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Determinants of the cost of starting a business in Mexico☆

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ABSTRACT

We construct a panel data at the state level in México for the years 2006, 2008 and 2011 in order to investigate the impact that entry deregulation efforts, states' financial strength, crime level, and potential market profitability have on the cost of opening new businesses in Mexico, where this cost is taken from the Doing Business in Mexico report of the World Bank. Using a model that controls for both regional fixed effects and endogenous effects, we find that our measures of entry deregulation and states' financial strength are associated with a reduction in the cost of opening a new business, while higher levels of crime and higher GDP per capita tend to increase it.

1. Introduction

Recent literature suggests that lowering the Costs of Starting Businesses (CSB) in market economies tends to foster growth and employment through different channels. Some research shows, for instance, that when the CSB decreases, the entry of firms to formal markets becomes easier, encouraging the

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creation of new firms, increasing business density and improving the productivity of existing firms.[1] Other research shows, in turn, that reforms aimed at lowering the CSB tend to positively affect the level of investment in industries such as transportation, communications, and the provision of services, sectors which are identified as tending to preserve and promote competition.[2] Likewise, other works report that more efficient regulations for firms' registration in formal markets increase productivity and performance at the macroeconomic level.[3]

The main message of this literature, namely, that lowering the CSB tends to boost production and employment, turns out to be of interest for a country like Mexico, where, according to World Bank data, the referred costs differ significantly among its states.[4] The magnitude of such differences is such that its elimination may result in higher levels of productivity and employment.[5] Considering the above, this work reviews the impact of different factors on the CSB in the Mexican states.

Although we recognize that there is already some literature focusing on the determinants of the CSB in Mexico, it is also the case that the existing work has focused mainly on explaining the impact that a specific program of the Mexican Government aimed at facilitating the opening of new businesses – named the Rapid Business Opening System, or *Sistema de Apertura Rápida de Empresas* (SARE)[6] – has had on the *opening-up rate* of formally registered firms. Kaplan, Piedra, and Seira (2006), for instance, use data of firms and employees registered at the Mexican Social Security Institute (IMSS, for its acronym in Spanish) from 2000 to 2006, and report that the SARE's adoption increased the opening-up rate of formal businesses in Mexico by 4–9 percent. Another example is Bruhn (2008), who uses data from the Economic Census and the National Occupation and Employment Survey of INEGI for the period 2000–2004 and reports that adopting the SARE has led to a higher number of formally registered firms, lower consumer prices and revenues of already established businesses, and higher income for workers who had been previously outside the labor market. Likewise, the Federal Commission of Regulatory Improvement (COFEMER, for its acronym in Spanish), which is the Mexican Government agency in charge of promoting the policy of regulatory improvement in Mexico and of managing the SARE, released a study in 2011, using data for five federal States for the period 2009–2010, that reports a positive impact of SARE's implementation over the amount of economic units in the formal sector of the economy.[7]

Our research, in contrast to existing work, seeks to explain directly the CSB in Mexico. In particular, we use panel data of these costs *at the state level* for the years 2006, 2008 and 2011, taken from the World Bank's reports *Doing Business in Mexico* (DBM) 2007, 2009, and 2012 respectively,[8] to study the impact of variables such as the regulatory framework for setting-up firms, states' financial solvency, and state's per capita income levels, over the referred costs. The study also controls for the possible impact of insecurity levels on the costs of setting-up firms,[9] and takes into account regional fixed effects so as to consider the possible effect of local factors on the costs of setting-up new businesses.[10]

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[1] See World Bank (2012), Klapper, Lewin, and Quesada-Delgado (2009), Klapper, Laeven, and Rajan (2006), Bruhn (2008).

[2] See Alesina, Ardagna, Nicoletti, and Schiantarelli (2005).

[3] See Loayza, Oviedo, and Serven (2005), Restuccia (2011), Barseghyan and Di Cecio (2011).

[4] These costs are presented in the reports *Doing Business in Mexico* 2007, 2009 and 2012, published by the World Bank. In these reports the World Bank also presents data at the state level regarding the costs of: (i) obtaining building permits; (ii) registering property; and (iii) ensuring contract enforcement. It should be pointed out that the *Doing Business* report of the World Bank calculates, for comparison purposes at the international level, an "Ease of Doing Business Index" (EDBI) which considers, besides the four indicators mentioned above, the indicators relative to: (v) the costs to obtain energy; (vi) easiness to obtain bank credit; (vii) investors protection; (viii) tax compliance; (ix) cross-border trade; and (x) resolve disputes. This EDBI, however, is only calculated for the countries' capitals, which implies that the data for Mexico indeed correspond to the Federal District.

[5] The *Doing Business* 2012 of the World Bank ranks Mexico 36th among 185 countries in the category "the business set-up cost", which can be considered quite acceptable. However, this datum, just as indicated in the previous footnote, refers to the Federal District data. Within the country, however, the differences in start-up costs are significant, varying not only across entities, but also across time. This variation is the one we are interested in this work.

[6] Section 2 presents a more detailed description of this program.

[7] See COFEMER (2011).

[8] It should be pointed out that for convenience throughout the document we will apply the term "state" to both the states and the Federal District.

[9] We must acknowledge that the list of explanatory variables used in our analysis was driven mainly by data availability.

[10] Regarding this local dynamics, see Banco de México (2012).