<b>32</b>	59	41	110	28	18	118	72	8	35	31
SK	<b>37</b>	48	40	74	6	46	115	69	60	81	93
CZ	<b>41</b>	77	87	60	57	13	58	70	24	21	121
PT	<b>42</b>	104	94	145	93	30	27	47	29	46	24
FR	<b>44</b>	9	23	142	144	123	76	35	44	13	27
HU	<b>52</b>	72	119	85	96	43	62	98	38	31	42
PL	<b>54</b>	92	120	64	75	82	25	106	34	102	40
SI	<b>63</b>	77	48	133	89	51	50	77	63	85	79
IT	<b>70</b>	45	93	138	48	33	96	102	90	76	47
GR	<b>80</b>	121	42	148	130	91	131	67	64	8	29

Source: Own calculations using the WB data (2005).

<sup>1</sup> Central and Eastern European countries in transition are seen as influenced by the German law to a great extent as a heritage of the Austrian-Hungarian Empire's impact. The German model includes Baltic economies, which in addition adopt certain qualities from economies of their wealthier Scandinavian neighbours.



The general comparison according to the positions achieved in individual indicators of conditions for doing business based on the WB survey identifies weaknesses and strengths of EU member states within the entire sample (see Table 1). Baltic countries, especially Lithuania and Estonia were among the new EU member states achieving the best results, while Italy and especially Greece were among the old member states lagging behind the rest the most. In the overall comparison, nine EU member states, seven Nordic European states (including five EU member states plus Norway and Iceland) and eight non-European states were among the first twenty countries. Denmark as the best EU member state was surpassed by New Zealand, Singapore, United States, Canada, Norway, Australia and Hong Kong, i.e. except for Norway mainly by countries with Anglo-American common law heritage.

As regards to the European Union, the results show that very significant differences between member states in conditions for doing business (regulatory quality) often remain. No significant harmonization among the original member states in this regard can be seen at this point. The position of EU states on average in the wider international comparison is clearly the worst in employment regulation (this indicator also shows the most significant differences between individual member states). High level of protection of European labour markets therefore undoubtedly contributes to their lower flexibility, especially with regard to (un)employment in more problematic groups. The second worst position of the EU countries of average is in conditions for paying taxes due to relatively high tax rates which in many cases are not matched by the quality of conditions for doing business. Low investor protection and registration of property remain a very significant weakness for the EU. On the other hand, the EU has achieved the best results in conditions for foreign trade and conditions for starting and closing business.

The following comparison shows relationships between the quality of conditions for doing business (as an alternative indicator of the institutional quality) and other economic and non-economic indicators. The EU countries are firstly distinguished according to the applicable tax burden (expressed according to an indicator from the WB survey) and the quality of conditions for doing business as a form of a public service. The following examination focuses on the relationship between the regulatory quality and the economic freedom index (published by *Heritage Foundation*) as an expression of intensity of regulation or the extent of state intervention and the relationship between the regulatory quality and the corruption perceptions index (published by *Transparency International*) as an approximation of the degree of abusing regulation.

The first relationship illustrates to what extent the level of redistribution matches the quality of conditions for doing business as a public service (Figure 1). The average values for both indicators for the EU-22 identify four groups of countries. The situation is the best in the case of a low tax burden accompanied by a high quality of conditions for doing business, which applies especially to Ireland, Denmark and Great Britain. The position of countries with a high tax burden, but also a high quality of conditions for doing business, such as in Sweden and Finland, can also be assessed as positive. What's more, a high level of institutional quality in combination with low intensity of state intervention (see below) has a positive impact on the effectiveness of public resource expenditure (if the society prefers a higher degree of redistribution). The third group of countries is characterized by a low tax burden in combination with a low regulatory quality, which can in fact bring additional costs for entrepreneurs, for example due to long waiting times, demanding procedures, high administration fees or

corruption incentives. This group includes especially Slovenia, Portugal and also the Czech Republic. The results in these cases clearly show that reforms should focus especially on improving the institutional quality, rather than reducing the tax burden. However, a low regulatory quality in connection with a higher intensity of state intervention negatively influences the effectiveness of public resource expenditure and the degree of redistribution should therefore be as low as possible. The situation in the last group of countries is the worst because in these cases a high tax burden is combined with a low quality of conditions for doing business. This is the case for example in Italy, Greece, Hungary and Poland. A higher tax burden may also be connected with a better range of other public services rather than a high regulatory quality. However, the question remains whether an ineffective regulatory system might make this range of public services costly.<sup>2</sup>

The third relationship demonstrates to what extent the quality of conditions for doing business reflects in the level of corruption in the relevant environment, in other words to what extent regulation is misused in the EU member states. Generally, we can assume that a lower quality of conditions for doing business is connected with a higher level of corruption (Figure 3). The relationship between the two indicators is again negative and very strong (the correlation coefficient is 0.73 and more than a half of differences between the member states in the level of corruption can be explained by differences in the regulatory quality). Similarly to the majority of the new member states, the Czech Republic is also included in the group of countries with a low regulatory quality and a high level of corruption. However, most of more developed EU member states with a comparably low quality of conditions for doing business demonstrate a lower level of corruption (Portugal, France, and Spain), while Estonia and Lithuania face greater corruption despite their higher regulatory quality. These specifics suggest differences in the efficiency of regulation enforcement or in the ability to prevent misuse of regulation in the form of corrupt practices. Although a low regulatory quality may present excessive burden for entrepreneurs, efficient control mechanisms are able to inhibit its corrupt effect.

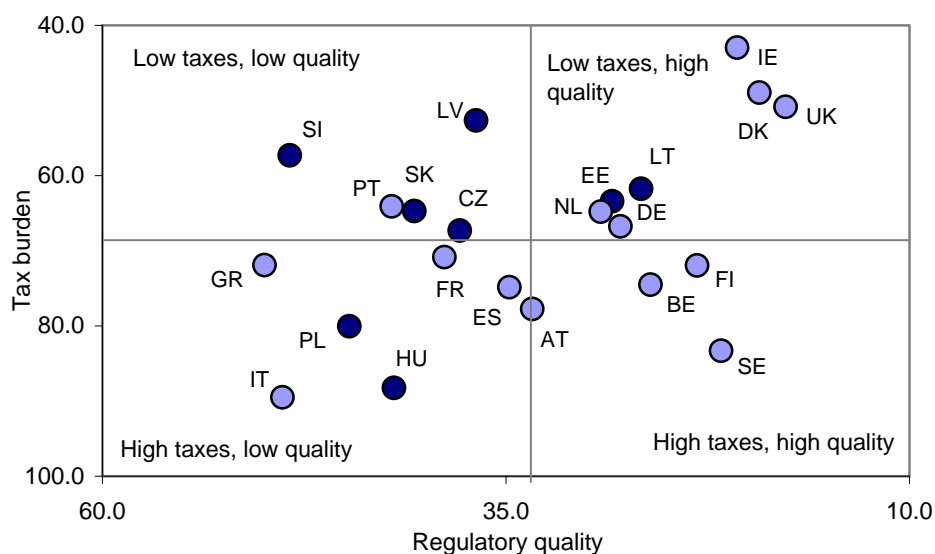
The relationships described above show that improving the quality of conditions for doing business is a vital systemic condition for reducing the level of corruption in a particular environment and the extent of grey economy (and subsequently for increasing tax revenues). A higher regulatory quality also allows more effective use of available resources, significantly facilitates development of entrepreneurial and innovative activities, especially in the case of small and medium-size firms, and increases employment. The example of Baltic countries shows that even new EU member countries

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<sup>2</sup> Nonetheless, it is necessary to point out that the importance of a better regulatory quality as a positive condition for doing business in countries with less developed economies may be reduced by their more significant lagging behind, for example in the quality of a physical infrastructure and services. This is why for example in the case of countries with similar degrees of regulation it is suitable to consider additional characteristics of the quality of public services, which can be demonstrated for example by the economic level (as an approximation of the infrastructure quality) or the mean life expectancy (as an approximation of the quality of life). These characteristics are elements of the human development index published by the UN (UNDP 2005). For example, Estonia and Lithuania with the best regulatory quality of conditions for doing business of the new member states may exceed the levels achieved by most of the original member states, but both lag behind these countries significantly in the two elements of the human development index referred to above. On the other hand, Italy, Greece, Spain and Portugal demonstrate regulatory quality at a (low) level similar to or even worse than the new member states but achieve better results in human development.

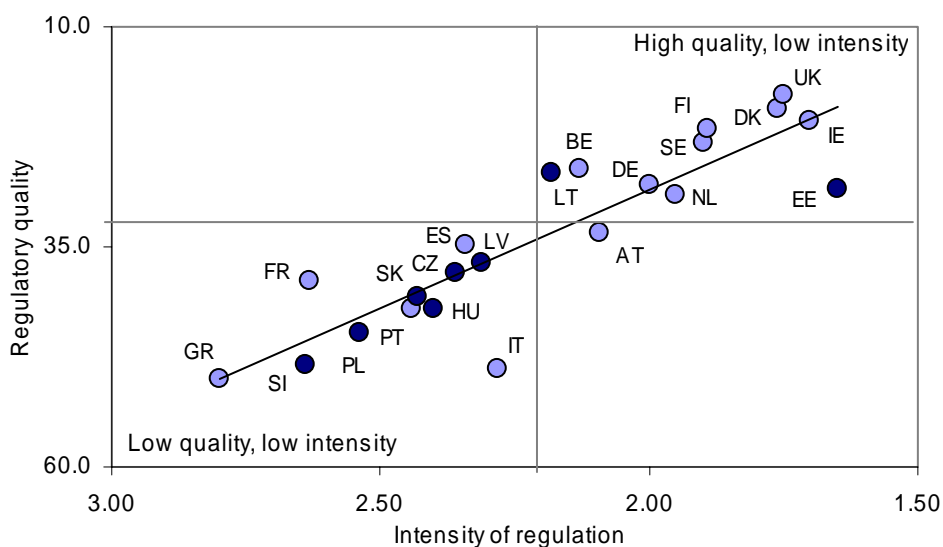
with a less developed economy and burdened by their socialistic past are capable of achieving significant success in this regard in a relatively short timeframe. It is necessary to focus first on areas where changes can be implemented relatively promptly and at lower costs and simultaneously prepare more in-depth and demanding systemic changes involving comprehensive legal regulation. The best way of reducing the time demands and the (indirect) costs of procedures related to enterprise is to minimize the participation of courts in cases regarding disputes that cannot be solved by private settlement.

**Figure 1: Relationship between the tax burden and the quality of conditions for doing business (in %)**

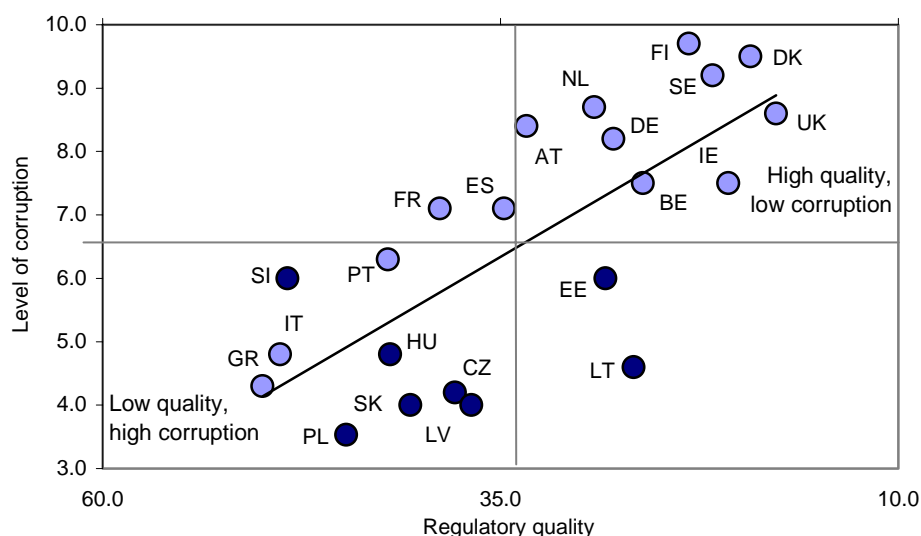


Source: WB (2005), TI (2005), Heritage Foundation (2005), own calculations.

**Figure 2: Relationship between the intensity of regulation and the quality of conditions for doing business**



Source: WB (2005), TI (2005), Heritage Foundation (2005), own calculations.

**Figure 3: Relationship between the quality of conditions for doing business (%) and the level of corruption (CPI)**

Source: WB (2005), TI (2005), Heritage Foundation (2005), own calculations.

#### 4. Conditions for doing business in the Czech Republic

The overall assessment of individual conditions for doing business and their elements for the Czech Republic is supplemented with a comparison against the average figures for the EU-22, the best values among the member states, which are used for comparison when assessing the progress in fulfilling the Lisbon Strategy. In this regard we can conclude that the values for the EU-22 are favourable only in the number of procedures required for obtaining an approval. Doing business in the EU is therefore subject to a significantly greater administrative and financial burden, though often with major differences at the national level. The subsequent summarising ranking according to individual elements of the monitored indicators allows us to identify the weakest areas of conditions for doing business in the CR and focus greater and more consistent reformation effort on these areas.

When conditions for **starting business** are assessed, the administrative burden according to the number of procedures required and the estimated number of days necessary for their completion is determined. The financial cost of starting business after all related obligations have been fulfilled and the minimum capital investment has been ensured is also defined. A lower burden from the conditions for starting business has a positive impact on the dynamics of founding new companies and thus development of entrepreneurial activities in the formal sector. A significant administrative burden arising from the high number of procedures and days in combination with relatively high requirements for the minimum capital investment is one of the main problems in CR (77<sup>th</sup> place). The (direct) financial cost of starting business is relatively low. The administrative burden should be gradually reduced by simplifying recording in the Commercial Register and establishing central registration facilities for entrepreneurs with the possibility of filling forms electronically. Connection to the information system of the public administration authorities will only allow one-off provision of information by entrepreneurs. A more significant systemic reduction in the administrative burden associated with starting business requires especially exclusion of courts and certification by a notary public from the process of registering companies. This does not involve mere formal and technical simplification of the procedures carried out in order to speed up the registration process, but requires transforming registration to a purely administrative process.

**Table 2: Starting business**

		EU-22	EU-14	EU-8	CZ
Procedures (number)	abs.	8	7	8	10
	perc.	28.7	27.6	30.7	50.6
Time (days)	abs.	28	24	34	40
	perc.	31.5	26.3	40.5	54.5
Cost (% income)	abs.	8.9	8.1	10.4	9.5
	perc.	22.7	21.3	25	24
Min. capital (% income)	abs.	46	34.6	65.9	39
	perc.	52.9	46.6	63.8	59.7

Source: The authors' own calculations using the WB data (2005).

In the case of conditions for **dealing with licenses**, all procedures required for obtaining the prescribed licences are recorded on the model example of civil engineering. The administrative burden arising from all related acts is determined according to the number of procedures and days and their financial cost. Low demands on the licensing proceedings help to reduce the occurrence of illegal construction and lessen the opportunities and motivation to engage in corrupt behaviour. In the CR (87<sup>th</sup> place), the burden arising from the number of procedures combined with great demands on time is the worst, while the costs of licensing proceedings are among the lowest. However, the high administration burden in fact makes preparation for construction costly. Preparation of an application for a zoning and planning decision and construction permit with the requirement to obtain consent from all affected state administration bodies and all distribution network owners is the biggest problem. The new Administrative Procedure Code should provide some relief from 2006. However, more significant changes can only be expected from the new Construction Act, which from 2007 should allow combination of the zoning and planning proceedings with the construction permit proceedings to a greater degree, determine fixed deadlines for all types of proceedings and permit implementation of a wider range of buildings based on a notification only.

**Table 3: Dealing with licenses**

		EU-22	EU-14	EU-8	CZ
Procedures (number)	abs.	16	14	19	31
	perc.	36.7	28	52	95.9
Time (days)	abs.	191	180	211	245
	perc.	46.2	41.9	53.7	70.6
Cost (% income)	abs.	81.5	83.2	78.5	16.1
	perc.	26	28.2	22.2	2

Source: The authors' own calculations using the WB data (2005).

Conditions for **hiring/firing workers** are evaluated according to the employment rigidity index, which represents the average value for three sub-indexes – the index of difficulty in hiring employees, the index of working hours inflexibility and the index of difficulty in firing employees. Another two indicators of the conditions for hiring/firing workers measure the cost of hiring and firing employees. Lower employment regulation supports the flexibility of labour markets and the supply of employment opportunities especially for problematic groups. It also allows employers to optimize the demand for labour according to the development of external economic conditions.

The burden associated with employment regulation in the CR (60<sup>th</sup> place) is among the lowest in the EU on average. However, the situation is very different with regard to the rigidity of regulation, which ranks among the best even in the wider interna-

tional comparison against the cost of employment. The rigidity of regulation is the strongest in the case of hiring employees, weaker in the case of firing employees and the weakest in rigidity of working hours. The cost of employment is very high in the case of hiring employees especially due to employers' payments towards social security, while the burden associated with the cost of firing employees is significantly lower. Despite strong reservations to the new version of the Labour Code on the part of employers, which were due to the continuing rigidity of regulation in favour of employee protection (especially in the case of restriction of terminating employment by a notice served for reasons on the part of the employer), the high cost of hiring employees continues to be the greatest problem in this regard and this problem significantly affects the demand for problematic groups on the labour market. In addition, the demotivating social benefit scheme has a negative impact on the offer of employment especially in low-income groups.

**Table 4: Hiring/firing workers**

		EU-22	EU-14	EU-8	CZ
Difficulty of hiring index	abs.	36	38	33	33
	perc.	46	47.8	42.8	40.5
Rigidity of hours index	abs.	62	63	60	20
	perc.	50	51.4	47.6	8.4
Difficulty of firing index	abs.	37	36	40	20
	perc.	46.5	44.9	49.3	22.8
<b>Rig. employment index</b>	abs.	45	46	44	24
	perc.	55.3	56.6	52.9	19.6
Hiring cost (% salary)	abs.	27.2	26.3	28.9	37
	perc.	75.2	70.4	83.7	97.4
Firing cost (weeks salary)	abs.	38.5	44.8	27.5	21.6
	perc.	44.9	51.1	34.1	27.2

Source: The authors' own calculations using the WB data (2005).

**Table 5: Registering property**

		EU-22	EU-14	EU-8	CZ
Procedures (number)	abs.	5	5	5	4
	perc.	31.5	32.7	29.4	15.7
Time (day)	abs.	72	48	116	123
	perc.	44.5	35.9	59.7	83.5
Cost (% value)	abs.	4.8	6.1	2.6	3
	perc.	40.6	51.1	22.1	27.6

Source: The authors' own calculations using the WB data (2005).

Conditions for **registering property** are assessed according to the number of procedures, number of days required for their completion and the relative cost of related payments. Lower administrative and financial demands on registering property facilitate disposing of assets and using assets in other types of transactions, and reinforce the institution of property rights. The conditions in the CR (57<sup>th</sup> place) are problematic especially in terms of the related time demands, while the number and the cost of procedures are relatively low. The great demands on time are caused mainly by long periods for entering registrations in the Land Registry. The fact that a record in the Land Registry alone does not prove the existence of ownership with certainty, despite the number of documents required for filling an application for registration also poses major problems. Ascertaining ownership of properties with certainty therefore often requires private investigation of the history of the real estate in question and additional contractual assurance of the transfer, which naturally results in

higher costs. Further improvement in the technical and personnel resources at the Land Registry (even if this improvement were to be supported by higher administration fees) would undoubtedly contribute to reducing the time demands of registering property. Opportunities for simplifying required documentation and the subsequent reduction of periods for approving registration while problems caused by the low level of property registration prior to 1989 and partially also at the beginning of the 90s remain the main issue in this regard.

Assessment of conditions for **getting credit** includes the issue of creditor and debtor rights and sharing credit information. The first set of indicators focuses on the effectiveness of the lien and bankruptcy laws for lending financial resources, while the second set of indicators studies the market coverage, extent of information, and the quality and accessibility of credit information through private and public credit registers. High-quality conditions for obtaining credit increase the accessibility of external financial resources within the economy mainly due to the decreased creditor risk. The Czech Republic's position (13<sup>th</sup> place) is quite positive in the extent and quality of credit information, as well as the intensity of creditor protection. The situation in these areas has improved significantly compared to the 90s. The right of lien is one of the safest methods of securing receivables owing to high-quality legal regulation. The quality of credit information is high and the extent of covering the population and the range of information gradually grow. The newly introduced interconnection between the banking and the non-banking registers has also increased the information value.

**Table 6: Getting credit**

			EU-22	EU-14	EU-8	CZ
Strength of legal rights index	abs.		6	6	6	6
	perc.		31	30.8	31.3	20.2
Depth of information index	Public	abs.	8.1	12	1.2	2.8
		perc.	29.8	28.8	31.7	19.6
	Private	abs.	32.6	42.5	15.3	37.9
		perc.	24.6	21.1	30.7	18.3
	Index	abs.	5	5	4	5
		perc.	18.9	15.3	25.1	11

Source: The authors' own calculations using the WB data (2005).

The **investor protection** indicator assesses the power of protection of minority shareholders against abusing corporate assets on the part of the managers. The indicators distinguish between three key areas of investor protection: transparency of transactions, managers' responsibility for operations and options for suing managers by shareholders. Adequate investor protection supports mainly the extent of investment activities in the economy by preventing misuse of entrusted resources or allows recourse for potential misuse. The situation in the Czech Republic (58<sup>th</sup> place) is very uneven. Openness and transparency of transactions is assessed with the worst results, while managers' responsibility for their actions is evaluated with very good results and options for suing managers by shareholders demonstrate the best results. However, the importance and actual impact of a positive level of responsibility and opportunities for suing for misuse of entrusted resources for personal gain is significantly reduced by the low level of openness of information on carried out transactions.

The fact that although formal regulation of protecting creditor rights exists, this regulation is not up to the standard in a number of cases (for example – provisions on con-

tracts on control, reports on associated persons, company mergers and divisions, transfer of assets, the right to purchase subscribed securities, etc., have been adopted incompletely and non-conceptually from the original usually German and Austrian legal regulation) poses a significant problem. The enforceability and effectiveness of investor protection is reduced by the overall unclear situation due to frequent amendments and unsanctioned breaches of information obligations, ineffectiveness of process instruments available to minority investors and non-existence of effective instruments for preventing misuse of economic power by majority owners.

**Table 7: Protecting investors**

			EU-22	EU-14	EU-8	CZ
Protect. investor index	disclosure	abs.	5	6	4	2
		perc.	44.8	37.7	56.2	82,6
	director liability	abs.	5	5	5	5
		perc.	41.1	43.6	42.7	29,8
shareholder	abs.	6	6	7	8	
	perc.	31.5	40	21.1	7,6	
Strength of investor protection index		abs.	5,3	5.7	5.3	5
		perc.	39,1	40.4	40	40

Source: The authors' own calculations using the WB data (2005).

In the case of conditions for paying taxes the number of tax procedures and their demands on time expressed as the number of hours per year required for preparing, filling and paying the three main types of taxes is assessed. The tax burden indicator measures all taxes payable by companies, except for the wage tax and social security payments. A lower burden associated with paying taxes has a positive impact on the fulfillment of tax obligations and therefore the amount of tax revenues, and supports the effectiveness of public expenses for tax administration. In the CR (70<sup>th</sup> place), the time demands represent the worst burden, the number of tax procedures is relatively low and the overall tax burden is one of the smaller tax burdens in the EU. Therefore, simplifying and clarifying the taxation system and improving the quality of the tax administrator work represent the greatest reforming challenge. Ideally, tax administration should represent a minimum burden for the tax payers and the comfort of fulfilling tax obligations should be improved. However, the procedure for simplifying the taxation system as such in order to achieve a significant reduction in the demands associated with paying taxes remains the key question. The issue of adequacy of the quality of public services provided for the collected taxes (which include the quality of conditions for doing business), i.e. the issue of effectiveness of public expenses or the extent of redistribution considered desirable or acceptable in the relevant society, is more relevant with regard to the tax burden.

Conditions for **trading across borders** are evaluated by recording all procedural requirements for export and import of a standardised shipment of goods. This indicator includes all official procedures from the agreement between the two contractual parties to delivery of the shipment. The demands on the number of signatures, documents and days required for the completion of all applicable procedures are assessed. A low administrative burden of commercial activities promotes the competitiveness of the production on foreign and local markets. The conditions in the CR (24<sup>th</sup> place) are more favourable in the case of export where only the time demands achieve worse results, while the number of documents and signatures is among the lowest even in the wider international comparison.



**Table 8: Paying taxes**

		EU-22	EU-14	EU-8	CZ
Payments (number)	abs.	21	18	26	14
	perc.	27.1	22.2	35.8	15
Time (hours year)	abs.	260	216	326	930
	perc.	42.6	35.9	52.6	93.7
Tax payable (% profit)	abs.	48.6	50.7	44.9	40.1
	perc.	60.1	65.8	50.2	37.2

Source: The authors' own calculations using the WB data (2005).

**Table 9: Trading across borders**

		EU-22	EU-14	EU-8	CZ
Export – doc. (number)	abs.	6	5	7	5
	perc.	18.7	12.8	33.9	4.8
Signatures (number)	abs.	4	3	5	3
	perc.	15.9	11.6	24.7	7.5
Time (days)	abs.	15	13	17	20
	perc.	16.2	15.3	21.4	25.5
Import – doc. (number)	abs.	7	6	9	8
	perc.	20.3	17.3	34.1	21.4
Signatures (number)	abs.	5	4	7	4
	perc.	15.9	11.7	26.6	13.6
Time (days)	abs.	17	15	21	22
	perc.	15.6	14.3	22.8	22.7

Source: The authors' own calculations using the WB data (2005).

The administrative burden in import is greater, though not dramatically. The worst results are again shown in the time demands and the number of documents and signatures follows. The conditions for trading across borders are affected to a certain extent by harmonisation with the EC laws. The differences in comparison with other member states are therefore caused mainly by other than legal circumstances, mainly the quality and promptness of the state administration and availability of assistance services.

**Table 10: Enforcing contracts**

		EU-22	EU-14	EU-8	CZ
Procedures (number)	abs.	22	21	25	21
	perc.	23.5	19.6	30.1	18.4
Time (days)	abs.	338	274	450	290
	perc.	32	22.6	48.5	31.8
Cost (% of debt)	abs.	11.8	12.4	10.8	9.1
	perc.	21.5	23.8	17.6	11.6

Source: The authors' own calculations using the WB data (2005).

Conditions for **enforcing contracts** are evaluated according to the number of procedures (requiring interaction between the parties to the proceedings), time demands of the entire proceedings from filling an action to enforcing a payment (including waiting times between individual stages of the proceedings) in the number of days and the cost of proceedings (including all related expenses). A high quality of conditions in enforceability of contracts positively influences the transaction costs of business activities and the level of risk associated with providing a loan. The conditions in the CR (21<sup>st</sup> place) are assessed as one of the best. The situation is the best in the cost of debt collection, the number of related procedures is also relatively low but the time demands continue to return less positive results. Arbitration proceedings before an independent arbitrator or a

permanent arbitration court are increasingly used as an alternative solution to the slow judicial proceedings frequently of an inferior quality. The previously highly problematic execution of a legitimate decision has significantly increased as the new legislation allowing the involvement of private judicial executors motivated to achieve the highest possible return on the amount owed for the creditor was introduced.

Assessment of conditions for **closing business** is specified for the course of bankruptcy proceedings. The time demands are expressed as the average number of years and include all possible delays caused by obstructing parties to the proceedings. The financial demands of the proceedings are expressed according to the cost of proceedings and the level of return on the resources the entitled parties may obtain from the insolvent company from the total amount of their receivables. Fast progress of closing business releases economic resources for their new use and thus promotes their effective allocation, and a high level of return on claimed finance positively influences development of investment activities. The conditions in the CR (121<sup>st</sup> place) are the worst in the overview of all monitored indicators of conditions for doing business.

**Table 11: Closing business**

		EU-22	EU-14	EU-8	CZ
Time (years)	abs.	2.1	1.5	3.3	9.2
	perc.	25.6	15.3	43.7	97.9
Cost (% of estate)	abs.	11	9	13	14
	perc.	32.2	28.0	39.6	46.1
Recovery rate (%)	abs.	61.2	70.5	45.0	17.9
	perc.	18.5	12.1	29.6	65.7

Source: The authors' own calculations using the WB data (2005).

Bankruptcy proceedings are relatively costly, provide a very low level of return and, most importantly, are excessively lengthy. The related legal regulation is complicated and subject to frequent amendments. Slow progress of the courts combined with obstructions by parties to the proceedings leads to significant delays and thus causes deterioration of the claimed resources. On the positive note, the reforming efforts focus on comprehensive transformation of the bankruptcy law with an emphasis on strengthening the role of creditors, allow acceleration of bankruptcy proceedings by determining binding periods for individual acts and introduce alternative insolvency solutions through bankruptcy proceedings with the aim to maintain a functioning company.

Using a more detailed structure allows classification of all individual elements of conditions for doing business in a descending order according to the Czech Republic's position in the wider international comparison with differences from the EU average included for each of the positions. The overview shows that major differences in the regulatory quality occur even within individual indicators. These differences are a reflection of the frequently occurring lack of a systemic character of individual regulatory conditions.

The CR achieves the worst results in conditions for closing business (especially in the time demands and the closely related level of return), conditions for granting licences (mainly in the number of procedures and the subsequent time demands), starting business (in most indicators) and paying taxes (in the time demands). These negative characteristics influence especially establishing business activities, releasing the existing resources for new and therefore more effective use, effectiveness of tax collection (and the subsequent higher tax revenues) and additional costs due to delays in licensing procedures or attempts to speed the proceedings up through illegal practices. With regard to individual

elements of indicators of conditions for doing business, the level of information openness in protecting investors, time demands associated with registering property and the cost of hiring employees are also considered negative. These characteristics reflect in greater opportunities for exploiting entrusted resources for personal gain, slowing down transfer of property and thus increasing the transaction costs for the parties involved, and a lower level of employment especially in low-income and problematic workers.

On the other hand, the CR's position is the most favourable in conditions for obtaining credit, enforcing contracts and the administrative burden associated with trading across borders (especially in export). These characteristics positively influence the availability of external financial resources for business and the creditor risk associated with their repayment, penetration of foreign markets by local production, and development of foreign competition of local manufacturers. Regarding the types of conditions for doing business in the CR, the worst results are in most cases demonstrated in the time demands associated with the required regulatory procedures (rather than the cost-related burden). Decreasing the time demands would therefore bring significant improvement in the overall standard of regulation and in combination with a reduced number of procedures would weaken the motivation and opportunities for engaging in corrupt behaviour, which has been the Czech Republic's long term problem.<sup>3</sup>

The Czech government joined the efforts targeted at improving the conditions for doing business in the National Lisbon Program for 2005-2008 (see Government of the CR 2005). However, this area has received more extensive attention only recently, undoubtedly also due to its inclusion in the long-term economic growth strategy completed by Jahn's team (Government of the CR 2005a). The results of reforming efforts have so far been limited or have not involved any more extensive and in-depth changes to the systemic character, which has been a typical trait of the Czech economic policy on a long-term basis. Rather than focusing on major improvement in the regulatory quality, attention for example to discussion on tax cuts is paid in the media, despite the tax burden in the Czech Republic being one of the lowest in the EU (while social security payments at a level well above the average remain unchanged).

Czech entrepreneurs give the worst rating in surveys to the low quality in execution of the state's authority, in particular the executive and judicial functions and their impact on the business sector. Execution of the state's authority, especially in tax administration but also in administrative supervision and decision making, has been subject to continuous criticism. The other recurring criticism refers to the complicated enforceability of justified claims of entrepreneurs through legal proceedings, which is caused mainly by the slow progress of the courts. In the case of authorities and courts, entrepreneurs see the limited predictability of final decisions and the differences between individual regions in the CR as a serious problem. Any major improvement in the entrepreneurial environment in the Czech Republic will therefore require effective reforms of the state administration and judiciary. On the other hand, entrepreneurs deliver significantly more positive evaluation of the accessibility of loans and information necessary for doing business, the work of state (EGAP, Czechtrade, Czechinvest) and other than state (professional chambers, associations) organisations providing assistance services than in the 90s. The effort of executive authorities to broaden

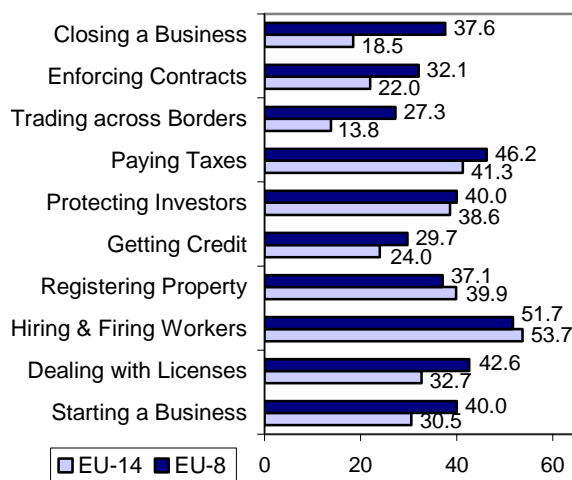
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<sup>3</sup> When the demands of the conditions for doing business is assessed in the wider international comparison, the time demands in the CR with twice as negative results compared to the burden arising from the number of procedures (20.2) are reflected in the average position (48.3).

the use of information and communication technologies in dealing with the state and public administration, and the standardisation of regular official procedures (forms, fixed periods, etc.) is also assessed positively.

The contents and formal legal quality of laws regulating enterprise in the CR continue to feel the negative effect of transformation from the totalitarian state rigorously controlling the economy to a modern liberal democracy regulating a market economy. Major legal codes (Civic Code, Labour Code and Penal Code) have been subjected to dozens of amendments but no significant modernising transformation. Judicature and interpretation have not been established in a number of cases. The so-called legislation rush, which was necessary at the end of the previous and the beginning of this century due to harmonisation of the local laws with the EC laws, has obviously sped up the reforming processes but at the same time at least temporarily reduced the clarity and stability of the legal environment. What's more, some of the provisions of laws (taxation, industrial, etc.) criticised by entrepreneurs are a natural consequence of the structure of political powers in the country, i.e. the fact that left centre has had the control of the government in the Czech Republic since 1998. On one hand, a left-wing government cooperates better with unions rather than entrepreneurial associations. On the other hand, the government needs to react adequately to changes in the integration of the Czech market in the single EU market and in the wider context to the globalisation processes, which bring increased competitive pressure on enterprises on the local and foreign markets.

**Figure 4: Conditions for doing business in the EU-8 and EU-14 countries (percentiles)**



Source: The authors' own calculations using the WB data (2005).

## 5. Comparison of the EU-8 and EU-14 countries

Figure 4 illustrates the conditions for doing business in the new EU-8 member states and the original EU-14 states according to their positions within the entire group of states. In the wider international comparison EU countries lag behind the most significantly in employment regulation, where the cost of hiring employees appears to be the worst indicator, and in conditions for paying taxes due to a relatively high tax burden. On the other hand, the area of trading across borders with the minimum number of administrative obstructions presents very favourable conditions for doing business. EU countries also achieve relatively good positions in conditions for enforcing contracts and obtaining credit.

## **6. Conclusion**

Improving the quality of conditions for doing business is a vital systemic condition for reducing the level of corruption and the extent of grey economy in the relevant environment (and thus increasing tax revenues). It also allows more effective use of the available private and public resources, significantly facilitates development of entrepreneurial and innovative activities especially in the case of small and medium-size enterprises and increases employment. In the Czech Republic, all of the areas referred to above are supported by a range of specific programs with significant financial resources. However, their effectiveness could be significantly increased firstly by improving the quality of conditions for doing business. The example of Baltic countries shows that even new EU member countries with a less developed economy and burdened by their socialistic past are capable of achieving significant success in this regard in a relatively short timeframe. It is necessary to focus first on areas where changes can be implemented relatively promptly and at lower costs and simultaneously prepare more in-depth and demanding systemic changes involving comprehensive legal regulation. The best way of reducing the time demands and the (indirect) costs of procedures related to enterprise is to minimise the participation of courts in cases regarding disputes that cannot be solved by private settlement.

Besides continuously updating the results according to newly available data, future research could focus on additional interesting topics, such as identifying the causes of often significant differences in indicators of conditions for doing business and their components at the national level or reasons for their persistence over time, and specifically in the case of the new member states distinguishing the quality of conditions for doing business according to the sources of the related legal standards and the time of their introduction (socialistic heritage with various levels of adjustment to the new conditions, completely new standards created at various stages of transformation under the influence of specific lobby groups, levels of expertise in submitting and approving entities or foreign models). This type of analysis would allow us to identify specifics, as well as more general trends in institutional reforms in the Czech Republic and the most problematic areas of their enforcement. Research should also evaluate differences in significance of the impact of a low quality in individual regulatory components on entrepreneurial activities (in addition to determining the country's position in the relevant indicator in the wider international comparison), ideally based on (regularly repeated) representative polls among entrepreneurs.

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**Table 1A: Doing business in the EU, year 2005 (selected indicators)**

	Starting business	Closing business	Registering property	Enforcing contracts	Hiring/firing workers	Getting credit	Protecting investors	Dealing with licenses	Paying taxes	Trading across borders
	days	years	days	days	index	credit info	index	days	hours	days
AT	29	1,1	32	374	44	6	4	195	272	8
BE	34	0,9	132	112	20	4	7	184	160	7
CZ	40	9,2	123	290	24	5	5	245	930	20
DE	24	1,2	41	175	55	6	5	165	105	6
DK	5	3,3	42	83	20	4	6	70	135	5
EE	35	3,0	65	150	51	5	6	116	104	12
ES	47	1,0	25	169	66	6	5	277	56	9
FI	14	0,9	14	228	48	5	6	56	..	7
FR	8	1,9	183	75	66	2	5	185	72	22
GR	38	2,0	23	151	66	4	3	176	204	29
HU	38	2,0	78	365	37	5	5	213	304	23
IE	24	0,4	38	217	33	5	8	181	76	14
IT	13	1,2	27	1390	57	6	5	284	360	28
LT	26	1,2	3	154	44	6	5	151	162	6
LV	18	1,1	54	186	59	3	6	160	320	18
NL	11	1,7	2	48	49	5	4	184	700	7
PL	31	1,4	197	980	37	4	6	322	175	19
PT	54	2,0	83	320	58	4	6	327	328	18
SI	60	3,6	391	913	64	3	6	207	272	20
SK	25	4,8	17	565	39	2	4	272	344	20
ŠE	16	2,0	2	208	43	5	5	116	122	6
UK	18	1,0	21	288	14	6	8	115	..	16

Note: days/years/hours – number, hiring/firing index – rigidity (100 = the worst); getting credit index – legal support (10 = the best); protecting investors index – availability and quality of information (10 = the best); trading – export; EU-15, EU-25 unweighted averages. Source: World Bank – Doing Business, up to 1. 11. 2005.



**Table 2A: Quality of governance**

	1998				2004						
	Policy	Go- vern- ment	Institu- tions	Ave- rage	Demo- cracy	Sta- bility	Go- vern- ment	Regu- lation	Law order	Coru- ption	Ave- rage
BE	1,14	1,12	1,28	1,17	1,35	0,94	1,71	1,25	1,47	1,53	1,38
CZ	1,05	0,75	1,28	0,76	1,03	0,84	0,63	0,97	0,69	0,30	0,74
DK	1,45	1,77	1,32	1,83	1,59	1,21	2,15	1,76	1,11	2,38	1,70
EE	0,83	0,74	1,27	0,70	1,13	0,92	0,99	1,61	0,91	0,82	1,06
FI	1,56	1,77	1,31	1,88	1,50	1,65	2,06	1,79	1,97	2,53	1,92
FR	0,94	1,31	1,26	1,26	1,24	0,53	1,42	0,91	1,33	1,44	1,15
IE	1,43	1,63	1,24	1,68	1,30	1,22	1,48	1,63	1,62	1,61	1,48
IT	1,20	0,93	1,20	1,05	1,06	0,31	0,58	0,97	0,74	0,66	0,72
CY	0,78	1,24	1,21	1,05	0,97	0,85	0,70	1,16	0,60	0,36	0,77
LT	0,61	0,19	1,21	0,31	1,00	0,34	1,02	1,23	0,85	0,80	0,87
LV	0,62	0,45	1,29	0,35	0,96	0,95	0,60	1,02	0,98	0,23	0,79
LU	1,44	1,69	1,38	1,72	1,40	1,66	2,08	2,02	1,98	2,16	1,88
HU	1,21	0,97	1,33	0,97	1,16	0,85	0,68	1,22	0,85	0,65	0,90
MT	1,38	0,72	1,38	0,93	1,26	1,46	1,03	1,30	1,23	1,25	1,26
DE	1,39	1,49	1,44	1,64	1,38	0,92	1,38	1,29	1,66	1,90	1,42
NL	1,54	2,02	1,38	1,94	1,49	1,15	2,00	1,67	1,78	2,08	1,70
PL	0,93	0,85	1,29	0,77	1,13	0,35	0,47	0,64	0,51	0,16	0,54
PT	1,40	1,34	1,38	1,39	1,31	1,06	0,92	1,14	1,14	1,23	1,13
AT	1,37	1,38	1,37	1,60	1,25	1,18	1,76	1,41	1,76	2,10	1,58
GR	0,62	0,80	1,26	0,73	0,91	0,53	0,74	0,85	0,75	0,56	0,72
SK	0,66	0,18	1,36	0,29	1,10	0,65	0,67	1,15	0,49	0,39	0,74
SI	1,00	0,69	1,69	0,85	1,12	0,99	1,02	0,89	0,93	0,97	0,99
ES	1,00	1,60	1,97	1,36	1,17	0,54	1,29	1,13	1,12	1,45	1,12
SE	1,49	1,56	2,22	1,76	1,52	1,38	1,92	1,54	1,85	2,20	1,74
UK	1,19	2,04	2,19	1,80	1,37	0,77	1,85	1,62	1,71	2,06	1,56

Source: World Bank – Database Governance Matters.







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