Doing Business in South Asia 2007

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Copies of *Doing Business 2007: How to Reform, Doing Business in 2006: Creating Jobs, Doing Business in 2005: Removing Obstacles to Growth,* and *Doing Business in 2004: Understanding Regulation* may be purchased at www.doingbusiness.org.

Overview

In India 8 million workers have formal jobs in the private sector—in a country of over 1 billion people and a workforce of 458 million. In Pakistan, an estimated 7 million out of a labor force of 45 million work in the formal private sector. Sri Lanka has about 4 million people working in formal jobs in the private sector—out of a workforce of 7 million.

Reform can change this, by making it easier for formal businesses to create more jobs. Women and young workers benefit the most. Both groups account for a large share of the unemployed. Reform also expands the reach of regulation by bringing businesses and workers into the formal sector. There, workers can have health insurance and pension benefits. Businesses pay taxes. Products are subject to quality standards. And businesses can more easily obtain bank credit or use courts to resolve disputes.

TABLE 1.1
Top 30 economies on the ease of doing business

1	Singapore	16	Lithuania
2	New Zealand	17	Estonia
3	United States	18	Thailand
4	Canada	19	Puerto Rico
5	Hong Kong, China	20	Belgium
6	United Kingdom	21	Germany
7	Denmark	22	Netherlands
8	Australia	23	Korea
9	Norway	24	Latvia
10	Ireland	25	Malaysia
11	Japan	26	Israel
12	Iceland	27	St. Lucia
13	Sweden	28	Chile
14	Finland	29	South Africa
15	Switzerland	30	Austria

South Asia rankings

53	Maldives
74	Pakistan
88	Bangladesh
89	Sri Lanka
100	Nepal
134	India
138	Bhutan
162	Afghanistan

Note: The rankings for all economies are benchmarked to April 2006. The ease of doing business averages country rankings across the 10 topics covered in *Doing Business 2007*. This year's rankings are not comparable to last year's as 20 new economies have been added, and the methodology for four topics was changed. See the Data notes for details.
Source: Doing Business database.

Many governments have taken action, in both rich and emerging economies. Twelve emerging economies, including 3 in Eastern Europe and 5 in East Asia rank in the top 30 on the ease of doing business (table 1.1).

South Asian countries have further to go. None make the top 30 list. The Maldives is the closest, with the highest ranking in the region at 53rd out of 175. At the other end, Afghanistan ranks 162nd. Reform is sorely needed.

Within countries, cities vary in their performance on the ease of doing business. *Doing Business* studies 4 cities in Bangladesh, 12 cities in India and 6 in Pakistan. In India, Hyderabad outperforms the rest. In Pakistan, Karachi, and in Bangladesh, Dhaka. But a big gap remains between India and Pakistan's best and the ease of doing business in Bangkok or Johannesburg (appendix III). Typically, large business centers such as Mumbai and Calcutta have a high volume of business activity, so regulatory bottlenecks create more congestion. Other *Doing Business* subnational studies show a similar pattern, for example in Brazil where Sao Paulo scores on the lower end of the ease of doing business.

Good practices exist within India, Pakistan and Bangladesh. If each Indian state were to adopt the country's best practice in each of the *Doing Business* indicators, India would rank 79th in the world on the ease of doing business instead of its current ranking at 134th. This means, for example, adopting Jaipur's regulations on

starting a business, Bhubaneshwar's rules on licensing, contract enforcement and taxes, Hyderabad's property regulations and Chennai's trade practices.

The same is true for Pakistan. If each Pakistani region adopted Lahore's regulations on starting a business, Peshawar's regulations on dealing with licenses, employing workers and contract enforcement and Karachi's regulations on bankruptcy, taxes and property, Pakistan's ranking would jump from 74th to 52nd on the ease of doing business. And if Bangladesh adopted for example Bogra's regulations on starting a business and dealing with licenses, Khulna's rules on contract enforcement, Chittagong's trade practices and Dhaka's bankruptcy regulations, its ranking would go up from 88th to 62nd.

Who is reforming?

Two hundred and thirteen reforms to business regulations—in 112 economies—were introduced between January 2005 and April 2006. Reformers simplified business regulations, strengthened property rights, eased tax burdens, increased access to credit and reduced the cost of exporting and importing.

Reform is moving at a faster pace in some economies than in others. The most reform took place in Eastern Europe, where 89% of countries took at least one step to make things easier for business (figure 1.1). Georgia, the global leader in reforms, improved in 6 of the 10 areas covered by *Doing Business 2007* (table 1.2). One of these reforms—in starting a business—reduced start-up time from 21 to 16 days and cut minimum capital requirements by 90%. And results were fast: registrations jumped by 55% over the previous year.

The pace of reform was slower in South Asia in 2005–06 than any other region—with only 25% of countries improving on the *Doing Business* indicator. Five reforms in India and two in Pakistan reduced the time, cost and hassle for businesses to comply with legal and administrative requirements. No other South Asian economy reformed its business regulations in 2005-06.

India, as the leading reformer in South Asia, took over the top reformer spot from Pakistan, which held it in last year's report and was also among the top 20 reformers worldwide. India cut the time to start a business from 71 to 35 days and reduced the corporate income tax rate from 36.59% to 33.66%. A Supreme Court decision made enforcing collateral simpler—easing access to credit. New risk management procedures in customs helped lower import time by 2 days and exports by 9 days. And reforms to stock exchange rules toughened protections for investors. Although the reforms improved India's ranking, it still ranks relatively low at 134th—41 places after China, which is reforming at a faster pace than India.

Pakistan was the runner-up reformer in South Asia

TABLE 1.2
The top 10 global reformers and South Asia

Economy	Starting a business	Dealing with licenses	Employing workers	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business
Georgia	✓	✓	✓		✓			✓	✓	
Romania		✓	✓		✓	✓		✓		✓
Mexico	✓					✓	✓			
China	✓				✓	✓		✓		
Peru	✓				✓	✓			✓	✗
France		✓			✓			✓	✓	✓
Croatia	✓			✓					✓	
Guatemala	✓	✓		✓						
Ghana				✓			✓	✓		
Tanzania	✓			✓		✓		✓		
South Asia Region										
Afghanistan										
Bangladesh										
Bhutan										
India	✓				✓	✓	✓	✓		
Maldives			✗							
Nepal										
Pakistan							✓	✓		
Sri Lanka							✗			

Note: Economies are ranked on the number and impact of reforms. First, *Doing Business* selects the economies that reformed in 3 or more of the *Doing Business* topics. Second, it ranks these economies on the improvement in rank in the ease of doing business from the previous year. The larger the improvement, the higher the ranking as a reformer. "X" indicates a negative reform.
Source: Doing Business database.

FIGURE 1.1

Slower pace of reform in South Asia than other regions

Source: Doing Business database.

in 2005–06. Reforms to modernize customs reduced time to import from 39 to 19 days and time to export from 33 to 24 days. Corporate tax rates fell from 39% in 2004 to 37% in 2005 and 35% in 2006.

Bangladesh also made progress. The Land Registration Act of 2004, in force since July 1, 2005, decreased the property registration cost from 11% to 10.5% of the property value. It also introduced standardized deeds and more transparency in land transactions to stem the level of fraud in land tenure and, as a result, the level of land litigation in future years.

Two countries—Sri Lanka and the Maldives—made doing business more difficult. Sri Lanka reintroduced a stamp duty and levied a new tax on profits. The Maldives now requires a mandatory two-month notice period before workers can be dismissed, a move that may especially discourage businesses from hiring poor, low-skilled and young workers.

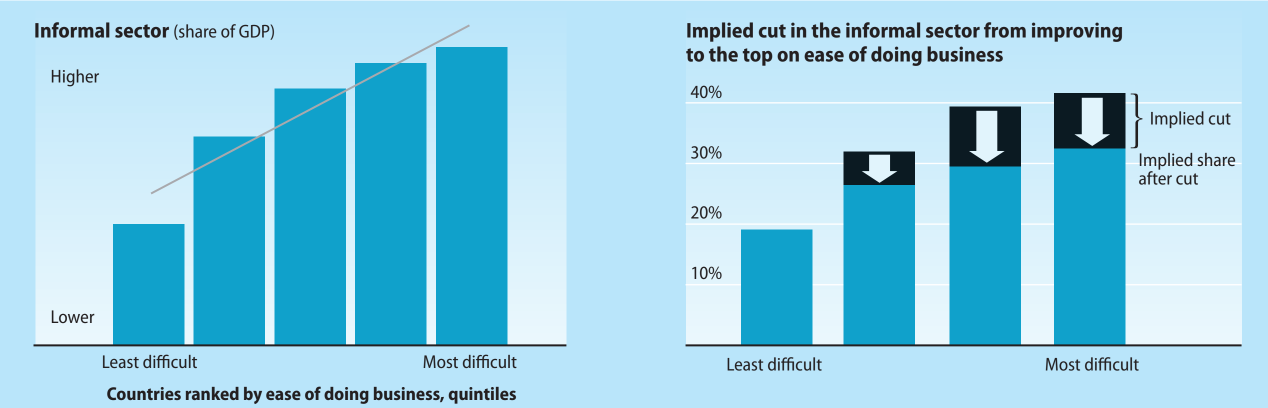
Reforms can improve competitiveness, reduce informality

Reforms allow firms to grow faster and create jobs. An increasing number of those jobs will be in the formal economy because the benefits of being formal—such as easier access to credit and better utility services—often outweigh the costs (such as taxes). Improving a country's performance on the *Doing Business* indicators to the level of the top 30 countries is associated with a 9 percentage point fall in the share of GDP accounted for by informal activity (figure 1.2).

Reform can ease the bureaucratic burden on all businesses. By providing easy start-up requirements and strong property rights, any business will have the opportunity to thrive. Better performance on the indicators measured by *Doing Business* is also associated with greater economic growth and lower unemployment. It also means less opportunities for corruption—as each point of contact between the entrepreneur and a bureaucrat is an opportunity for a bribe to exchange hands. Yet good regulatory performance is not a function of wealth: poorer economies can—and frequently do—perform better than richer economies on *Doing Business* indicators.

FIGURE 1.2

The ease of doing business is associated with less informality



Note: Relationships are significant at 1% level and remain significant when controlling for income per capita.
Source: Doing Business database, Schneider (2005), WEF (2004).

What to reform in South Asia

As a region, South Asia performs comparatively well in two *Doing Business* areas: new business start-up and investor protection (tables 1.3 and 1.4). It is extremely difficult to dismiss workers, however, and access to credit is severely limited. Trading across borders and contract enforcement are also slow and complex. Priorities for reform across the region are: make labor market regulations more flexible, ensure more efficient contract enforcement, and facilitate trade.

Making labor market regulations more flexible

To improve labor flexibility and help create jobs, South Asian governments can:

- **Simplify procedures for redundancy dismissal.** India, Nepal and Sri Lanka all have rigid requirements for redundancy dismissal. If a firm cannot fire excess workers in times of low demand, it is less likely to hire in times of high demand. This hurts both the worker and employer—with fewer jobs overall and less flexibility for the firm to grow. Australia, Denmark and Thailand are examples of the many economies that have more flexible requirements for redundancy firing.
- **Cut the mandated notice period and the severance payment for redundancy dismissal.** The notice period for firing a worker is 13 weeks in India. Sri Lanka requires a severance payment of 39 months of wages. When such tight restrictions are placed on a firm's ability to fire, that firm necessarily becomes wary of hiring. While political reaction to suggested labor reforms can be severe, the reforms work: Colombia cut severance payment from 26 to 11 months, and the mandated notice from 8 to 2 weeks. This helped create 300,000 new jobs. South Asian countries could also look to Armenia, Hong Kong (China), and Uruguay for examples on how to reduce severance pay for redundancy.
- **Remove time limits on term contracts.** Pakistan permits term contracts for a maximum of only 9 months. Bhutan permits them for only 1 year. Such inflexibility in the timing and use of employees limits companies' ability to grow and thrive. Both countries can look to China, Malaysia, Singapore and New Zealand who place no limits on the duration of fixed term contracts, and in so doing increase job opportunities for workers.

Ensuring more efficient contract enforcement

Without efficient courts, less wealth is created. When contracts can be enforced efficiently, businesses expand their trade networks and employ more workers. Steps towards improving contract enforcement are:

- **Introduce specialized commercial divisions** in existing courts or set up specialized separate commercial courts, which are associated with faster contract enforcement because judges become experts in handling commercial disputes. Although some specialized courts exist in South Asian countries, such as the Money Loan Courts in Bangladesh and the Debt Recovery Tribunals in India, these courts do not deal with all types of commercial disputes that can arise between businesses. Countries like Tanzania and Peru recently introduced separate commercial courts and can serve as models in South Asia.
- **Impose strict deadlines** for the exchange of evidence and give judges the authority to enforce such

TABLE 1.3
Priorities for South Asia are contract enforcement, labor, and trade regulations

		Starting a business	Dealing with licenses	Employing workers	Cost of firing	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business
1	High income: OECD	1	1	2	2	1	1	1	1	1	1	1
2	East Asia & Pacific	3	3	1	3	4	4	3	2	2	3	5
3	Eastern Europe & Central Asia	4	6	5	1	2	2	5	7	5	2	2
4	Latin America & Caribbean	5	2	3	5	5	3	4	5	3	6	4
5	Middle East & North Africa	6	5	4	4	3	5	7	3	4	4	3
6	**South Asia**	**2**	**4**	**6**	**7**	**6**	**6**	**2**	**4**	**6**	**7**	**6**
7	Sub-Saharan Africa	7	7	7	6	7	7	6	6	7	5	7

Source: Doing Business database.

TABLE 1.4
Doing Business rankings of countries in South Asia

Country ranking (1–175)		Starting a business	Dealing with licenses	Employing workers	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business
53	Maldives	31	9	5	172	143	60	1	91	83	114
74	Pakistan	54	89	126	68	65	19	140	98	163	46
88	Bangladesh	68	67	75	167	48	15	72	134	174	93
89	Sri Lanka	44	71	98	125	101	60	157	99	90	59
100	Nepal	49	127	150	25	101	60	88	136	105	95
134	India	88	155	112	110	65	33	158	139	173	133
138	Bhutan	79	145	116	41	159	118	68	150	56	151
162	Afghanistan	17	..	74	169	174	173	30	152	165	151

Source: Doing Business database.

time limits. In 2002, India amended its Code of Civil Procedure to allow out-of-court evidence exchange in the High Courts. Bangladesh recently introduced a maximum number of adjournments before the Money Loan Courts. All countries in the region can improve the efficiency of their courts by imposing and enforcing procedural deadlines. Limiting interlocutory appeals will also reduce court delays.

- **Introduce transparent and objective processes** for selecting judges to attract the best and brightest to the judiciary. When judges are highly regarded, they have the moral authority to enforce court rules. Publicizing cases of corrupt judges or other court personnel, such as bailiffs, will show citizens that a government is serious about reducing corruption. In Kenya, opinion polls showed that the public approved of the government's prosecution of judges charged with corruption.

Facilitating trade

Businesses engage in more trade when port and customs administration is efficient. To cut the red tape a business confronts when trying to import and export, South Asian countries can:

- **Make document filing electronic.** India is the only country in the region that allows for electronic filing of documents, and it is only partial. When Singapore introduced electronic filing for all documents necessary for trading, time for cargo clearance fell from 4 days to 30 minutes. The number of shipments processed rose threefold to 32,000 a day and the cost to businesses of handling trade documents fell by a third. Mauritius and Tunisia provide similar examples to learn from.
- **Apply a risk assessment policy for inspections.** Almost 70% of cargo containers are opened and inspected when clearing customs in South Asia. In OECD countries, only 5% of imports undergo inspection. The difference is explained by risk assessment policy. In OECD countries, a software program calculates the probability of inspection based on the profiles of the business and the freight forwarders, the type of goods and their destination. This system has allowed Mexico to limit inspections to 10% of shipments, Thailand to 15%, and Latvia to 20%, cutting trading delays. It has also increased the detection of smuggled goods. As part of their trade reforms, India and Pakistan started implementing risk management techniques which have contributed to a reduction in trading time.

How to reform

Globally, the top reforming economies for the past 3 years made nearly 85% of reforms in the first 15 months of a new government. The message: for a government recently elected or reelected, the time to push through ambitious reforms is at the start of its term. In the words of one reformer: "Reform is like repairing a car with the engine running—there is no time to strategize." When the government succeeds in these early reforms, citizens start seeing benefits—more jobs and more resources for health and education. The appetite for further reforms grows. In Georgia and Romania—the countries that have moved up fastest in the *Doing Business* rankings—reformers took on simultaneous reforms in several areas at the start of their mandate.

But few countries have the opportunity (or feel the pressure) for a reform blitz. Instead, reformers must decide which reforms to tackle first. Four steps to successful reform are:

- Start simple and consider administrative reform that don't need legislative changes.
- Cut unnecessary procedures, reducing the number of bureaucrats entrepreneurs interact with.
- Introduce standard application forms and publish as much regulatory information as possible.
- And remember: many of the frustrations for businesses come from how regulations are administered. The internet alleviates these frustrations without changing the spirit of the regulation.

Pakistan did all these things in reforming its trade administration. Apart from implementing risk management techniques, Pakistan also introduced a new customs clearance process that allows importers to file cargo declarations before goods arrive at the port. Now it takes 19 days to import goods—from the conclusion of a sales contract to the arrival of the goods at the warehouse. In 2004 it took 39 days.

Whatever reformers do, they should always ask the question, "Who will benefit the most?" If reforms are seen to benefit only foreign investors, or large investors, or bureaucrats-turned-investors, they reduce the legitimacy of the government. Reforms should ease the burden on all businesses: small and large, domestic and foreign, rural and urban. This way there is no need to guess where the next boom in jobs will come from. Any business will have the opportunity to thrive—whether it's making movies in Mumbai, writing software programs in Bangalore or making surgical instruments in Sialkot.

Starting a business

When an entrepreneur draws up a business plan and tries to get it underway, the first hurdles that need to be overcome are the procedures required to incorporate and register the new firm. Cumbersome entry procedures push entrepreneurs into the informal economy, where businesses pay no taxes and many of the benefits that regulation is supposed to provide are missing.

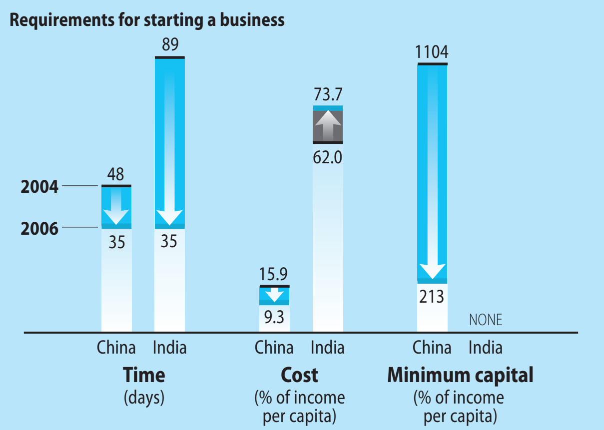
Because reforms to make business start-up cheaper and faster are often simple, they have attracted a lot of attention. Forty-three countries globally eased business entry in 2005-06. Yet India was the only South Asian country to streamline start-up last year. India cut the time to start a business from 71 days to 35 days by simplifying a complex tax registration system. Previously, stamp duty payment was routed through the stamp office only. Now, certain dealers have been authorized to affix stamps on most of the documents. The time for start-up is now at par with China (figure 1.3). The cost of setting up a new company increased from 62% of income per capita to 73.7% in 2005-06, largely because of an increase in value added tax (VAT) registration fees.

Reforms are ongoing. In March 2006, the Indian Ministry of Company Affairs launched its "MCA21" program to computerize and link all company registration offices. It will be possible in the future to incorporate an Indian company from anywhere in the world. The implementation of the system is most advanced in Delhi.

India's improvement in business start-up helped elevate the South Asia region to the second position on the ease of business entry, trailing only high-income OECD countries (figure 1.4). On average, it requires

FIGURE 1.3

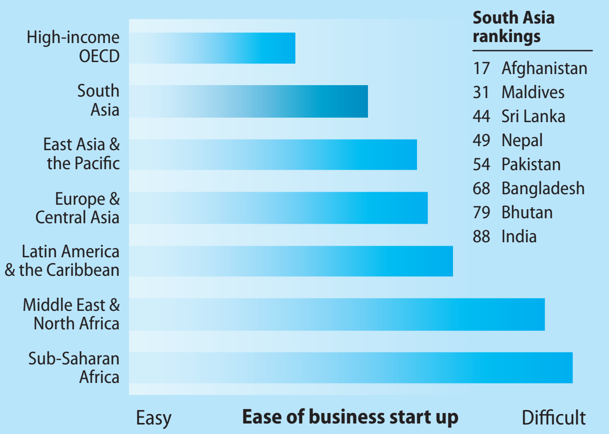
Big improvements in China and India



Source: Doing Business database.

FIGURE 1.4

South Asia performs well on ease of starting a business



Source: Doing Business database.

8 procedures and 32 days to set up a new company in South Asian countries. Only the Maldives has a legal requirement on the minimum start-up capital. However, the average cost of start-up in the region is still a lofty 47% of income per capita. By comparison, in OECD countries and Central Asia, the cost is 5% and 14% of income per capita, respectively.

Dealing with licenses

Stricter licensing protects public safety and health—except when the regulation is so burdensome that businesses move to the informal economy. *Doing Business* uses construction licenses as the starting point for the discussion of licensing because construction is among the largest sectors in every economy. Moreover, the rationale for such licensing is straightforward: well-built homes and offices save lives.

The ease of dealing with licenses is measured by the number of procedures, time and cost required for a typical medium-sized company to construct a 2-story warehouse with an area of 1,300 square meters (14,000 square feet). On average, complying with building rules in South Asia is relatively straightforward. The region ranks just after OECD high income countries and East Asia. It takes on average 16 procedures, 226 days and costs 375% of income per capita to obtain all the required building permits.

Nevertheless there is room for improvement in most countries. Within the region, complying with building requirements takes the most time in Nepal—a builder needs 424 days. Pakistan has the most expensive process, costing 973% of income per capita. In Japan, one of the easiest countries in which to build a warehouse, a builder need only to complete 11 procedures requiring 96 days and 20% of the average annual income to fulfill all regulations. The region's best performer is the Maldives, where completing regulatory requirements takes 10 procedures, 118 days with a cost of 40% of income per capita.

No country in the region reformed the law and administration over construction activities in 2005–06. Sri Lanka made it slightly easier for businesses to obtain a fixed telephone line. Sri Lanka Telecom has now computerized its records, so an inspector no longer inspects the company on site before installing a fixed telephone line.

Employing workers

Rigid employment regulation stifles new job creation. With it, employers choose among job candidates conservatively. Some workers benefit—mostly men with years of experience on the job. But young, female and low-skilled workers often lose out. In countries where labor markets are inflexible, this lack of opportunity pushes workers into the informal sector.

Labor regulations in South Asia are a matter of extremes. The region has the lowest hiring cost in the world. Social security contributions only account for 7% of a worker's salary. The rigidity of hours index for South Asia is also low, at 25 in a scale from 0 to 100 (where 100 is the highest rigidity), reflecting relatively few restrictions on overtime and annual paid vacation. This level even surpasses that of OECD countries (an average of 45).

Firing workers is a different story. In South Asia, firing a redundant worker costs on average 72 weeks of salary (figure 1.5). In 2005 Sri Lanka was the most expensive place in the world to dismiss workers after Zimbabwe, Sierra Leone and Egypt. In New Zealand and the United States, the cost of dismissing redundant workers is zero.

Procedural requirements for dismissing workers are also a burden. The region is ahead of only Africa on the difficulty of firing index. India, Nepal and Sri Lanka impose the most restrictions, requiring a host of notifications and approvals to fire.

Registering property

Property registries were first developed to raise tax revenue. Defining and publicizing property rights through registries has proven good for entrepreneurs as well. Land and construction account for between half and three-quarters of the wealth in any economy. Securing rights to this property strengthens incentives to invest and facilitates trade. And with formal property titles, entrepreneurs can obtain mortgages on their homes or land and start businesses. But when registering property is cumbersome, ownership slips back to informal.

It takes 8 procedures, 425 days to register property in Bangladesh and 252 days in Afghanistan, but only 1 day in Norway and 2 days in Sweden. South Asia fares poorly in terms of ease of registering property, scoring only higher than Africa and Latin America among regions. The average time for completing a property transfer is 118 days, compared with 32 days in OECD countries and 86 days in the East Asia and Pacific region. The cost is also high, at 5% of the value of property, compared with 4% in East Asia. Nepal boasts the simplest property system in the region, with property registration taking 3 procedures, 5 days and costing 6% of property value. But the value of registration remains low because of numerous title disputes.

Bangladesh was the only South Asian country that made progress in property registration in 2005–06, cutting its registration fee from 11% to 10.5% of the property value. A new registration act introduced standardized deeds and greater transparency in land transactions, with a goal of reducing corruption.

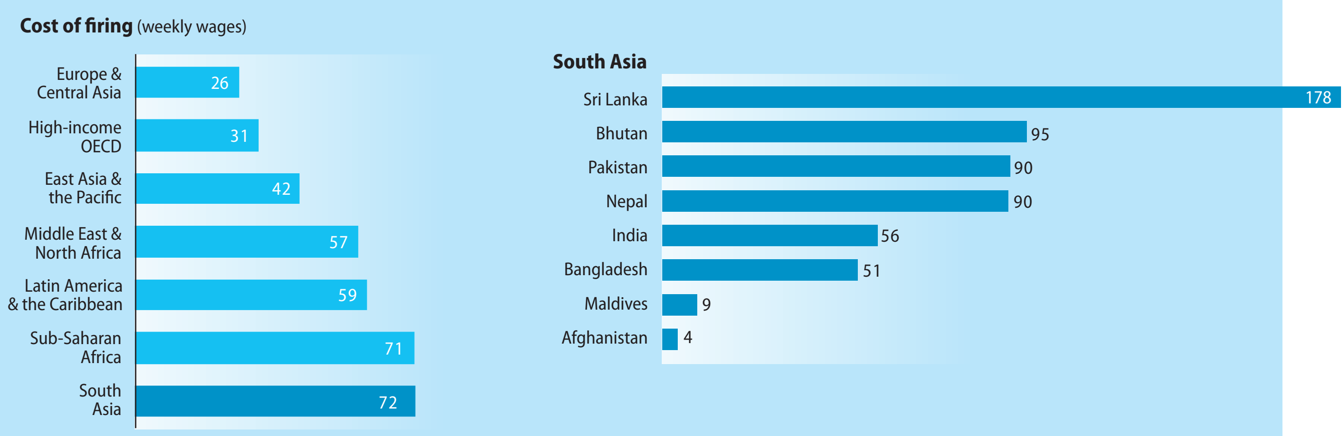
Getting credit

Access to credit is consistently rated by firms as one of the greatest barriers to operating and growth. Small businesses are constrained the most. Businesses get better access to loans and more favorable terms of credit when creditors and borrowers have stronger legal rights and information on credit histories is available. But in most poor countries, credit registries and effective collateral laws are lacking. Banks make fewer loans.

Compared with other regions, South Asia falls behind in both the availability of credit information and the legal rights of borrowers and lenders. The average performance on the index of credit information is only 2 out of a 0-6 scale, second worst in the world behind Africa. Credit registries (both public and private) cover only 1% of the adult population on average, the lowest in the world, compared with an average of 69% and 35% in OECD countries and Latin America, respectively (table 1.5). South Asian countries did not implement any changes that improved their scores on the credit information indicators in 2005-06.

The collateral and bankruptcy laws of most South Asian countries do not effectively protect the legal rights of borrowers and lenders. The *Doing Business* legal rights index measures how well laws facilitate access to credit, including whether they allow all assets to be used as collateral, provide for a unified registry of security interests, and permit out-of-court enforcement of loan agreements. Out of the 10 criteria in the index, Afghanistan scores 0, making it the worst performer in this indicator globally. The region's average is 3.8, also the lowest in the world.

FIGURE 1.5
High firing cost in South Asia



Source: Doing Business database.

TABLE 1.5
Poor coverage of credit information in South Asia

	Public registry coverage (% of adults)	Private bureau coverage (% of adults)
Afghanistan	0	0
Bangladesh	0.6	0
Bhutan	0	0
India	0	6.1
Maldives	0	0
Nepal	0	0.1
Pakistan	0.3	1.1
Sri Lanka	0	3.1

Source: Doing Business database.

Once the type of security is agreed on, lenders want to check for existing rights to the collateral. The best way is with a collateral registry. Collateral registries are most effective when they are unified by region and cover all types of assets. In South Asia, although most countries have some type of collateral registry, restrictions on their coverage of firms and types of assets limit their value.

The good news is that countries are acting. India's Supreme Court recently upheld the right of banks to take possession of collateral without court involvement. A simple notice to the debtor is now sufficient to obtain payment in at least half of defaults. The reform also introduced time limits on initial judgments and appeals in collateral enforcement cases. Under the amended Enforcement of Security Interest and Recovery of Debt Law, the Debt Recovery Tribunals are now required to decide appeals within 60 days.

Protecting investors

Protection of investors is crucial to entrepreneurship and investment. In countries with higher risk of expropriation by corporate insiders, investment as a share of GDP is half that in countries with good investor protection. Stock markets are smaller and underdeveloped.

On average South Asia scores relatively well on the strength of investor protection index, trailing as a region only the OECD and East Asia. Except in Afghanistan and Bhutan, which are far from having vibrant equity markets, countries in the region give shareholders strong powers to challenge transactions involving conflicts of interest. However, the region has a low score in the extent of disclosure index—4 out of a 0-10 scale. Afghanistan and the Maldives require no disclosure on "related-party" transactions at all, not even in the annual report; and no external auditor reviews the transaction before it takes place. The CEO or managing director alone can provide legally sufficient approval for the transaction. Other countries in the region only require directors to disclose such transactions in the annual report—long after the possible damage is done. In Afghanistan and Nepal, it is difficult to hold directors liable for the damages caused by the related-party transaction unless there is evidence of fraud or bad faith.

The payoff for protecting investors is large. India, with the most developed stock markets in the region, is taking action. In 2005-06 India continued the corporate governance reforms it started last year. As of January 2006, India's listed companies must comply with new standards. This includes having more independent directors on the companies' boards and audit committees, a code of conduct for board members, more responsibilities for audit committees and mandatory certification by the CEO and COO of a company's financial statements.

Nepal has strong investor protection provisions on the books, but these are rarely invoked and equity markets are nascent. In 2005, Nepal made its laws stronger but at the same time included a provision stating that the protections for investors do not apply to transactions that are part of the "company's ordinary course of business." In practice, directors can avoid all the stronger investor protections in the new law by claiming the transaction is a part of the company's ordinary course of business.

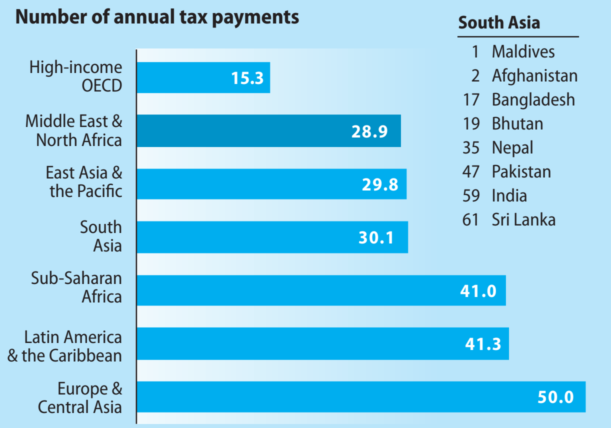
Paying taxes

Taxes are essential. Without them, there would be no money to build schools, hospitals, courts, roads, airports or other public infrastructure that helps businesses and society be more productive and better off.

Still, there are good ways and bad ways to collect taxes. In Hong Kong (China), all the taxes a medium-size business needs to pay each year is 1 income tax and 1 fuel tax totaling 29% of commercial profits (i.e. sales less materials and labor costs). It takes 4 annual electronic filings and 80 hours to comply with tax requirements. However, a medium-sized business in India has to make 59 tax payments totaling 81% of commercial profits. A Bangladeshi firm needs to make 17 payments, but the whole process takes 400 hours.

On average South Asia has a relatively simple tax system compared to other regions in the world. Companies make an average of 30 tax payments each year (figure 1.6). The average total tax payment amounts to about 45% of commercial profits, lower than Africa,

FIGURE 1.6
Relatively few tax payments per year in South Asia



Source: Doing Business database.

Latin America, the OECD and Eastern Europe and Central Asia. Nevertheless, there is more to be done. The time to comply with tax requirements averages 304 hours, compared with 202 hours in OECD countries. These high compliance costs create incentives to evade, driving many firms into the underground economy, and do not translate to higher revenues.

Two countries in the region made it easier to pay taxes in 2005-06: India and Pakistan. India reduced its corporate tax rate from 36.59% to 33.66%. India also shifted from sales to value added taxes, which are harder to evade. Pakistan lowered its corporate income tax rate from 39% to 37%. For the year ending on December 31, 2006, the corporate income tax rate will be further reduced to 35%. Pakistan also made its revenue system more taxpayer-friendly by introducing electronic filing and one-stop shops for taxpayers.

Sri Lanka moved in the opposite direction, reintroducing a stamp duty, raising its profit tax and levying a new tax on profits.

Trading across borders

When a Bangladeshi company imports goods, it has to prepare 16 separate of documents. The whole process takes 57 days. In Afghanistan, where 70-80% of businesses import, it takes 88 days and involves 11 documents to ship goods from abroad. Contrast this with the single signature a Danish or Finnish importer needs.

Trade in South Asia takes an average of 34 days and 8 documents to export, and 42 days and 13 documents to import, making it the second least trade-friendly region in the world. The cost to import and export goods is only higher in Africa and Eastern Europe and Central Asia. More cargo traded is inspected in South Asia than in any other region, leading to significant delays (table 1.6). Every container is opened in Nepal and Sri Lanka. Contrast this with OECD countries, where 5% of imports undergo inspection. Three countries—Afghanistan, Bangladesh and Bhutan—require both import and export licenses for shipments. Sri Lanka requires licenses for importing.

The benefits of trade are well documented. So are some of the barriers to trade. Much attention has been given to reducing trade barriers such as tariffs and quotas. But regulatory hurdles can incur higher costs to trade than tariffs. For manufactured exports, the cost of trade transactions in developing countries—which includes the cost of dealing with customs and the cost of inland transport—exceeds the cost imposed by tariffs in the European Union and the United States. Red tape is estimated to cost more than 10% of the value of exports in developing countries.

Contrary to popular belief, customs paperwork and other red tape (often called "soft infrastructure") cause the most delays in exporting and importing. In South Asia, only one third of the delays are caused by problems with "hard infrastructure" such as poor port facilities or roads (figure 1.7). In Sri Lanka, fulfilling pre-arrival documentation and customs requirements takes 23 of the 27 days to import. In Bangladesh, 45 out of 57 days.

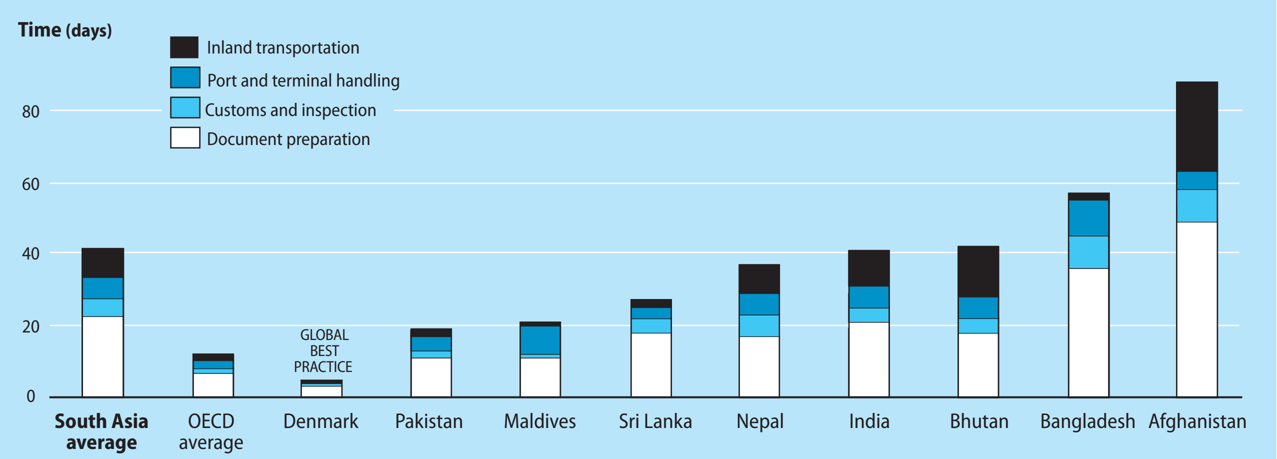
In 2005-06, 19 countries made it easier to trade across borders. In Pakistan, trading is now significantly easier than just a year ago. Time to import dropped from 39 to 19 days. The improvement comes from a new customs clearance process that allows traders to file cargo declarations before shipments arrive and to pay tariffs and port fees electronically. Risk management techniques are now used for choosing which containers to inspect. A pilot run between April 2005 and January

TABLE 1.6
Many inspections in South Asia

Region	% of import cargo inspected
High income OECD	5
East Europe & Central Asia	18
East Asia & Pacific	31
Latin America & Caribbean	51
Middle East & North Africa	63
Sub-Saharan Africa	67
South Asia	**69**

Source: Doing Business database.

FIGURE 1.7
Big delays in importing caused by red tape



Source: Doing Business database.

2006 trained staff and the main traders. The Karachi container terminal has since fully moved to the new system. Less time is also needed to export goods from Pakistan: a drop from 33 days in 2004 to 24 days in 2005-06.

India reformed as well: time to export decreased from 36 days to 27 days and time to import from 43 days to 41 days. Like Pakistan, India now applies risk management techniques to decide which containers to inspect. The Bangalore Customs Commissioner introduced an electronic payment system which allows companies to pay customs duties online. Nearly 63% of import documents and 35% of export documents have been filed online since the introduction of the Electronic Data Interchange in Bangalore.

Enforcing contracts

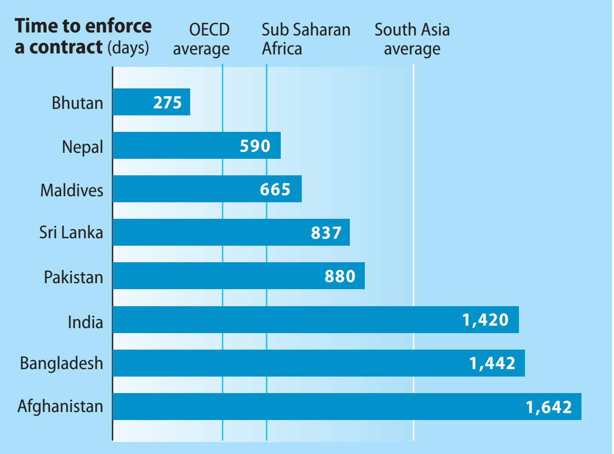
Efficient contract enforcement encourages businesses to engage with new customers. The institution that enforces contracts—between debtors and creditors, suppliers and customers—is the courts. Yet in many countries around the world courts are slow, inefficient and corrupt. Complex enforcement procedures lead business to avoid courts in favor of simpler, often informal, alternatives. In developing countries, more procedures are associated with less—not more—fairness and impartiality in the legal system.

Resolving commercial disputes through the courts is more time consuming in South Asia than any other region. It takes 969 days on average compared with 642 days in Latin America, 606 days in the Middle East and 581 days in Sub-Saharan Africa. On average, litigants must go through 38 procedures, compared with 22 procedures in OECD countries. Twenty-six percent of the claim's value is lost in the process, more than double the costs in rich countries.

The majority of countries in South Asia—India, Pakistan, Afghanistan and Bangladesh—are among the 20 countries with the most lengthy contract enforcement process. A simple commercial case takes almost 5 years in Afghanistan and almost 4 years in Bangladesh and India. (figure 1.8). In Bangladesh, 46% of the claim is lost in attorneys' fees and court fees.

Yet reforms in South Asia are slow in coming. In 2005–06, 18 countries reformed procedures for contract enforcement. None were in South Asia. Because of long court delays, companies start to look for alternative ways to resolve their disputes. In India, mediation and arbi-

FIGURE 1.8
Lengthy delays in enforcing contracts



Source: Doing Business database.

tration have become more popular in recent years. But arbitral awards still end up in court because the Indian Supreme Court gives courts large powers to annul the decisions from arbitrators. In November 2005, Pakistan opened a mediation center in Karachi to respond to the need for a more efficient justice system.

Closing a business

Every country needs effective procedures for closing a failed business or saving a viable one that is experiencing temporary problems. Efficient bankruptcy systems encourage entrepreneurs to start up businesses, as easier exit means easier entry. Bottlenecks in bankruptcy cut the amount that claimants can recover, scaring away creditors.

Bankruptcy is hopelessly inefficient in most countries. Claims are eroded by long delays, high costs and by laws that either kill viable businesses or keep unviable ones alive. Creditors, workers, tax agencies and other claimants recover, on average, only 31 cents on the dollar after a bankruptcy case winds up.

Sub-Saharan Africa and South Asia have the worst recovery rates in bankruptcy, averaging 18 cents and 20 cents of every dollar, respectively. The insolvency process also takes longer in South Asia than in any other region, averaging 4 years. India has the longest bankruptcy proceedings in the world. A bankruptcy case takes an average of 10 years. Only 13 cents of every dollar of debt can be recovered in the end.

With the new bankruptcy law that came into effective in 2005, Brazil, which previously had delays as long as India's, has more than halved the time necessary to go through the bankruptcy process. Twelve other countries revamped their insolvency laws during 2005-06. No countries in South Asia reformed bankruptcy in 2005-06. India continued implementing reforms to repeal the Sick Industrial Companies Act (SICA) through the proposed Companies (Amendment) Act, 2002. SICA had previously prevented bankrupt companies from being liquidated. The reforms will establish bankruptcy tribunals, but they are not yet in full operation. Once the amendment comes into force, recovery rates are expected to rise considerably. Pakistan and Maldives have draft laws to improve the bankruptcy process. But so far, these laws have not been adopted.