



Implementing Regulatory Reform

Foreign Investment Advisory Service

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WHAT TO REFORM AND WHO TO LEARN FROM

Over 515 million people live in absolute poverty in South Asia. Economic growth and job creation, made possible through streamlined and modern business regulations, can help them rise out of that poverty. Findings from *Doing Business in 2005*¹ show governments should focus their reform efforts for the greatest impact in labor regulations, court efficiency and credit information sharing.

South Asia vs. other regions: Where is it easier to do business?

South Asia imposes some of the highest regulatory obstacles to running a company in the world, second only to sub-Saharan Africa in the overall difficulty of doing business (see Figure 1).

India ranks in the bottom 20% for overall regulatory burden. Bhutan appears among the 30% of countries where it is most difficult to do business. Bangladesh, Nepal, Pakistan, and Sri Lanka all rank close to the midpoint of countries.³

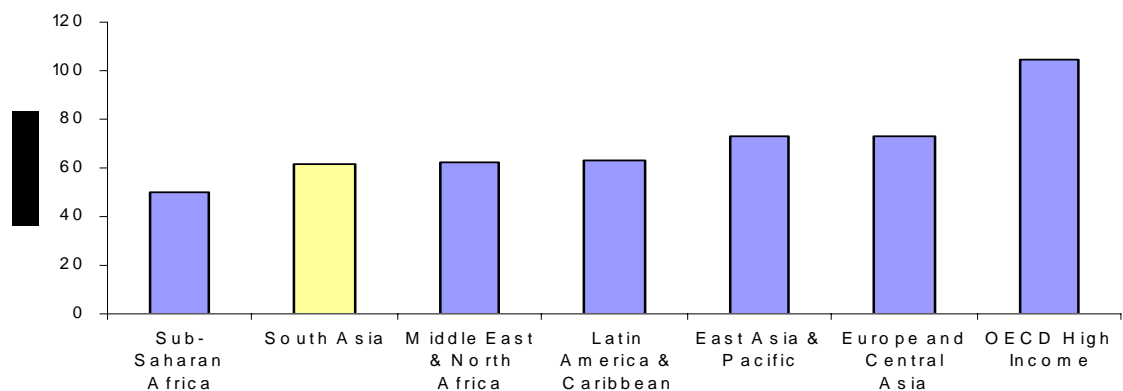
As a region, South Asia performs comparatively well in two *Doing Business* subjects:

new business start-up and property registration. Labor regulations are extremely restrictive, however, and access to credit is severely limited. Enforcing contracts through the courts is also slow and costly.

- **Starting a business:** South Asia performs well on two significant measures of simplicity when registering a new business: minimum capital requirement and procedural hurdles. No country in South Asia imposes a minimum capital requirement to open a business – a strong example of regional best practice. On average, South Asian countries require 9 procedures to start a new business – a long way from best practice but trailing only the OECD and East Asia as a region. The 47 days required to complete those procedures, however, moves South Asia to the middle of regions overall in time necessary to register the company. In addition, the administrative cost of starting a business in South Asia is 45% of income per capita, excessive when compared to Europe and Central Asia’s 15%.

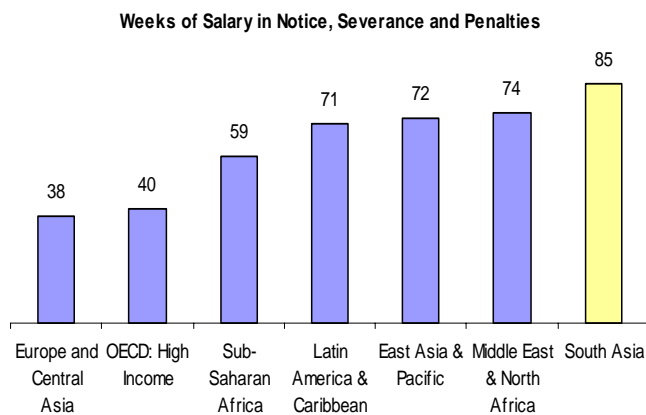
- **Hiring and firing workers:** Labor regulations in South Asia are a matter of extremes: flexible on working hours, but difficult to fire.

Figure 1: South Asia scores poorly on the Ease of Doing Business Index²



The Rigidity of Hours Index for South Asia is the lowest in the world (37 in a scale from 0 to 100, where 100 is the highest rigidity), reflecting few restrictions on night or weekend work, length of workday and workweek, and days of annual paid vacation. Compare that to 53 for Latin America and the Caribbean and 64 for Sub-Saharan Africa. Countering this flexibility in hours is great difficulty in firing workers. According to the *Doing Business* Difficulty of Firing Index⁴, the South Asia region ranks the worst in the world for procedural barriers to and cost of firing for unproductive workers. As one example, on average, South Asian countries require a firm to pay more than 85 weeks of salary to dismiss an unproductive worker (Figure 2), while Europe and Central Asian countries require that same firm to pay only 38 weeks on average.

Figure 2: Highest firing costs in South Asia



- Registering property:** Registering property in South Asia is relatively simple and efficient when compared to other parts of the world. For the standard case of buying a warehouse in the peri-urban area of the country's largest city, the average South Asian country requires 6 steps and 56 days to transfer title of a piece of property. The cost to complete that transfer, however, is high: 5.8% of the property value. Only Sub-Saharan Africa and the countries in the Middle East have greater costs (6.84% and 13.22%, respectively.)

- Enforcing contracts:** Collecting an unpaid debt through the courts requires significant time, money and effort on the part of South Asian businesses. The average number of procedures (30) is lower than many other regions in the world, but the time and cost relating to their completion are noteworthy: almost a year (349 days) and 38% of the debt's value must be dedicated to the effort. Expense is only higher in Sub-Saharan Africa (43% of the debt

is lost in the procedures to enforce it) and East Asia and the Pacific (45%).

- Getting credit:** South Asia offers the least credit information in the world to potential lenders. Only Bangladesh, Nepal and Pakistan have a public credit information registry, and only India, Pakistan and Sri Lanka have a private credit bureau⁵. Public registries provide information on fewer than 2% of adults in the region, with private bureaus adding a mere 3% of coverage. The scope, access, and quality of that credit information is also extremely limited. In addition, collateral and bankruptcy laws provide lenders with few legal protections to create and enforce security efficiently: when measured by the Legal Rights Index in a scale from 0 (worst) to 10 (best), South Asia scores at the bottom of all regions with 3.75.

- Protecting investors:** Shareholders in South Asia's listed companies enjoy relatively high protection against expropriation of their investment. Borrowing from the UK tradition of fiduciary duties, India, Pakistan, Bangladesh and Sri Lanka all prohibit directors from operating the company in a way that prejudices minority shareholders. Disclosure requirements surrounding their actions, however, are weak and untimely. Directors generally must disclose large transactions involving conflicts of interest only in the annual report — long after the possible damage is done.

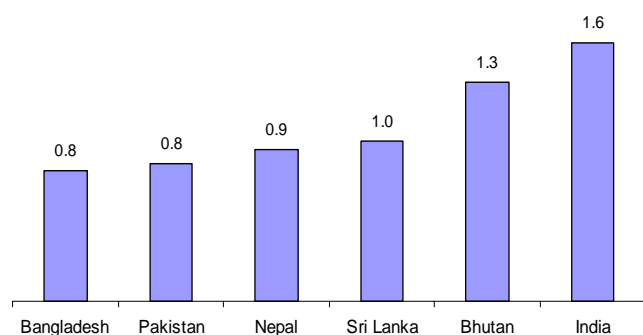
- Closing a business:** When a firm becomes bankrupt, a creditor recovers, on average, only 21 cents on the dollar in South Asian countries — the lowest of all regions. It takes an average of 5 years and costs 8% of the value of the bankruptcy estate to go through the insolvency process. This poor result is driven in part by India, which has the most delays in bankruptcy globally, along with Chad and Brazil. Like in many other poor countries, bankruptcy is rarely used in the rest of the South Asia region. Governments can improve the lot of creditors by streamlining foreclosure and standard court enforcement procedures.

Regional priorities for reform

The payoff for reforms is high. If India, now among the 20% of countries where it is most difficult to do business, were to reform and adopt the laws and regulations of a country among the top 20%, it could add approximately 1.6 percentage points to its annual economic growth. This would imply adding about 10 billion dollars per year to total output. And not only rich countries reach this goal of regu-

latory efficiency – Thailand and Botswana rank among the most business-friendly regulatory environments in the world. Figure 3 shows the benefits across the region: if each country were to reform to the level of Thailand, the estimated gains are significant.⁶

Figure 3: Implied additional GDP growth from reforming to the level of Thailand (annual percentage points)



The need for comprehensive regulatory reform stretches across South Asia. Priorities across the region are: labor market regulations, credit information sharing and contract enforcement. In particular the following reforms are recommended:

Make labor regulations more flexible. To improve labor flexibility and help create jobs, South Asian governments can:

- allow redundancy as a fair ground for dismissal;
- cut the mandated notice period and the severance payment for redundancy dismissal; and
- expand the time limit of term contracts.

Increase court efficiency. Suggested areas for court reform in South Asia are:

- summary proceedings for debt collection;
- case management; and
- move enforcement of judgment out of the courts.

Improve credit information sharing. South Asian governments can:

- share both positive and negative credit information;
- permit non-bank sourcing of credit;
- provide online access to credit registries; and
- impose substantive penalties for withholding credit information.

Notes:

1. *Doing Business in 2005* has quantitative indicators to study the impact of regulations on business activities in 145 countries: starting a business, hiring and firing employees, registering property, getting credit, protecting investors, enforcing contracts and closing a business.
2. The Ease of Doing Business Index is the simple average of country rankings in each of the 7 topics covered in *Doing Business in 2005*. The ranking for each topic is the simple average of rankings for each of the indicators. The ease of doing business measure ranges from 1 to 135, with higher values indicating more efficient regulation and stronger protections of property rights.
3. *Doing Business* does not yet have complete data for Maldives or Afghanistan.
4. The Difficulty of Firing index has 8 components: (1) whether redundancy is not grounds for dismissal; (2) whether the employer needs to notify the labor union or the labor ministry for firing 1 redundant worker; (3) whether the employer needs to notify the labor union or the labor ministry for group dismissals; (4) whether the employer needs approval from the labor union or the labor ministry for firing 1 redundant worker; (5) whether the employer needs approval from the labor union or the labor ministry for group dismissals; (6) whether the law mandates training or replacement prior to dismissal; (7) whether priority rules apply for dismissals; and (8) whether priority rules apply for reemployment. The index has values between 0 and 100, where 0 corresponds to a country where is easier to fire a worker, while 100 corresponds to the most difficult countries.
5. Sri Lanka's bureau is owned 49% by the Central Bank.
6. Based on a hypothetical improvement to the average of the top quartile of countries on the ease of doing business indicator. See Djankov, Simeon, Caralee McLiesh, and Rita Ramalho. 2004. "Growth and the Ease of Doing Business," Working Paper, World Bank, Washington, DC.

