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"Effect of Business Regulations on the Economic Growth: Case of an Underdeveloped Economy"

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ABSTRACT

Economic growth is a crucial factor for the survival of the countries. Still, it is observed that business organizations face many challenges and obstacles due to the stringent and complex regulations. The present study is conducted to investigate the relationship between business regulations and economic growth. The case of an underdeveloped economy is taken by using data from a world enterprise survey. A strong relationship was identified between economic growth and business regulations, findings show that the effect of business regulations can either result in high economic growth or a declining trend for growth. In addition to the barriers that are faced by firms after implementing business regulations, many other factors like corruption, literacy level, and infrastructure also contribute to slow progress or no economic growth. It is observed that formal firms become informal to avoid the adverse effects of business regulations. The study concludes that business regulations are a major determinant of economic growth, it is recommended that regulators formulate policies that will create an enabling environment for economic growth.
Keywords: business regulations, corruption, economic growth, economic development, education

1. INTRODUCTION

For poverty reduction and development, economic growth plays a significant role. Many factors can influence or promote the growth of an economy, the business regulation is the one factor that can be considered as a key determinant of economic growth. Regulations are implemented by regulatory authorities formed to carry out the purpose of the legislation and two main types of regulations is economic regulations which can adjust the conditions and prices of an economy the other is social regulations, which can protect the interest of the public. Business regulations can be defined with the help of different indicators e.g. starting a business (business entry regulations), doing business, or enforcing a contract (measuring the effectiveness and efficiency of the judicial system).
There are very few studies that link these two variables: business regulations and economic growth. According to Djankov et al (2006,), higher long-term growth is associated with simple business regulations. Klapper (2011) links new business regulations and the creation of a firm. There is one another aspect of regulation that will be discussed in this article is heavy regulations. Due to heavy regulations and constraint-like property, and financial issues, formal firms tend to become informal. In short Norris and Inchauste (2008) conclude that informality as an important channel through which regulatory and other constraints affect firm growth.
Business regulations have been explained using data from the World Enterprise Survey, which comprises nine indicators that are clearly mentioned in the World Enterprise Survey, e.g. Understanding a firm's growth is the core of the development process making it much research area in finance and Economics. The reason behind selecting Business Regulations (B.R) and Economic Growth is that B.R focuses on the effect of regulation implemented on firms by the government. Very little amount of work has been done on this side and it helps in understanding the obstacles that are faced by firms and showing the importance of regulations, and their effects will be considered as one important policy decision for the government to focus more on while making regulation policies related to business.

1.1- Problem statement:

Finding the relation between Business Regulations (B.R) and other is Economic Growth with the help of taking data from the World Enterprise Survey will be considered as one important factor why some countries grow at a faster pace than others because for underdeveloped countries and there is a need to grow at a faster pace and why there are high and low-income countries. And then several obstacles are faced by firms especially in developing countries by implementing regulations and several studies discuss it but very few solve them.
The most important thing is that the government should give more priority to reforming its business regulations when designing growth policies because heavier regulations hinder economic growth and vice versa.

- Do business regulations have that much effect on economic growth to be considered as a key determinant of it?
- What are the solutions to the obstacles or challenges that are faced by firms in underdeveloped countries?
- Are the informal firms helping to promote economic development which becomes informal due to heavy regulations in terms of an underdeveloped country's perspective?

1.2- Objective:

To establish the link between GDP per capita, considered a proxy for economic growth, and business regulation, nine different indicators are used. Then, to get and understand the solutions to obstacles and challenges faced due to regulations, the focus is on a particular institution, business regulation, to see whether it has been reflected in improved performance and has a significant implication for the policy. The other important thing is to understand why firms become informal and show whether this is more helpful to the economy than a formality.

2. LITERATURE REVIEW

Eifert (2007) examines the relationship between business regulations and economic growth and investment using panel data. The study highlights that improved business regulation indicators are positively associated with higher economic growth and increased investment. Similarly, Divanbeigi and Ramalho (2015) investigated the link between business regulations, firm creation, and economic growth over a decade of panel data. Their findings reveal a strong relationship between effective business regulations and the rate of firm creation, which, in turn, correlates with GDP growth. They demonstrate that while minor improvements in business regulation have a modest impact on economic growth, substantial enhancements—such as moving from the lowest to the highest regulatory quartile—yield significant increases in economic growth.

Hall and Jones (1999) identify institutions as a critical determinant of economic growth and national wealth. Expanding on this, Djankov et al. (2006) introduce an additional measure of institutional quality, focusing specifically on the role of business regulations. Rodrik (2007) emphasizes the role of property rights as a key aspect of business regulation, noting that they influence not only the volume of investment but also the efficiency of resource allocation.

While many studies do not directly attribute economic growth to business regulations alone, they explore the indirect effects through key drivers such as investment, total factor productivity, and innovation. For instance, Busse and Groizard (2008) employ standard cross-country growth regressions to examine the impact of business regulations on foreign direct investment (FDI) inflows, incorporating other control variables into their analysis

Djankove, et. al (2006) took cross-country data and used the same empirical equation but the indicators of business regulation is taken from doing business and found the result that it has a significant impact on economic growth and considered it as one of the key determinants. Here I am taking data from a world enterprise survey and the indicators are more clearly defined.
Then we can check that either growth rate is a function of business regulation and by applying OLS we find the determinant of growth rate that is B.R and see whether it is significant or not. But in OLS there comes a problem of endogeneity so we are taking 2SLS to remove endogeneity, and see the results then.

Several researchers have further explored the intricate relationship between business regulations, economic growth, and investment. A World Bank paper titled "Business Regulations and Growth" analyzed regulatory changes over ten years, across more than 180 countries. The paper identifies a link between business regulations, firm establishment, and economic growth, suggesting that improvements in business regulations are associated with increased firm creation and subsequent economic growth.

Furthermore, a study focusing on East African countries highlights the relationship between business regulations, foreign direct investment (FDI) inflows, and economic growth. The findings suggest that efficient business regulations can attract FDI, which in turn contributes to economic growth. However, the empirical evidence on the link between regulation and economic growth has been mixed. Some studies find a positive relationship, while others do not. This suggests that the impact of regulations on economic growth may be contingent on other factors, such as the quality of institutions and the specific context of the regulations.

Moreover, research on the impact of business regulatory reforms on economic growth indicates that various empirical studies have examined business regulation trends across countries over the last decade. For example, Djankov et al. (2002) present new data on the regulation of entry of start-up firms in 85 countries, highlighting that heavier regulation of entry is associated with higher corruption and larger unofficial economies, but not with better quality of public or private goods.

In summary, while there is substantial evidence suggesting that efficient business regulations can foster economic growth and investment, the relationship is complex and may be influenced by various factors, including the quality of institutions, the specific nature of the regulations, and the broader economic context.

3. GAP ANALYSIS

Many articles clearly show the impact of the regulation on one of the drivers of economic growth like innovation, technology, labor force, etc. but they lack in showing the one-to-one effect or direct effect of business regulation on economic growth. There are very few articles related to it. The second most important thing is that why formal firms will become informal is it due to heavy regulations and then neither of these firms helps in promoting the growth of an economy.

4. FINDINGS DISCUSSION

World Enterprise survey is a survey at the firm level and it contains the data of private firms including 135000 firms in more than 139 countries this survey includes a broad range of topics related to a business climate like access to finance, infrastructure, firm performance, crime, workforce, etc. and provide the detailed data and include the number of indicators. In the case of regulations and taxes that contain 10 indicators like the number of days to obtain an import license etc. already mentioned under the category of theoretical framework.

For underdeveloped countries 1247 firms and provided detailed data on all 1247 manufacturing firms including crime, infrastructure, corruption, taxes, regulations, etc. The small firms are to be taken from 5 to 19, medium firms from 20 to 100, and large contain 100 plus employees. The business sectors include food, textile, garments, chemical and chemical products, motor vehicles and Tran’s equipment, retail, and other services.

Business regulations are explained with the indicators used by the World Enterprise Survey are

- Senior management time spent dealing with the requirement of government regulations.
- Percent of firms visited required to meet tax officials.
- Number of days required to get an obtaining license.
- Number of days required to get a construction permit.
- Number of days required to get an import license.
- A percentage of firms consider tax rate as a major constraint.
- Percent of firms identifying tax administration as a major constraint.
- Percent of firms identifying business licensing and permits as major constraints.

These indicators consist of manufacturing firms taking all these indicators and making an index of it and uses as a proxy for business regulations. And the data for economic growth will be coming from state banks

Corruption has been determined by expert assessments and opinion surveys, law and order can be defined as a situation characterized by respect and obedience to the rules of society and civil conflict is a violent conflict between a state or one or more organized non-state actors in the state's territory.

In addition to the barriers that firms face after implementing business regulations, several other factors significantly contribute to the stagnation or slow progress of economic growth. Among these, corruption stands out as a pervasive challenge that undermines the effectiveness of regulatory frameworks. Corruption not only discourages foreign and domestic investment but also distorts market competition, allowing informal practices to thrive at the expense of formal and legitimate businesses. Similarly, low literacy levels in a population can limit the capacity of individuals to engage in and benefit from economic opportunities. A poorly educated workforce often struggles with compliance requirements, technological adoption, and innovation—all essential components of a dynamic economy.

Moreover, inadequate infrastructure, such as unreliable transportation networks, inefficient energy supply, and limited access to digital connectivity, creates additional bottlenecks that hinder business operations. These deficiencies raise operational costs and reduce productivity, further deterring firms from scaling their activities.

An important trend observed in response to these challenges is that formal firms often revert to informality to evade the adverse effects of stringent or poorly designed business regulations. This shift to the informal sector undermines the intended purpose of regulations, reduces tax revenues, and exacerbates inequality in the economic landscape. The proliferation of informal firms also creates an uneven playing field, discouraging compliance and innovation among formal enterprises.
Given the critical role of business regulations as a determinant of economic growth, policymakers and regulators must design and implement policies that foster an enabling environment. Such policies should strike a balance between ensuring compliance and supporting business operations. Simplifying regulatory processes, combating corruption, investing in education, and upgrading infrastructure are vital steps toward achieving this goal.

5. CONCLUSION

This study helps to find the reasons why formal firms become informal either due to heavy regulations or instance competition. Informal firms contribute towards economic growth and stringent business regulation force firms to be formal which can hamper the growth resulting in overall decline in the economy. However rational business regulation not only facilitates the firms to continue work formally it can contribute towards economic growth as well.

In conclusion, while business regulations are intended to organize and stabilize economic activities, their effectiveness depends on addressing complementary factors such as corruption, literacy, and infrastructure development. A holistic approach that integrates regulatory reform with broader socio-economic interventions is essential to create an environment conducive to sustainable economic growth and development.

6. FUTURE RESEARCH DIRECTION

According to the vast literature drivers for economic growth are innovations, technologies, and labor force, etc, but very little literature is available to demonstrate the direct link between business regulations and economic growth.
Future research could explore the varying impacts of business regulations on economic growth across different regions, income levels, and cultural contexts. The impact of sector-specific regulations (e.g., in technology, manufacturing, or agriculture) on productivity and innovation can be analyzed, as the influence of economic performance in various industries. Investigating the interplay between business regulations and institutional quality, such as governance, legal frameworks, and corruption control, could provide a deeper understanding of how regulations influence economic outcomes. The increasing importance of sustainability calls for research into the impact of environmental and social regulations on economic growth. Studies could examine how balancing economic and sustainability goals influences regulatory design and effectiveness.

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