



Asia-Pacific  
Economic Cooperation



# THE EASE OF DOING BUSINESS IN APEC

The Impact of Regulatory Reforms



APEC Economic Committee

June 2009



**Asia-Pacific  
Economic Cooperation**

EC 03/2008T

Prepared by the World Bank\*  
The World Bank, 1818 H St, NW, Washington, DC 20433

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APEC#209-EC- 01.1 ISBN 978-981-08-3722-8

\* This study was prepared by a core team of specialists of the World Bank's East Asia and Pacific Poverty Reduction and Economic Management Network. The findings, interpretations, and conclusions expressed in this study are entirely those of the authors. They do not necessarily represent the views of the World Bank and its affiliated organizations, or those of the Executive Directors of the World Bank or the governments they represent



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## Table of Contents

Preface	1
Executive Summary	3
Part I: Impact on Aggregate Economic Outcomes – Evidence from Doing Business Data	7
Introduction	8
Doing Business Database and Impact of Regulatory Burdens and Reforms	11
Evidence on the Impact of Regulatory Burdens	13
Evidence on the Impact of Regulatory Reforms	19
Capturing the Impact of Regulatory Reforms	22
Conclusions	26
References	27
Data Appendix: Sources and Measurement	30
Methodology Appendix A: The Impact of Regulatory Burdens on Industry Investment	31
Methodology Appendix B: The Impact of Regulatory Reforms on Economy Performance	32
Table 1: Impact of Regulatory Burden on Industry Investment, Single DB indicator	33
Table 2: Impact of Regulatory Burden on Industry Investment, Multiple DB indicators	35
Table 3: Improvement in Each Indicator, APEC	36
Table 4: What reforms? Improve and Reversal in Regulations (2003-2008)	37
Table 5: Who reforms?	38
Table 6: Who reforms? Are economies reformists?	39
Table 7: Is Timing of Reforms Associated with Macroeconomic Conditions?	40
Table 8: Which Reforms are Enacted Together?	41
Table 9: Are Reforms Associated with Improved Outcomes?	42
Table 10: Does the Impact of Regulatory Changes Vary Across Economies?	44
Table 11: Does the Impact of Regulatory Changes Vary Across Economies?	47
Part II: Impact of Regulations on Firm Performance: Evidence from Enterprise Surveys on <i>de facto</i> Measures of Regulations	49
Introduction	50
Data: Enterprise Surveys	51
I. How large a gap is there between de facto and de jure measures of regulations?	51
II. Can regulations help explain firm outcomes?	56
Conclusion	61
References	62
Part III: Case Studies	63
Overview of Case Studies	64
The 2005 Company Law of China	67
Korean Customs and Border-Related Trade Reforms	81
Reform of the Real Estate Industry in Malaysia	98
Business Registration Reform in Mexico	120
Peru's Secured Transactions Reform: Bringing More Credit to the Private Sector?	130
Credit Reporting Systems – A Case Study of the Philippines	143
Tax Administration Reform in Thailand	159
Land Titling Reforms in Vietnam	180



## The Ease of Doing Business in APEC: The Impact of Regulatory Reforms

### *Preface*

This report was prepared by the World Bank at the request of the Ministry of Trade and Industry of the Republic of Singapore on behalf of the Economic Committee of APEC. The principal authors are Deepak Bhattasali, Mary C. Hallward-Driemeier, and Yue Li<sup>1</sup>.

This report is in three parts. We have taken a number of approaches to address the issue of the impact of regulatory reforms. Part I looks at cross-economy variation, sector variation within an economy at a point in time, and aggregate variation within economies over time, using the *Doing Business* indicators that are produced annually by the World Bank Group. Part II uses firm-level data from the World Bank's detailed Enterprise Surveys, looking at issues of enforcement and interactions of regulations with other dimensions of the business environment. Part III contains eight in-depth case studies to examine the significant factors shaping individual reform efforts.

The case studies of regulatory reform in eight APEC economies are based on inputs provided by experts on each of the economies. They include: Hongbin Cai (China), Junsok Yang (Korea), Mahani Zainal Abidin, Izzatina Aziz, Steven Wong and Terence Too (Malaysia), Miriam Bruhn (Mexico), Raha Shahidsaless (Peru), Marjo Elevado (Philippines), Cheanchom Tongjen and Kirida Bhaopichitr (Thailand), and Vo Dang Hung (Viet Nam).

We would like to thank Christopher Tan and Wei Yang Cheong of the Ministry of Trade and Industry of the Republic of Singapore and participants in two meetings organized by the APEC Economic Committee (in Peru and Singapore) for helpful comments on earlier versions of these reports.

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## The Ease of Doing Business in APEC: The Impact of Regulatory Reforms<sup>1</sup>

### *Executive Summary*

The business environment plays a central role in promoting national competitiveness which, in turn, underpins rapid and sustained economic growth. By participating actively in the global economy, APEC economies have benefited from trade, capital flows, and transfers of knowledge to hone their competitiveness, promote employment and raise incomes. There is great diversity among the economies of this group, but all of them have undertaken significant regulatory reform to build stronger market institutions, improve government services, and make it easier to do business in their territories.

This study has three aims: (i) to measure the impact of formal regulations and regulatory changes on aggregate economic outcomes; (ii) to assess the impact of regulatory enforcement across locations and firms; and (iii) to draw lessons from eight economy case studies by evaluating those dimensions of reforms that lie beyond narrowly defined quantitative indicators. While the first two parts of this study mine information from World Bank databases, chiefly the Doing Business indicators and Enterprise Surveys, the third draws upon background reports by knowledgeable experts from the covered economies. The case studies facilitate a discussion of the quality of reform, supplementing the simple counts of reductions in the number of procedures and the costs associated with them.

### *How does the formal regulatory environment affect aggregate economic outcomes?*

Using the Doing Business indicators, which benchmark ten areas of regulation across time, the first finding is that the ranking of economies correlates well with investment, business entry (a proxy for competition), and employment.<sup>2</sup> Causality is difficult to establish, for several technical reasons. However, the finding, for example, that the rate at which new firms are created is associated positively with how quickly firms can be established in formal regulatory environments provides a powerful rationale for some of the reforms we see in APEC economies. Business formation, global integration, and finance are three areas where much of the regulatory effort has focused. There is also some evidence to suggest that reducing delays in the enforcement of contracts can stimulate the growth of investment, while easier entry regulations for firms and greater flexibility in recruitment and layoff rules increase the private sector's access to finance from formal financial institutions.

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<sup>1</sup> This study is a product of the World Bank, requested by the Ministry of Trade and Industry of the Republic of Singapore on behalf of the Economic Committee of APEC. The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent.

<sup>2</sup> The ten areas covered are: starting a business; transferring property; dealing with construction permits; accessing credit; employing workers; enforcing contracts; protecting investors; trading across borders; paying taxes; and closing a business. The data counts the number of procedures and the time and costs of compliance, relying in inputs from a small number of professionals in each area. The coverage now extends to 181 economies, with six years of data for most. See Doing Business 2008, World Bank, Washington DC and [www.doingbusiness.org](http://www.doingbusiness.org)

Significantly, for many sets of “improvements” in regulatory reform indicators—for example, expanding credit information—outcomes are better in economies where overall governance (the control of corruption) is better. A general observation about this part of the assessment is that interactions among different regulatory clusters need to be taken into account, and that there may be other unobserved characteristics that could account for observed economic outcomes. The link between changes in outcomes and regulatory reform is complex, and needs to be tested rigorously.

### ***Do gaps between de jure and de facto regulations matter?***

While *Doing Business* captures data on the formal regulatory requirements faced by firms, the Enterprise Surveys provide detailed statistics on the actual experiences of firms.<sup>3</sup> By combining the information from both sources, it is possible to gauge the importance of enforcement and the broader governance environment. Specifically, the analysis shows that consistency in enforcement is very strongly associated with higher economic growth. Similarly, although firms spend more time dealing with government officials in economies where regulatory burdens are higher, regulations as well as interactions with officials can be beneficial to growth when the rule of law is stronger. This is also true of other measures of the condition of the business environment, for example, access to finance. More procedures are not always considered to be harmful.

However, there is great variation in enforcement across and within individual economies and across different types of firms, which translates into sizeable differences in the economic outcomes from regulatory reform. Regulations, taxation, and governance are the most significant factors affecting firm performance in middle income economies. For low income economies, the availability of adequate and uninterrupted electricity supplies and access to finance are the top reported constraints. High income economies report much lower levels of constraints overall, although the regulatory framework seems to be the most binding.

### ***Can we learn useful lessons from the in-depth case studies of regulatory reform?***

The two previous sections showed that both formal regulations and the enforcement of those regulations determine the effectiveness of regulatory reforms in achieving better economic results. But, analyses that are limited to quantifiable indicators may not tell the whole story. Gaps in the quantitative analysis of these two factors can be filled by case studies that describe the political and institutional context in which they operate. Toward this end, the study concludes with case studies of regulatory changes in eight APEC economies.<sup>4</sup>

For low- and middle-income economies, the desire to improve national competitiveness in an increasingly integrated world is a prime motive for initiating regulatory reforms. For economies in transition from one system to another—for example, China and Vietnam—national leaders have grasped the need for root-and-branch regulatory change. However,

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<sup>3</sup> The data cover over 100 economies, and are based on interviews with more than 70,000 entrepreneurs and senior managers of firms of varying size, sector of operation, and ownership. They include subjective and objective measures of the business environment.

<sup>4</sup> The 2005 Company Law in China; Customs and Border-Related Reforms in Korea; Real Estate Industry Reforms in Malaysia; Business Registration in Mexico; Secured Transactions in Peru; Credit Reporting Systems in The Philippines; Tax Administration in Thailand; and Land Titling in Vietnam.

in all the cases studied, complementary reforms in other parts of the economy were important in supporting successful regulatory change. For example, when policymakers embed regulatory reform within broader reforms of public administration, they increase the probability of success. At the same time, however, changing the mindset of officials turns out to be the most difficult challenge of a public administration reform, especially moving public agencies toward a service orientation. Moreover, the alignment of incentives with goals requires simultaneous action on several fronts, including information, education and communication programs on top of changes in remuneration. The use of IT has proven to be very effective in addressing governance issues, chiefly by permitting the transparent and parallel processing of transactions and reducing the scale of abusive bureaucratic intervention. Finally, extensive and continual consultation with all affected parties, backed up by a systematic monitoring and evaluation mechanism, help make regulatory reforms effective, yet flexible enough to cope with changing needs.



# The Ease of Doing Business in APEC: The Impact of Regulatory Reforms

## Part I: Impact on Aggregate Economic Outcomes Evidence from Doing Business Data\*

**Abstract:** This paper uses several approaches to examine the relationship between measures of regulations and regulatory reforms with economic outcomes (growth, investment, firm entry, unemployment). Doing Business indicators are analyzed across economies at a point in time, across sectors within economies, and within economies over time. The relationships between the Doing Business indicators and economic outcomes are strongest looking at cross-economy correlations. Looking across sectors within an economy also indicates that sectors more exposed to certain regulations are indeed affected by them relatively more. Looking over time, those with weaker initial indicators have generally been more likely to introduce reforms. There is some evidence that changes in indicators are associated with higher rates of investment, firm entry and lower unemployment, particularly when allowing for variations across economies and over time. However, when applying the more stringent test of looking at the effects of reforms *within* economies over time, the relationship is no longer robust for most of the indicators. Allowing the impact to vary by broader measures of institutional quality does provide additional insights, with the impact of reforms being somewhat more significant in better-governed economies. A more stringent test, the panel estimates, are hard to estimate precisely given the relatively short period covered by the data, and will be worth reexamining as the data series expand.

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## ***Introduction***

People respond to incentives. For entrepreneurs and managers, regulations help define their incentives and shape how they will run their businesses. It is not only the requirements and prohibitions themselves that matter. What can also have an impact is how easy or burdensome it is to meet these requirements. For example, registration is a first step in setting up a business—but it can take 116 days in Brunei yet only 4 days in Singapore. Enforcing a contract can take 842 days in the Philippines, four times longer than in Hong Kong (China) or New Zealand. The work here examines how regulatory requirements and the red tape associated with meeting them affects important firm decisions—whether to invest, hire new workers or expand.

Regulations are generally justified as an important way that governments can serve the public interest and address externalities or market failures. Indeed, there are legitimate and important functions fulfilled by regulations. However, regulations can also carry costs in terms of delays or expenses needed to meet requirements that too often have little bearing on the rationale of the regulation. So the issue is not that regulations per se need to be minimized, but rather the red tape that itself makes no contribution to public welfare should be reduced. The indicators used here to measure regulation capture a mix of the quality of the regulation with measures of red tape.<sup>6</sup> In evaluating any individual case for reform, the content of the measures needs careful scrutiny.<sup>7</sup> In an aggregated analysis such as this, it is not possible to do so, so it is important to keep in mind what the indicators used do and do not capture.

Attention to the impact of regulations – and to regulatory reforms – has grown in recent years. Recent findings in the growth literature have put renewed focus on the role of institutions. Empirically, larger changes in regulatory regimes, e.g. deregulation, privatization, dismantling import substitution regimes, have shown that reforms can have significant impacts (e.g. Nicoletti and Scarpetta, 2003; Alesina et al., 2003).

This greater interest in the impact of regulations also reflects a growing concern on the part of law makers on the competitiveness of their economy in an increasingly globalized economy. Some of it also stems from greater information. The Doing Business project is contributing to this effort by shining a spotlight on indicators of regulatory burdens, providing a tool to benchmark economies and to monitor changes over time. For ten areas of regulation, including construction permits<sup>8</sup>, obtaining credit, hiring and firing workers, and closing a business, the project measures the number of procedures and the official time and costs of compliance. For a tightly specified hypothetical firm, it records how long it should take and how much it should cost to complete given transactions if the firm complies with all the requirements and the government completes its processes within the stated guidelines. This methodology provides a relatively cost-effective and standardized way of making comparisons across locations and over time.

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<sup>6</sup> The measures that are indices have more of a focus on whether particular substantive elements are included, closer to a measure of quality, (e.g. investor protection) than those that simply indicate the number of procedures and the time of compliance, without regard to the actual rights or safeguards within the procedures, (e.g. time to register property or a business).

<sup>7</sup> This is the rationale for including 8 case studies of individual reform initiatives in this broader project.

<sup>8</sup> The area is labeled as licensing in previous versions of the database.

In its own publications, Doing Business emphasizes the correlations between higher delays and greater costs of compliance with higher unemployment, lower investment, greater informality and weaker governance. However, the associations do not necessarily have a causal interpretation. It could be that an economy's level of development or the dynamism of its private sector affect the types of regulations that get adopted. Or, there can be important economy characteristics that are not controlled for that may confound the results, possibly leading to an overestimation of the importance of measures of regulations.

This study extends the analysis of how regulations and regulatory reforms affect economic performances on two dimensions, using two different methodologies that can address the potential effects of unobserved economy effects. Rather than looking at correlations in a simple cross-economy fashion, this looks at 1) whether there are greater effects *within an economy* in those sectors expected to be most exposed or sensitive to regulatory burdens, and 2) whether *changes* in regulations, i.e. reforms, are associated with improved outcomes over time.

Regulatory burdens may be more restrictive in some industries than in others, depending on sector-specific characteristics. The one we highlight here involves access to external finance. We find that regulatory burdens reduce capital investment in industries with high dependence on external finance disproportionately more. For instance, take an industry like machinery production that is at the 75<sup>th</sup> percentile of external finance dependence and food processing that is at the 25<sup>th</sup> percentile of external finance dependence. The results suggest that the difference in investment between machinery production and food processing is about 21% higher in Singapore or Thailand (which is at the 75<sup>th</sup> percentile in terms of quality of credit information) than in Cambodia or Laos (which is at the 25<sup>th</sup> percentile in terms of credit information).

The second approach takes advantage of the growing time dimension in the Doing Business database. Doing Business indicators are now available for six years, 2003-2008, with annual updates published in September.<sup>9</sup> The study examines the impact of changes in Doing Business Indicators over time within economies. This part of the analysis takes two steps. First, we look at some stylized facts of reforms. Within APEC, there are some improvements in every area. Economies take action in as many as seven areas and, in several cases the changes are more than 100 percent. Among all economies, there is some evidence that economies with more initial red tape tend to reform. Initial growth rate, political stability and other aggregate conditions also matters. Economies tend to be reformists--streamlining regulations and procedures over time, but not necessarily simultaneously.

Then, to capture the impact of reforms, we relate multiple-year of Doing Business indicators with aggregate economic outcomes, with a focus on investment, access to credit, firm entry and unemployment. Taking advantage of the panel dimension of the data, we conduct fixed-effect estimation to see whether changes within economies matters. This way, all time-invariant economy characteristics are controlled for. Several macroeconomic and political characteristics are also been taken into account. Our work still cannot prove causation, but it can show whether the associations are significant and robust. In fact, these tests are relatively stringent. Any results will be driven solely by variations within

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<sup>9</sup> Note: with an additional round of data available in September, the next draft of this work will incorporate the expanded dataset. The longer time series should help address the weak power of some of the estimates.

economies over time – not by the cross-economy variations already demonstrated to be significant.

The panel regressions show there is little evidence that reforms matter for all economies. However, broader economy characteristics affect the impact of regulatory reforms, including control of corruption, income level and labor market rigidity. For instance, reforming credit information system and enforcement contract tend to stimulate investment and increase credit in economies with better governance. Reforms in business registration, contract enforcement, credit information, and labor market regulations are positively associated with economic performance mostly in high and upper-middle income economies.

These results highlight two points and motivate the second part of this study. First, in looking at the drivers of firm performance, regulations are an important part of the story. Clearly, they are not the whole story. Many other factors can affect firms' incentives and their abilities to conduct their business. Political stability, violence, the quality of infrastructure, available natural endowments, and access to markets are other significant factors. Indeed, the analysis here confirms their importance. But controlling for them, there is still an important impact of regulatory reforms.

Second, enforcement and the broader institutional environment matter. What is important is not simply what is on the books, but what is actually experienced on the ground. In practice, delays may actually be longer than what is stipulated in the regulation. Third parties may be available to simplify the process. Or additional payments may be able to speed up transactions. There is also ample evidence that firms do not comply with all requirements. If there is little correspondence to the de jure requirements and their de facto implementation, then changing the official requirements may have little impact. This issue is taken up more directly in the next paper, but here it should be noted that this gap is likely to make it harder to find significant relations between reforms and impact. To the extent that significant results are found, it provides additional support for the importance of these changes. Also, closing loopholes and reducing the number and time of interactions with officials can itself make enforcement easier and more consistent – not only closing the gap, but making the government more credible and reducing uncertainty facing firms on what the regulatory burden is actually likely to be.

The second part of the study will look more closely at issues of enforcement and put the effects of regulations into a broader context of business environment conditions affect firm decisions. This first part of the study is organized as follows. It begins with describing Doing Business Indicators and related literature on the impact of regulations. In the second section, it first describes the general patterns between regulations and aggregate economic outcomes. It then examines how regulatory burdens affect industry investment applying the Difference-in-Difference approach. In the fourth section, the paper presents some stylized facts on regulatory reforms. As a second approach, it then looks at how changes in indicators are associated with aggregate outcomes. The paper also checks whether broader economy characteristics affects these relationships. The final section concludes with remarks and policy implications.



## ***Doing Business and the Impact of Regulatory Burdens and Reforms***

### ***Doing Business Database<sup>10</sup>***

The Doing Business indicators were first published in 2003 with five indicators of regulations. The number of regulatory areas covered expanded in 2004 and again in 2005 so that there are now 10 areas included. Economy coverage has also expanded to cover 181 economies. The aim of the project was to provide comparable indicators that would facilitate benchmarking and monitoring of progress over time. The methodology aims to do this in a cost-effective manner. For each of the regulatory areas, the indicators measure the number of procedures, time and costs that a well-specified hypothetical firm (e.g. domestically owned firm with 50 employees producing for the local market) would face to fully comply with all the requirements associated with a transaction (e.g. registering property or enforcing a contract). Respondents are generally lawyers or accountants who provide their measures based on their reading of the formal regulatory requirements. As the methodology tries to avoid subjective assessments and given the focus on de jure measures, there is no need to canvas large, randomly selected samples of firms.<sup>11</sup>

In assessing the impact of the Doing Business indicators (DB), one issue is how well they capture conditions actually facing private sector actors. At the aggregate level, there are alternative measures that attempt to capture regulatory quality or government efficiency such as the Worldwide Governance Indicators, or more specific areas of regulations in the Global Competitiveness Report. What is telling is that the correlations between these indicators and DB are generally pretty good – but only in richer economies or those with better control of corruption. In lower income economies, the correlation is not significant (Kraay et al). A similar test is done using firm-level data from 100 economies. It finds that gaps between de jure and de facto regulations can be explained by differences in governance (Aterido et al.). This raises the hypothesis that, in testing for the impact of regulatory changes, it could be important to look at the broader institutional environment and whether the impact of reforms differs by the quality of institutions. This is addressed at the end of this chapter.

### ***Impact of Regulatory Burdens and Reforms***

The recent literature trying to understand factors driving growth have focused on the role of institutions. Work by Acemoglu, Johnson and Robinson (2001), building on insights of Engerman and Sokoloff, argued that institutions affected economies' long-term growth. This set off a debate about which institutions matter and the extent to which they can be changed over time or influenced by policy makers. Rodrik in particular has expressed skepticism about understanding what is in the black box of 'institutions', doubting that any one-size-fits-all approach will be successful in any case. A number of authors have looked to see which broad areas within institutions matter. Johnson, MacMillan and Woodruff (2002) looked at the relative importance of finance and property rights, finding the latter to

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<sup>10</sup> For information on other data used please see Data Appendix.

<sup>11</sup> The Doing Business project has recently been evaluated by the Independent Evaluation Group. It takes seriously a number of concerns raised with the project. It does recommend greater transparency in the collection and revision of data, expanding the number of respondents per indicator (currently an average of 1.7 respondents per economy-indicator) and moderating the claims of the data. However, it finds little evidence that economies are systematically trying to game the system, making paper changes to improve their ranking that have little impact on the ground.

be relatively more important in explaining firm's investment rates. Other papers examine a particular dimension, e.g. a particular regulatory area and see if differences across economy outcomes can be explained by variations in these measures. For example, in the case of labor regulations, a number of papers find important effects on entry, job creation and growth, Botero et al. (2003), Besley and Burgess (2004), Almeida and Carneiro (2005), Haltiwanger, Scarpetta and Schweiger (2006), Petrin and Sivadasan (2006) and Autor, Kerr and Kugler (2007). Other papers examine the effect of regulations on firm entry, growth and informality: Djankov et al (2003); Loayza, Oviedo and Servén, 2005. Others look at regulatory developments in other areas, such as finance, Beck, Demirgüç-Kunt and Maksimovic (2005), Demirgüç-Kunt and Maksimovic (1998), Galindo and Micco (2005). Almost all the studies focus on cross-economy variation.

Within this literature, there are a number of papers that look at individual Doing Business indicators and that relay them to outcomes, relying on variation across economies (Djankov et al.(2002); Klapper and Rajan (2004) ). There is indeed an impressive correlation between many of the indicators and outcomes of interest. Thus, measures of higher regulatory burden are associated with higher rates of unemployment, higher incidence of corruption and informality. And burdens are often highest among the poorest economies; economies in Africa are heavily represented in the bottom end of the distribution of indicators.

Djankov, McLeish and Ramalho (2006) look at the effects of the DB Index on growth. They look at growth over the period 1993-2002. They regress this on the DB index in 2005. Implicitly they have to assume the ranking in 2005 would reflect conditions at the beginning of the period if they want to make their argument that there is a causal relationship. They instrument for the DB index using legal origin, absolute latitude, initial GDP, religion and language and find large effects; improving from the 4<sup>th</sup> to the 1<sup>st</sup> quartile would raise GDP per capita growth by 2.3 percentage points. Erikson, in expanding the data to cover an additional 40 economies and using the 2006 ranking, while finding results are robust, but with a lower level of significance and with the magnitude of the effects cut in half.

These papers are almost all looking at longer run relationships, that there is a link between the quality of institutions or regulations and overall per capita income. However, the correlation across economies does not necessarily indicate the relationship is a causal one. There could be other economy characteristics that are not controlled for that are driving the result. Or the relationship could go in the other way, with regulatory improvements introduced in good economic times. Pointing out significant associations is still useful, but care needs to be made in the extent of the claims made.

Another approach is to follow a difference-in-differences method developed by Rajan and Zingales (1998). The underlying idea behind this method is that if a certain condition is restrictive for business development or growth, industries that are extremely sensitive to that condition should be relatively more affected than others, and be relatively less developed in economies where this issue is more restrictive. Rajan and Zingales (1998)) show that industries that inherently require a high share of external financing grow faster in financially developed markets. Beck et al. (2004) find that industries with higher shares of small firms grow disproportionately faster with greater financial development using the US industry size distribution as the 'natural' benchmark. Klapper, Laeven and Rajan (2004) show that industries in which, due to structural or technological reasons firm entry is more

important, exhibit less growth in economies with important restrictions to firm entry. Finally, Micco and Pagés (2006) show that industries that are inherently more volatile create fewer jobs and are less developed in economies with very restrictive hiring and firing regulations.

There are two advantages associated with this approach. It allows for the impact of regulations to vary within an economy. Second, by looking at this variation across sectors, one can control for economy fixed-effects. This reduces the potential of biasing the results due to omitting a significant control variable. Two Doing Business Indicators, starting a business and employing workers, have been used to look at entry and labor turnover. But the wider set of regulations has not been systematically examined using this approach. Combining Doing Business database with the newly available UNIDO INSTATA4 database, we use the methodology to examine if there are effects in investment.

The existing studies discussed above have all relied on cross-sectional variation, either between or in some cases within, economies. They have not examined whether changes in the index have any effects. A more stringent test of the hypothesis that reforming regulations has real effects is to look at how changes in the indicators are associated with changes in outcomes. The time series dimension of Doing Business Indicators is not as long as desirable, but it should provide enough variation to indicate whether there are significant associations over time. Following this thought, we also conduct economy fixed-effects analysis using this new panel dataset on regulations. The one paper that does use a similar approach is Eifert (2008).<sup>12</sup> He finds some evidence supporting the positive impact of regulation reforms for relatively well managed or poor economies. This analysis differs in two respects. First, Eifert largely uses measures of stability or deviations from equilibrium in the selection of economy controls (e.g. current account balance, risk indicators, output gap etc.). Here, we use variables that control for economy characteristics in levels. The inclusion of fixed effects has the effect of looking at changes in these controls. Thus, if one used the GDP gap between actual and potential GDP, the variation then comes from changes in these deviations, whereas controlling for GDP has an interpretation of the impact of growth. Second, as a consequence of selecting measures of economy characteristics in levels rather than gaps, data is available to be able to include additional economies in the analysis.

## ***Evidence on the Impact of Regulatory Burdens***

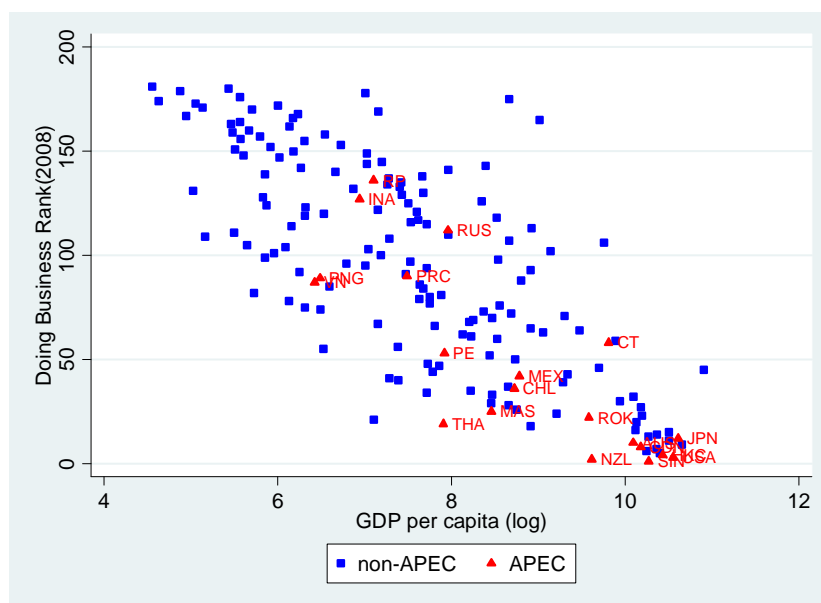
### ***Depicting Cross-Economy Patterns***

Before turning to sectoral variations, it is worth looking at some of the cross-economy patterns in the data. One thing to note is that the number of procedures and times needed to complete transactions are often longest in poorer economies (Figure 1). Indeed, Sub-Saharan Africa as a region has the longest times needed to get things done. It does raise the question of which way causation is running; do greater delays slow growth or do higher incomes and growth raise demands for fewer delays? Plausible arguments can be made in both cases. For the empirical work presented here, GDP per capita is controlled for either explicitly or using economy fix-effects, so that other patterns can be analyzed abstracting from the relationship with income level.

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<sup>12</sup> Eifert hypothesizes that should be more impact associated with those measures that affect the variable costs of firms than fixed costs, although the latter might affect entry. He does not find much support in the data, but recognizes this may stem from the relatively short time-dimension of the data so far available.

Figure 1 - Correlation between an Economy's DB Rank and Its Income



Source: *Doing Business*

We look at four outcome variables of interest: investment, access to credit, firm entry rates and unemployment.<sup>13</sup> These are all variables that reflect decisions by private sector actors and that should be sensitive to changes in regulatory incentives. The first notable feature of the data is that, there is a clear cross-economy correlation between these variables and *Doing Business* indicators (Figures 2-5). In particular, investment rates are higher and there is more access to credit by private sectors in economies with better aggregate DB rankings. Firm entry rate is positively associated with how quickly an enterprise can be registered and unemployment rate is negatively related to how rigid the labor market is. The significance of these effects, however, depends on the performance measures. Investment rate and unemployment rates tend to be weakly associated with cross-economy differences in DB indicators. Finally, the correlations do not necessarily imply a causal relationship. There can be many other important factors in an economy that are influencing the outcomes and that are not controlled for in these scatter plots. It makes it difficult to judge the significance and robustness of these correlations.

<sup>13</sup> Growth itself is another outcome. However, changes in growth are considerably less persistent than DB indicators. While there is a correlation in the cross-section (see discussion in text), there is not a significant one in the panel data.

Figure 2 - Correlation between Investment and DB Ranking

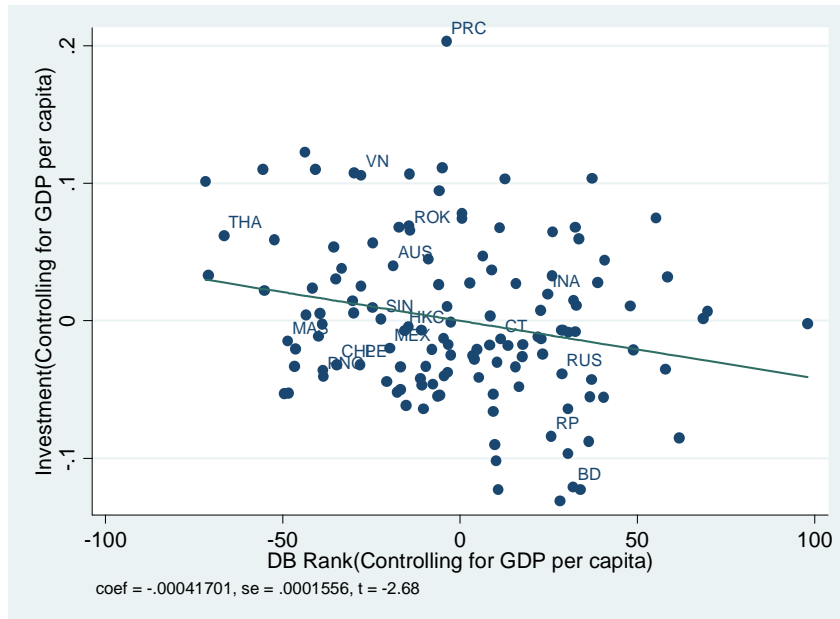


Figure 3 - Correlation between Credit to Private Sector and DB Ranking

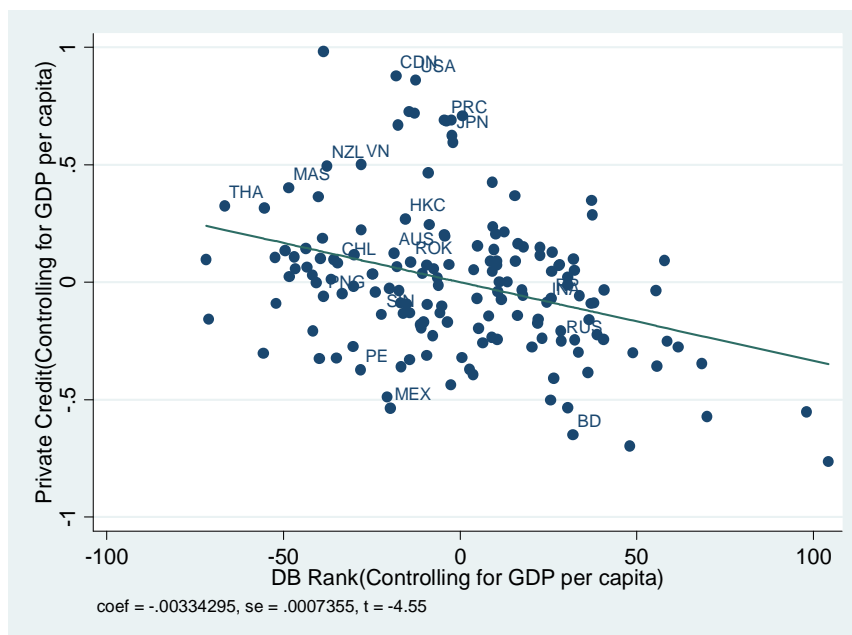


Figure 4 - Correlation between Firm Entry Rate and Time to Register A Business

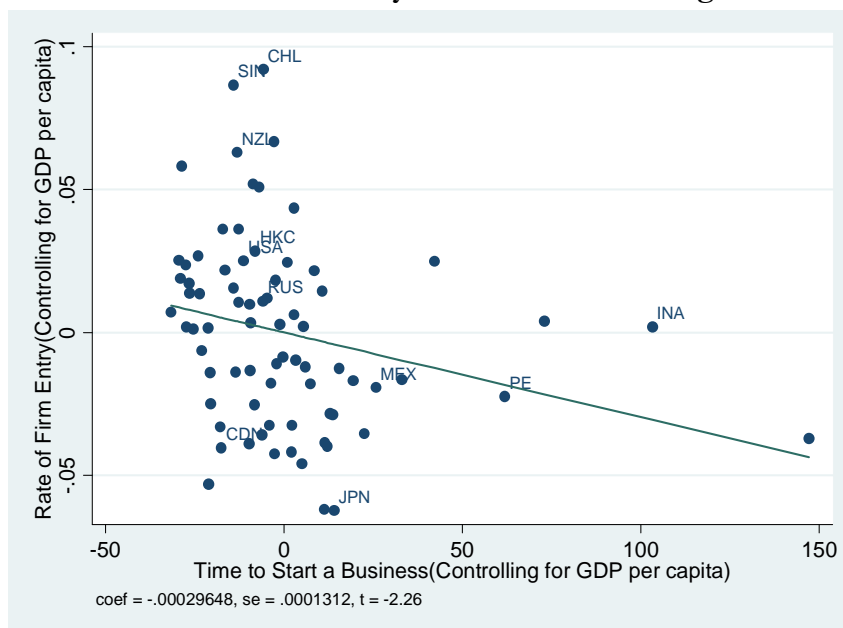
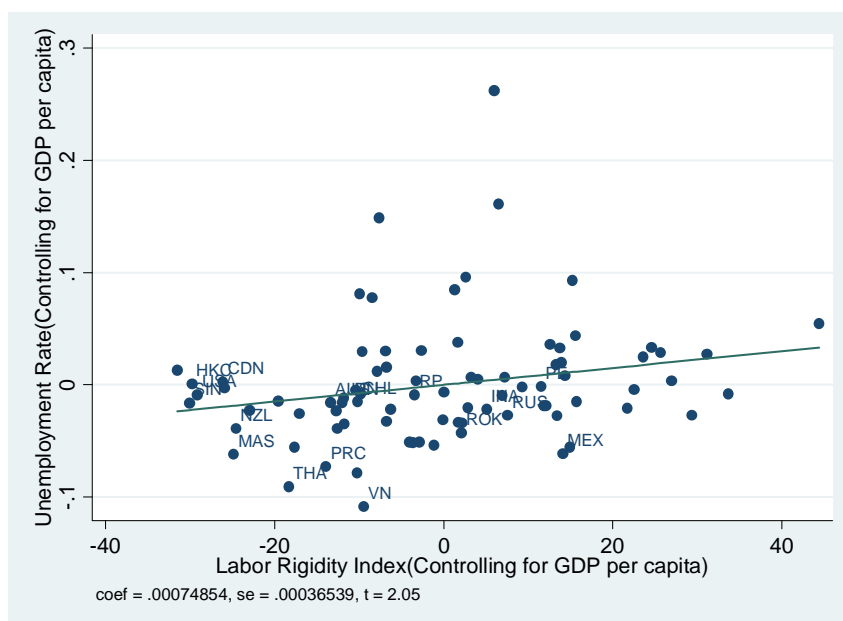


Figure 5 - Correlation between Unemployment Rates and Labor Rigidity Index



One option is to use instrument variables for the Doing Business indicators. The most common approach in the literature is an economy's legal origin. Using these as instruments confirms the significance of the results on firm entry and unemployment, although the results are somewhat weaker for investment and credit. One challenge in interpreting the instrumented results is that the instruments would be broadly consistent with a number of measures of institutions, making it harder to know the contribution of specific Doing Business measures. The instruments are also capturing features of an economy that are largely time invariant, and so would be poor candidates for explaining the many changes we see in the Doing Business indicators themselves.

### ***Capturing the Impact of Regulatory Burdens on Industry Investment***

The patterns depicted above provide some evidence on how simpler, more efficient and cost effective regulations are associated with better economic performance. In this section, we take the cross-economy analyses a step further and look for cross-industry differences in the impact of regulations.<sup>14</sup>

#### ***Why may impact differ across industries?***

Red tape may be more restrictive in some industries than in others, depending on sector-specific characteristics. Following a difference-in-differences method first developed by Rajan and Zingales (1998), Micco and Pages (2004) demonstrates that job security regulations slow down gross job flows disproportionately more in sectors that require higher labor flexibility. Taking the same method, Klapper et al. (2006) finds that costly regulations hamper the creation of new firms, especially in industries with higher natural propensity for entry.

These studies analyze the effect of different aspects of the business environment at the economy-industry level. The underlying idea behind this method is that if a certain condition is restrictive for business development or growth, industries that are extremely sensitive to that condition should be relatively more affected than others, and be relatively less developed in economies where this issue is more restrictive.

Here, we are interested in exploring whether the investments of sectors that are more dependent on external finance are more responsive to regulations. We would assume the regulations that will be most significant in this regard are those directly affecting access to credit. For instance, when the scope of credit information is limited and the quality of information is poor, the cost of external credit will be high. Firms in industries that are more dependent on external finance could then be relatively more likely than firms in other sectors to find themselves without sufficient funds to expand their businesses. In other words, firms that generally need external finance will likely invest at lower rates than those with less need for external finance – particularly in economies that have weaker indicators of access to credit.

However, it is also possible that other regulatory areas could matter too. Starting up a business, investing, hiring workers and enforcing contracts are costly – and can be made more so by regulations. We thus also test whether investment in sectors more reliant on external finance is more sensitive to the broader set of regulations.

#### ***Are there differences? How large?***

We ask whether industries that depend more on external finance invest disproportionately less in economies where regulatory burden is higher. We use industry investment data available from the UNIDO INDSTAT4, focusing on the years 2003 and 2004 as those are the most complete years for which there is corresponding Doing Business data.<sup>15</sup>

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<sup>14</sup> This section draws on Hallward-Driemeier and Li (2008).

<sup>15</sup> Following the Difference-in-Difference methodology, we interact the Doing Business indicators with a measure on industry dependence on external finance from Rajan and Zingales (1998). We include a set of economy fixed-effects to absorb economy characteristics, for instance, level of income, political stability, and access to foreign markets, which tend to affect all industries equally. It significantly mitigates the omitted

We find that regulatory burden reduces capital investment in industries with high dependence on external finance disproportionately more. We first examine the impact of one DB indicator at a time. Table 1 presents the results. Regulatory burden on six different aspects, including starting a business, contracting, closing a business, labor market, obtaining credit, and registering property<sup>16</sup>, all hamper investment. For instance, investment is relatively higher in sectors that rely more on external finance in economies with shorter business start-up compliance time, simpler property registration procedures, and more flexible labor regulations.

As a next step, we include multiple DB indicators in the analysis<sup>17</sup>. The estimates are reported in Table 2. The coverage of some of the indicators is closely related. Economies that have better practice in one regulation area tend to perform well in other areas. There are potential collinearity problems. By including multiple indicators as covariates, we can evaluate the impact more accurately. The results suggest that the scope and quality of accessible credit information does affect investment decisions. In addition, the complexity of contract enforcement procedures, the time of compliance for closing a business, and the restrictions on hiring workers do too. Investment is relatively higher in sectors depending more on external finance in economies where credit information is better, contract enforcement is simpler, the time of compliance for closing a business is shorter, and labor hiring regulations are more flexible.

To be more precise, take an industry like machinery production that is at the 75<sup>th</sup> percentile of external finance dependence and food processing that is at the 25<sup>th</sup> percentile of external finance dependence. The coefficients estimate from column 2 of Table 2 suggest that the difference in investment between machinery production and food processing is about 21% higher in Singapore or Thailand (which is at the 75<sup>th</sup> percentile in terms of quality of credit information) than in Cambodia or Laos (which is at the 25<sup>th</sup> percentile in terms of credit information). Figure 6 illustrate the same idea for the differences between investment in 90<sup>th</sup> percentile industry and 10<sup>th</sup> percentile industry in terms of external finance when moving from 90<sup>th</sup> percentile economy to 10<sup>th</sup> percentile economy. It also presents the impact when looking at differences in regulations of contract enforcement and labor hiring.

The approach, however, is subject to two limitations. First, there may be some economy characteristics that are not controlled for that affect the investment of the industries which rely on external finance disproportionately more. The quality of financial services is one example. Second, due to its cross-section nature, the approach does not look at changes in indicators within an economy and does not directly provide evidence on the impact of regulatory reforms. We address the issues in the next section.

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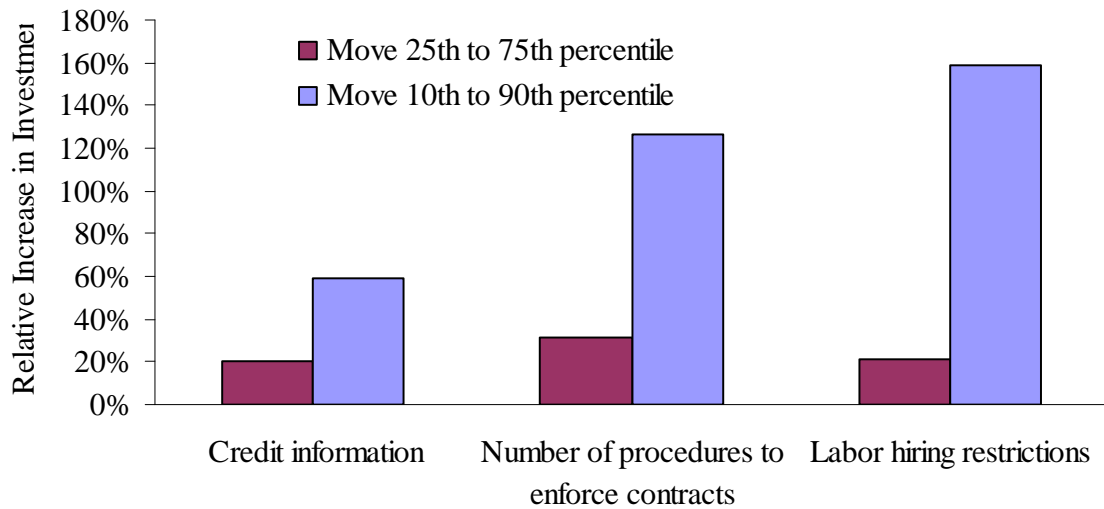
variables problems associated with simple cross-economy studies. We also control for industry share in an economy's total investment and industry fixed-effects.

<sup>16</sup> Other DOB indicators on regulatory burdens began since 2005 when we do not have reliable data on industry performance.

<sup>17</sup> We have tested other combinations of indicators, and find no significant differences.



Figure 6 - Impact of Regulatory Burden on Industry Investment, DB Indicators



Source: Hallward-Driemeier and Li 2008

## *Evidence on the Impact of Regulatory Reforms*

### *Standardized Facts About Regulatory Reforms*

Before turn to evaluate the impact of reforms, we first look at some stylized fact about regulatory reforms reflected by DB indicators.

#### *What's has been done by APEC?*

Within this dataset, a reform is taken as a change in the indicator, usually a reduction in the number of procedures or time taken to complete a transaction. It should be noted that this can be missing changes in areas other than those covered by the indicators, or dimensions within the regulatory area that are not covered. It also generally is silent about the impact on the quality of the economic rights protected by the regulation or of the requirements generated by the reforms. However, it does provide a clear criterion for measuring change across time in a way that is comparable across economies.

Table 3 shows which economies within APEC are the reformers, in what areas they reform and how large are the reforms. An economy is taken as a reformer in an area if the economy introduces a reform in any of the sub-indicators within a regulatory area over the years covered by the indicator. For instance, “starting a business” includes the number of procedures, the time associated with these procedures and minimum capital requirements<sup>18</sup>. It should also be noted that the time covered by each indicator varies: there are 6 years covered for ‘starting a business’, ‘closing a business’, ‘enforcing a contract’, ‘hiring and firing workers’, and ‘accessing credit’. There are 5 years for ‘registering property’ and 4 years for ‘taxes’, ‘construction permits’, ‘trading’, and ‘investor protection’. The largest

<sup>18</sup> DB, in addition, provides information on the cost associated with the regulations. However as they are expressed as a share of GNI, many of the seeming improvements are simply a reflection of growth in the economy over time and so were not included in this exercise.

percentage change of sub-indicators within a regulatory area is reported as the magnitude of the reform.

Indonesia and China have implemented reforms in the most regulatory areas. Both economies introduced reforms in the areas of starting a business, getting credit, taxes, trade and closing a business. In addition, China has reformed in the area of investor protection and Indonesia has in construction permits and labor regulations. In contrast, New Zealand, the United States, Chile and Papua New Guinea only reformed in one area covered by the Doing Business indicators. The magnitude of reforms varies considerable across APEC economies. It is as large as 133 percent as Peru improved the ease to getting credit. When the Philippines reformed its regulation on trading across borders, the change was about 10 percent.

### ***What is being reformed?***

As a next step, we look at the patterns of reform across all economies. Table 4 shows that there are some striking differences across regulatory areas as to which areas are being changed over time. “Starting a business” is clearly the most common area for reform. Part of this stems from the inclusion of this requirement in determining IDA eligibility. It is also an area that is relatively easy to address, with more limited costs to improving requirements and fewer identifiable ‘losers’ from reforms.

Areas with particularly few reforms are the issues of investor protection – although some of this is simply due to the smaller time period for which this has been monitored. Another area of note is labor market regulations. This is certainly an area where the politics of change will be more complicated, with clearly winners and losers from changes. However, this is also a particularly critical regulatory area. Research indicates that the degree of labor market flexibility can be a determinant in whether changes in other areas will be realized or not. For example, Freund et al. found that greater trade openness only contributed to higher growth in economies with more flexible labor markets.

### ***Who is reforming?***

To test if there are systematic patterns in which economies are reforming, Table 5 shows the correlations between reforms and a number of economy characteristics. The dependent variable is whether the economy introduced a reform in any of the sub-indicators over the years covered by the indicators. Here, we focus on the time of compliance when possible as it captures the overall burdensome of a regulation area and is the most reliable sub-indicator.

Are those with the most burdensome red tape more likely to be reforming? The initial level of the indicator is included to test for this. In seven of the eleven areas, there is evidence of this. Initial longer compliance time is associated with higher probability to reform for “starting a business”, “registering a property”, “paying taxes”, “trading across borders”, and “closing a business”. For ‘labor rigidity’, greater initial rigidity is positively associated with the probability of reform. Clearly there are individual exceptions; e.g. Singapore reformed its procedures to start a business and many poorer economies have failed to (yet) implement reforms. But, the overall pattern that those with weaker indicators are more likely to reform is an encouraging one.

We include a dummy for “APEC”. The base probability of reform in each area is only significant in the case of ‘investor rights’, one of the areas with the fewest instances of reform. Otherwise, the broad pattern of who is reforming which indicators appears to be the same within APEC as in other economies.

GDP growth rate and openness to trade are two macroeconomic variables examined. The analysis reveals whether growing economies are more or less likely to be reformers. The results indicate economies with higher initial growth are more likely to be reforming “registering a property”, “accessing credit”, and “investor rights. One hypothesis about trade openness is that economies with more international transactions might feel greater pressure to streamline procedures so as to increase their competitive position. However, the evidence appears to be mixed: the initial share of trade in GDP is positively associated with the probability of reforming in “investor rights” but is negatively related with the probability of reforming in “registering a property” and “trading across borders”.

Another hypothesis is that political stability and governance of an economy matters for regulatory reform. It could be that reforms are achieved in times of greater stability. Or, they could be introduced at times of political change over or even turmoil – or as part of a program to try to reduce turmoil. The indicator used here is the Worldwide Governance Indicator (WGI) on political stability that draws on many outside sources in devising its indicators. Centered on 0 with a standard deviation of 1, higher numbers are associated with greater stability. Our analyses indicate that greater political stability is associated with greater probability to reform in “closing a business” but less probability to reform in “accessing credit”. Three other indicators of WGI are examined to taking into account the impact of governance, namely, “government efficiency”, “rule of law” and “accountability”. Their impact is similar to political stability. What’s worth noting is that stronger rule of law and better accountability is negatively associated with the probability of reforming in labor regulations which reflects the complexity and political sensitivity of the area.

Finally, we ask if economies that reform in one area is likely to reform in other areas during 2003-2008. Do economies tend to be reformists? Table 6 presents the results. There is clearly evidence. Economies are more likely to reduce time of compliance for starting a business if they reduce time for enforcing contracts and closing a business. Economies tend to enact reforms in contract enforcement if they also introduce reforms in labor rigidity and business start-up. Reforms in credit system are likely to happen in economies where close recover rate is reduced. What interesting is that reforms in business closure are less likely in economies where reforms in labor rigidity take place. The two types of reforms may be treated as replacement to each other. Within APEC, there is no particular pattern.

### ***When are reforms more likely?***

We, then, turn to examine whether there are correlations as to the timing of reforms. The first set of analyses look at economic indicators. We choose only the five regulatory areas with longest time series. The top panel of Table 7 reports the results when looking at reform in selected sub-indicator for each of the five areas. In particular there is interest to know if reforms are more likely to be pro-cyclical (reforms are more likely as the economy is growing) or counter-cyclical. We take a linear probability model. The full panel is utilized, with fixed effects controlling for time-invariant economy characteristics. These fixed effects mean that results are based on within economy variations in the controls, i.e.

not on the level of (log) GDP per capita, but rather on changes in the variable over time, i.e. on growth. There is evidence that the timing of reforms is pro-cyclical. For “starting a business” and “employing workers”, reforms are more likely when growth is higher. Reforms are also more likely in “closing a business” and “accessing credit” in APEC economies when growth is higher or inflation rate is higher. The results are mixed for political stability. What is also interesting is that the probability of reforming in “accessing credit” is high when trade level is falling in APEC economies.

Table 8 then looks at whether economies tend to target on individual areas or to streamline regulations and procedures in multiple areas. In other words, is there evidence that reforms are passed as a package? This exercise is similar to the test for reformist economies but to test for actual simultaneous changes, the results are not surprisingly weaker. The two areas that were most likely to be passed together were expanding credit information availability and reforming business registration. However, reforms in business registration and closure are not likely to take place simultaneously. Within APEC, the pattern was slightly different, with starting a business reform more likely to be paired with contract enforcement.

### ***Capturing the Impact of Regulatory Reforms***

#### ***What impact do reforms have on aggregate economic outcomes?***

The next step is to see if changes in the indicators are associated with outcomes of interest. We selected four outcome variables: investment, access to credit, firm entry and unemployment. For unemployment, we also examine two subcategories, female unemployment and youth unemployment as these are two groups that may be most vulnerable to deteriorations in conditions – and possibly stand to gain the most from improvements.

We relate multiple-year of Doing Business indicators with economy aggregate performance. Taking advantage of the panel dimension of the data, we focus on changes within an economy and conduct fixed-effects estimation. These tests are relatively stringent. All time-invariant economy characteristics or those characteristics that can be treated as constant within the five-year time period are controlled for, for instance, factor endowment and geographical characteristics. Other economy controls, including income level, inflation rate, trade openness, political stability, and government efficiency, are also added into the analysis to capture macro-economic conditions, elements of business cycle and political environment.

We conduct the tests using three levels of reform measures. The first uses the actual variation in the Doing Business indicator, choosing one sub-indicator per area. The second is somewhat broader. It uses a dummy variable that takes the value of 1 if any of the sub-indicators improve. Dummies are used for each of the regulatory areas. The third uses the broadest measure of reform. It uses a single dummy variable for reform. It takes the value of 1 if any of the Doing Business sub-indicators improve in that year (taking a cutoff of 10% to avoid classifying as a reform some of the cost measures that vary due to be normalized by GDP per capita).

## i) Selected sub-indicators in each regulatory area

The focus is first on the five regulatory areas that have the longest time series available. They are “starting a business”, “enforcing a contract”, “closing a business”, “accessing credit”, and “employing workers”. For each area, we select a sub-indicator that is relatively reliable and witnesses frequent reforms (Table 3).<sup>19</sup> All sub-indicators are included simultaneously. As the earlier tables show, there is limited collinearity in reforms across regulatory areas. And, the danger of omitted variable bias in looking at each individually reinforces the need to include all areas in the same regression. As the inclusion of the economy fixed effects raises the bar in terms of finding significant results as only variations over time within an economy will identify effects, results are also given when these dummies are excluded. However, there is a danger that important economy characteristics are not included, so these results should be interpreted with caution. Table 9 presents the results.

*Investment:* Without economy fixed-effects, longer time needed to enforce a contract is associated with lower investment rates. However, the significance no longer holds with the inclusion of economy fixed effects.

*Credit to the private sector:* Decreasing labor rigidities and shortening times needed to start a business are associated with increases in the credit extended to the private sector, with only the latter effect significant with economy fixed effects.

*Entry:* Data is only available for a sub-set of economies and a shorter period. Here the findings are somewhat harder to interpret. Greater labor rigidities and increasing times to enforce a contract are associated with increased entry. Only once variation across economies is included does the time to register a business have a negative effect on entry rates.

*Unemployment:* The effects here are weak. No Doing Business indicators are significant in explaining changes in unemployment. Part of this is no doubt due to the fact that unemployment data is not available for the last year of indicators and is missing for more economies. For female unemployment, there is only a link with increasing time to enforce a contract being associated with higher female unemployment – but again, only when including the cross-economy variation, not the time-series variation within economy. For youth unemployment, the variable that is significant (again, only with cross-economy variation included) is credit information; raising credit information is associated with lower youth unemployment.<sup>20</sup>

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<sup>19</sup> The results presented here focus on 'time to complete procedures' as it was the most straightforward to compare across indicators. An alternative, the 'number of procedures' has the difficulty that it mixes together some procedures that are easily met with some that could be quite cumbersome to comply with, i.e. one procedure may not be the same as another. And more simple procedures may not necessarily be more burdensome than fewer complex ones.

It should also be noted, however, that we did test for the importance of other sub-indicators. They did not produce additional significant results, and so we have not included them in the tables presented here.

<sup>20</sup> Adding time trends eliminates many of these results.

- ii) Using dummies for change within any sub-indicator by regulatory area

Does the way to define reform affect the result? Our choice of sub-indicators may miss an important dimension. In order to capture broader changes in regulation, we define a dummy based on improvement in any sub-indicator for each of the above five areas. We conduct similar analyses with all dummies included simultaneously. The results do not provide more evidence on the impact of regulatory reforms. In fact, the results indicate there are no systematic association between reforms and economy economic performance.

- iii) Using an overall dummy if any change in any regulatory area

Does a reforming economy perform better in general? Well-targeted reform and streamlining regulations and procedures across areas may both be beneficial. However, collinearity may keep us from accurately evaluate the impact of reform in one area. There are also other five areas that have fewer time series available. To check these questions, we define another dummy based on improvement in any sub-indicator of any area. Using this dummy to represent a reform economy, we conduct both fixed-effects analysis and analysis without fixed effects. We do not find more evidence associating reform with economic outcomes.

### ***Does the impact vary by broader economy characteristics?***

The impact of reforms may vary systematically across economies. Enforcement is an important linkage between regulation and impact. What matters is not simply what is on the books, but what is actually experienced on the ground. In practice, delays may actually be longer than what is stipulated in the regulation. Third parties may be available to simplify the process. Or, additional payments may be able to speed up transactions. If there is little correspondence to the de jure requirements and their de facto implementation, then changing the official requirements may have little impact. In this section, we consider three economy characteristics that may affect enforcement. A dummy is defined for each economy characteristics. We interact each DB sub-indicator with the dummy to examine differences in effects. The results are report in Table 10.

- i) Selected sub-indicators in each regulatory area

*Control of Corruption:* One possibility is that reforms will have more impact in economies with better control of corruption<sup>21</sup>. In such economies, the gap between the formal requirements and their actual implementation is likely to be smaller. Thus reforms are more likely to affect the experiences of firms and thus have a bigger impact on their incentives and behavior. For investment, the time to register a business is negatively associated with investment. What is interesting is the result on 'credit information'. More credit information expands overall credit to the private sector – but only in economies with better control of corruption. The effect is actually negative for economies with lower than average control of corruption. One interpretation is that the greater transparency could be improving the allocation of credit, denying credit to those that are not-credit worthy but political connected in more corrupt economies.

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<sup>21</sup> 'Control of corruption' was measured using the World Bank Governance Indicators. The index is normalized with an average at zero. The sample is divided using this average value across all economies; those with 'strong control of corruption' are those economies with an above average score for this Governance Indicator.

*Income Level:* Higher income economies may have better resources to enforce and monitor reforms. On the other hand, lower income economies may face more political pressure to have effective reforms. We classify high and upper-middle income economies as rich economies and the rest as poor economies. Our results support the first hypothesis. The positive impact of expanding credit information on raising investment is only found in higher income economies; the effect is again negative for lower income economies. For access to credit, there are additional patterns. Lowering the time to register a business and lowering labor rigidities are both associated with raising access to credit – but only in higher income economies.

*Labor market flexibility:* Following on Freund’s finding that labor rigidity can affect the efficacy of other reforms, a dummy was created whether an economy was above or below the median labor rigidity index. The one pattern was the same finding that expanding credit information can lower investment, but only in economies with more rigid labor markets.

ii) Using dummies for change within any sub-indicator by regulatory area

Again, our selection of sub-indicators may miss the important dimension of change, so we use the broader set of dummy variables, one for each of the five areas. Table 11 presents the results.

*Control of Corruption:* Consistent with the results using selected sub-indicators, improvement in credit information system only expands credit in economies with better than average control of corruption. Similarly, only for those economies, reforms in contract enforcement translate into expanded credit. However, reducing labor rigidity in these economies tend to be associated with less credit to private sectors.

*Income Level:* The results provide some further evidence that economies with more resources for enforcement are more likely to see the impact of regulatory reforms. Improvement in contract enforcement is likely to expand credit but only in high income economies. The positive impact of reforms in credit information system on private credit is found to be positive for rich economies but negative for poor economies. Reducing the burdens of starting a business is found to increase firm entry rate but only in high income economies.

*Labor Market Rigidities:* No significant patterns are found when splitting economies based on labor market flexibility.

iii) Using an overall dummy if any change in any regulatory area

As a final exercise, we use the dummy on reform in any area. The results do not provide evidence on the significance of the impact.

Overall, the results obtained from focusing on improvements in particular Doing Business indicator are most promising. Broader binary indicators that indicate whether reforms took place are much weaker in correlation to improvements in economic outcomes.

## ***Conclusions***

The evidence supporting the impact of regulations is strongest when looking at cross-economy patterns. Doing Business indicators on entry, access to finance, labor flexibility and contract enforcement are associated with income, firm entry rates, credit to the private sector and labor turnover. However, causation is still not determined and omitted economy characteristics can be driving the results.

Looking at variations within economies by sectors more likely to be affected by regulations provides stronger evidence on the impact of regulations. The work here shows that investment rates are higher in sectors more reliant on external finance in areas where indicators of access to credit is stronger.

The results looking at aggregate variations within economies over time are relatively weak. Some results are significant, but some have the unexpected sign. And few are robust to the inclusion of economy fixed effects. Dividing the sample by broader measures of institutional quality does strengthen some of the results. But, the effects are still modest. The most robust effect is that improved credit information helps raise credit to the private sector and investment in better-governed economies. As the panel dimension grows, the power of the tests will improve. This exercise will be worth repeating.



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## ***Data Appendix: Sources and Measurement***

Doing Business Indicators: The data is from “Doing Business Database” published by the World Bank and the International Finance Cooperation annually (accessible at [www.doingbusiness.org](http://www.doingbusiness.org)). It covers information from 2003 (5 regulatory areas, 133 economies) to 2008 (10 regulatory areas, 181 economies). For details on methodology and data sources please check <http://www.doingbusiness.org/MethodologySurveys/>.

Industry Investment: The data is from “Industrial Statistics Database at 4-digit Level of ISIC 2008 (INDSTAT4)”, published by UNIDO. For each industry of an economy, it reports number of establishments, employment, wages and salaries, output, value added, gross fixed capital formation and number of female employees. For methodology and data sources please check <http://www.unido.org/index.php?id=o3533>. We use gross fixed capital formation as measure on investment. The current coverage is from 1985 to 2005 but varies by economies. Due to data quality, only data of 2003 and 2004 was used.

Economy Investment, Access to Credit, Unemployment and Macroeconomic Characteristics: We use gross fixed capital formation as percentage of GDP, and private credit as percentage of GDP to measure investment and access to credit. Both variables are available from “World Development Indicators 2008”, published by the World Bank. The database provides information of unemployment rates. Controls on economy macroeconomic conditions, including GDP per capita, GDP growth rate, inflation rate, and trade openness as trade share of GDP, are also taken from the same data source. The current version includes data till 2007. However, for unemployment rates, high quality information is only available till 2005. For more information please check <http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:21725423~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html>.

Economy Firm Entry Rate: Our firm entry rate is calculated base on “Entrepreneurship Database 2008”, collected by the World Bank and the International Finance Cooperation annually (accessible at <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTPROGRAMS/EXTFINRES/0,,contentMDK:21454009~pagePK:64168182~piPK:64168060~theSitePK:478060,00.html>). The data provides the numbers of corporations and new corporations for 83 economies over 2002 to 2005.

Governance: Our measures of governance are from “Worldwide Governance Indicators, 1996-2007”, published by the World Bank (accessible at <http://info.worldbank.org/governance/wgi/index.asp>). The data includes six measures on quality of governance: political stability, government efficiency, rule of law, voice and accountability, control of corruption, and regulatory quality.

### ***Methodology Appendix A: The Impact of Regulatory Burdens on Industry Investment***

When examining the impact, we take the following approach:

$$\ln GFCF_{cj} = \alpha + D_c + D_j + \beta \cdot Industry\_Share_{cj} + \gamma \cdot (Exfinance_j \cdot DB_c) + \varepsilon_{cj}$$

where  $c$  denotes economy,  $j$  denotes industry. The dependent variable is logarithm of Gross Fixed Capital Formation (GFCF).  $D_c$  and  $D_j$  represent a set of economy dummies and industry dummies, respectively. They will absorb economy-specific and industry-specific factors. *Industry\_Share* represents an industry's share in an economy's aggregate value, which is either GFCF, or employment, or number of enterprises. We use *Industry\_Share* to account for the possibility that the size of an industry relative to the economy is correlated with its investment.

The variable of interest is the interaction term, where *Exfinance* represents an industry's dependence on external finance, and *DB* denotes Doing Business indicators. *Exfinance* is calculated based on information of US manufacturing industries taken from Rajan and Zingales (1998). A higher value represents more dependence on external finance. Doing business indicators includes measures on policies conducive to investment, where a higher value represents better investment climate. We refer them as *Good DB* in what follows. As industries with higher dependence on external finance is more sensitive to regulation, we expect good investment climate stimulate capital investment in these industries more. It translates into a positive  $\gamma$  when the interaction is between *Exfinance* and *Good DB*. Doing Business indicators also includes measures on regulatory burdens, where a higher value represents investment climate less conducive to business, for instance, time to start a business and level of labor rigidity. We refer them as *Bad DB*. We expect regulatory burden reduce capital investment in industries with higher dependence on external finance disproportionately more. It implies a negative  $\gamma$  when the interaction is between *Exfinance* and *Bad DB*. One limitation of the model is that we cannot examine the magnitude of the impact of regulation burdens and can only predict the relative magnitude on industries with higher dependence on external finance.

## ***Methodology Appendix B: The Impact of Regulation Reforms on Economy Performance***

When examining the impact, we take the following approach:

$$y_{ct} = D_c + D_t + D_{FuelExporter} \cdot D_t + X_{ct} + \phi \cdot DB_{ct} + \varepsilon_{ct}$$

where  $c$  denotes economy,  $t$  denotes year. The dependent variable is a measure on aggregate economic outcomes, including investment, access to credit, entry rates, and unemployment rates.  $D_c$  represent a set of economy dummies. They will absorb time-invariant economy-specific effects and allow us to test impact of changes within an economy.  $D_t$  represent a set of year dummies controlling for macro-economic shocks. Considering that fuel exporters may respond differently to economic shocks, we define a dummy for fuel exporters and interact it with  $D_t$  to take that into account.  $X_{ct}$  are a set of time-varying economy characteristics, used to control for business cycle and political conditions. They are GDP per capita, inflation rates, trade openness, political stability and governance efficiency.

The variable of interest is  $DB$  as doing business indicators. The coefficient suggests whether there is real impact from the changes in  $DB$  to economic outcomes. We also consider whether broader economy characteristics affect the impact. In order to test that, we define a dummy for an economy character and interact the dummy with  $DB$ .

Table 1 - Impact of Regulatory Burden on Industry Investment, Single DB Indicator

	Investment (log)			
	2003 and 2004	2003	2004	Average
external_finance_dependence*starting_a_business (time)	-0.728*** (0.180)	-0.990*** (0.261)	-0.23 (0.374)	-1.076*** (0.316)
external_finance_dependence*starting_a_business (No. of procedures)	-1.836*** (0.476)	-1.910*** (0.805)	-0.768 (0.942)	-1.741* (0.962)
external_finance_dependence*contract_enforcement (time)	-0.905*** (0.297)	-0.777 (0.465)	-0.885 (0.650)	-0.691 (0.596)
external_finance_dependence*contract_enforcement (No. of procedures)	-5.675*** (0.862)	-5.380*** (1.711)	-4.812** (1.856)	-5.453*** (1.845)
external_finance_dependence*closing_a_business (recovery rate)	0.394*** (0.143)	1.115** (0.430)	0.34 (0.311)	1.260** (0.484)
external_finance_dependence*closing_a_business (time)	-1.337*** (0.259)	-1.425** (0.614)	-1.161 (0.726)	-1.423** (0.659)
external_finance_dependence*labor_market (rigidity index)	-0.538*** (0.106)	-0.554*** (0.172)	-0.460** (0.181)	-0.600*** (0.205)
external_finance_dependence*labor_market (restrictions on hiring)	-0.419*** (0.079)	-0.532*** (0.149)	-0.280* (0.157)	-0.460*** (0.157)
external_finance_dependence*labor_market (restrictions on firing)	-0.384*** (0.125)	-0.393* (0.232)	-0.311 (0.249)	-0.488* (0.257)
external_finance_dependence*labor_market (restrictions on hours worked)	-0.167 (0.108)	-0.139 (0.221)	-0.25 (0.209)	-0.135 (0.215)
external_finance_dependence*labor_market (non-wage labor costs)	-0.398*** (0.117)	-0.354 (0.245)	-0.351 (0.314)	-0.421 (0.284)
external_finance_dependence*accessing_credit (credit information)	0.948*** (0.236)	0.962* (0.477)	0.823 (0.682)	0.991* (0.519)
external_finance_dependence*accessing_credit (public registries coverage)	-1.487*** (0.560)	-1.304 (1.697)	-2.184 (1.520)	-2.48 (1.947)
external_finance_dependence*accessing_credit (private registries coverage)	2.300*** (0.393)	2.574*** (0.703)	1.728** (0.765)	2.623*** (0.702)
external_finance_dependence*accessing_credit (legal rights)			3.497*** (1.178)	
external_finance_dependence*registering_properties (time)			-0.005 (0.177)	

Table 1 - Impact of Regulatory Burden on Industry Investment, Single DB Indicator (Cont.)

	Investment (log)			Average
	2003 and 2004	2003	2004	
external_finance_dependence*registering properties (No. of procedures)			-2.182** (0.981)	
economy fixed-effects	Y	Y	Y	Y
industry share in an economy's total investment	Y	Y	Y	Y
industry fixed-effects	Y	Y	Y	Y
No. of Observations	3604	1866	1738	2058
No. of Economies	47	42	39	44

Robust errors in parentheses, Significant levels: \* 10% \*\* 5% \*\*\* 1%  
Data covers from 2003 to 2004.



Table 2 - Impact of Regulatory Burden on Industry Investment, Multiple DB Indicators

	Investment (log) (2003 and 2004)				
	1	2	3	4	5
external_finance_dependence*starting_a_business (time)	-0.147 (0.201)	-0.071 (0.195)	-0.041 (0.193)	-0.504** (0.197)	-0.136 (0.191)
external_finance_dependence*contract_enforcement (time)	0.069 (0.391)			-0.543* (0.325)	-0.219 (0.329)
external_finance_dependence*contract_enforcement (No. of procedures)	-3.769*** (1.098)	-3.803*** (1.178)	-3.427*** (1.132)		
external_finance_dependence*closing_a_business (recovery rate)	-0.104 (0.132)	-0.017 (0.107)		-0.015 (0.118)	
external_finance_dependence*closing_a_business (time)	-0.394 (0.330)		-0.298 (0.291)		-0.597* (0.339)
external_finance_dependence*labor_market (rigidity index)	0.403 (0.301)				
external_finance_dependence*labor_market (restrictions on hiring)	-0.454*** (0.105)	-0.341*** (0.076)	-0.351*** (0.077)		-0.412*** (0.080)
external_finance_dependence*labor_market (restrictions on firing)	-0.014 (0.251)			0.211 (0.180)	
external_finance_dependence*accessing_credit (credit information)	0.387 (0.293)	0.427* (0.256)	0.367 (0.283)	0.865*** (0.257)	0.583** (0.276)
economy fixed-effects	Y	Y	Y	Y	Y
industry share in an economy's total investment	Y	Y	Y	Y	Y
industry fixed-effects	Y	Y	Y	Y	Y
No. of Observations	4284	4354	4284	4354	4284
No. of Economies	50	52	50	52	50
F test	23.4	24.8	24.5	24.6	24.4
R-squared	0.65	0.65	0.65	0.65	0.65

Robust errors in parentheses, Significant levels: \* 10% \*\* 5% \*\*\* 1%  
Data covers from 2003 to 2004.

Table 3 - Improvement in Each Indicator, APEC

Economy (Yrs data available)	Total	Trading									
		Starting a Business (6 yrs)	Accessing Credit	Across Borders	Paying Taxes	Investor Rights	Construction Permits	Closing a Business	Employing Workers	Enforcing Contracts	Registering Property
Indonesia	7	55%	100%	33%	53%	100%	14%	38%	15%		
China	6	87%	100%	45%	74%	100%	29%				
Vietnam	6	21%	100%			100%			67%	17%	15%
Peru	5	34%	133%	19%	14%	14%			15%		
Korea	5	23%	20%	33%	14%	39%					
Thailand	4		25%	75%	34%	250%					
Hong Kong, China	4		25%	71%	13%	35%					
Australia	3		45%						100%		29%
Singapore	3	50%	33%			63%					
Canada	3	50%	50%			12%					
Russia	3	68%			15%		14%				
Philippines	3	13%		11%						14%	
Malaysia	2	57%			66%						
Japan	2	100%	17%								
Mexico	2	52%				62%					
Chinese Taipei	2	21%	33%								
New Zealand	1	92%									
United States	1				42%						
Chile	1							20%			
Papua New Guinea	1							13%			
APEC*	64	14	10	9	7	6	5	5	3	3	2

\*Data covers from 2003 to 2008.

Table 4 - What reforms? Improve and Reversal in Regulations (2003-2008)

	APEC			Non-APEC			%improve	
	Improve	Reverse	Same	Improve	Reverse	Same	APEC	non-APEC
start_n	7	1	13	71	7	79	33%	45%
start_t	12	1	8	98	5	54	57%	62%
start_mc	6	2	13	90	11	56	29%	57%
license_n	2	1	18	19	8	129	10%	12%
license_t	8	1	12	36	20	100	38%	23%
labor_hiring	2	1	18	29	28	100	10%	18%
labor_firing	0	1	20	7	13	137	0%	4%
labor_hours	1	0	20	8	5	144	5%	5%
labor_rigidity	3	2	16	32	38	87	14%	20%
labor_nwcost	5	1	14	17	8	130	24%	11%
labor_fire_cost	0	0	21	8	15	133	0%	5%
prop_n	0	0	20	22	4	127	0%	14%
prop_t	2	1	17	54	4	95	10%	34%
tax_n	6	1	14	29	15	113	29%	18%
tax_t	7	2	12	31	16	110	33%	20%
trade_exp_n	5	2	14	36	13	108	24%	23%
trade_exp_t	7	1	13	68	16	73	33%	43%
trade_imp_n	7	0	14	49	7	101	33%	31%
trade_imp_t	8	0	13	68	9	80	38%	43%
contract_n	4	0	17	32	7	118	19%	20%
contract_t	3	1	17	33	3	121	14%	21%
close_t	3	0	18	8	1	123	14%	5%
close_recovery	9	11	1	87	38	32	43%	55%
credit_legal_rights	5	0	16	21	3	133	24%	13%
credit_info	8	0	13	54	7	96	38%	34%
credit_pub_reg	5	1	15	67	6	84	24%	43%
credit_pvt_bur	12	1	7	56	11	90	57%	36%
invest_disclose	3	0	18	13	1	143	14%	8%
invest_dir_liab	2	0	19	12	1	144	10%	8%
invest_share_suit	2	0	19	4	0	153	10%	3%
invest_protection	6	0	15	20	0	137	29%	13%

Data covers from 2003 to 2008.

Table 5 - Who reforms?

Reform Area	DB	Dummy	Macroeconomic Variables		WGI				
			Higher GDP Growth Rate	More Openness	More Political Stability	More Efficient Governance	Stronger Rule of Law	More Accountability	
Longer Initial Compliance Time		APEC economies							
starting a business (time)	+					+			
construction permits (time)	+					-			
employing workers (hiring restrictions)	+		+	-					-
registering property (time)	+								
paying taxes (time)	+								
trading across borders (time)	+								+
enforcing contracts (time)	+								
closing a business (time)	+								
accessing credit (info)			+		+				+
investor rights (disclosure)			+						-
investor rights (protection)		+							

Only results significant at conventional levels are reported.

+: positive association; -: negative association.

WGIs are included one at a time.

Data covers from 2003 to 2007.

Table 6 - Who reforms? Are economies reformists?

All Economies	Dummy on Reform of				
	Start_t	Contract_t	Recovery Rate	Labor Rigidity	Credit Info
Start_t_reform		0.211*** (0.063)	0.255*** (0.077)	0.044 (0.066)	0.113 (0.078)
Contract_t_reform	0.292*** (0.087)		0.006 (0.094)	0.160** (0.077)	0.092 (0.092)
Close_Recovery_reform	0.231*** (0.070)	0.004 (0.062)		-0.117* (0.062)	0.164** (0.074)
Labor_rigidity_reform	0.058 (0.088)	0.154** (0.074)	-0.171* (0.091)		0.061 (0.090)
Credit_Info_reform	0.106 (0.073)	0.063 (0.063)	0.170** (0.076)	0.044 (0.064)	
N	178	178	178	178	178
F	7.924	5.238	5.656	2.309	3.207
r2	0.155	0.108	0.116	0.051	0.069
APEC	Dummy on Reform of				
	Start_t	Contract_t	Recovery Rate	Labor Rigidity	Credit Info
Start_t_reform		0.262 (0.162)	0.234 (0.260)	-0.014 (0.183)	0.133 (0.256)
Contract_t_reform	0.536 (0.331)		-0.222 (0.377)	0.237 (0.256)	-0.212 (0.366)
Close_Recovery_reform	0.205 (0.229)	-0.095 (0.162)		-0.025 (0.172)	-0.098 (0.241)
Labor_rigidity_reform	-0.027 (0.341)	0.215 (0.232)	-0.053 (0.363)		0.355 (0.341)
Credit_Info_reform	0.124 (0.240)	-0.097 (0.167)	-0.104 (0.257)	0.179 (0.172)	
N	21	21	21	21	21
F	0.86	0.967	0.269	0.512	0.383
r2	0.177	0.195	0.063	0.113	0.087

1=reform over 2003-2008; 0=otherwise. Conducted for data of 2003-2008.

Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%, \*\*\*=1%.

Table 7 - Is Timing of Reforms Associated with Macroeconomic Conditions?

All Economies	Dummy on Reform of				
	Start_t	Contract_t	Close Recovery Rate	Labor Rigidity	Credit Info
GDP per Capita	0.909*** (0.259)	-0.136 (0.149)	-0.356 (0.280)	0.591*** (0.155)	0.278 (0.196)
Inflation	-0.11 (0.254)	-0.07 (0.147)	-0.212 (0.276)	0.081 (0.154)	0.301 (0.188)
Trade	0.195 (0.243)	-0.192 (0.140)	0.019 (0.234)	-0.057 (0.114)	0.097 (0.181)
Political Stability	0.137 (0.109)	-0.120* (0.063)	0.063 (0.113)	0.114* (0.062)	0.189** (0.082)
Government Efficiency	0.004 (0.177)	-0.08 (0.102)	0.179 (0.169)	0.022 (0.084)	0 (0.132)
APEC*GDP per Capita	-0.869 (0.879)	-0.702 (0.508)	0.667 (0.972)	-0.305 (0.555)	1.107* (0.651)
APEC*Inflation	-0.454 (1.984)	-0.61 (1.147)	4.779** (2.045)	-0.43 (1.170)	0.029 (1.465)
APEC*Trade	0.15 (0.631)	0.802** (0.365)	-0.291 (0.679)	0.027 (0.382)	-1.242*** (0.467)
APEC*Political Stability	-0.53 (0.336)	0.102 (0.194)	-0.864** (0.361)	0.023 (0.206)	0.001 (0.248)
APEC*Government Efficiency	0.148 (0.628)	-0.52 (0.363)	0.289 (0.563)	-0.023 (0.318)	-0.231 (0.464)
Number of observations	648	648	701	739	643
Number of economies	157	157	164	169	157
F	2.04	1.615	1.314	2.259	1.998
r <sup>2</sup>	0.041	0.032	0.024	0.039	0.04

Linear probability regression, 1=reform during the period covered; 0=otherwise  
 Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%, \*\*\*=1%.  
 Panel regression with economy fixed effects.  
 Conducted for data of 2003-2007.

Table 8 - Which Reforms Are Enacted Together?

All Economies	Dummy on Reform of				
	Start_t	Contract_t	Close Recovery Rate	Labor Rigidity	Credit Info
Start_t_reform		0.028 (0.022)	-0.085* (0.046)	0.041 (0.028)	0.062** (0.029)
Contract_t_reform	0.097 (0.075)		-0.005 (0.085)	0.063 (0.052)	0.063 (0.054)
Close_Recovery_reform	-0.066* (0.036)	-0.001 (0.020)		-0.021 (0.025)	0.014 (0.026)
Labor_rigidity_reform	0.086 (0.059)	0.039 (0.032)	-0.056 (0.067)		0.028 (0.042)
Credit_Info_reform	0.121** (0.057)	0.036 (0.031)	0.034 (0.064)	0.026 (0.039)	
N	781	781	781	781	781
N_g	178	178	178	178	178
F	3.155	1.283	1.111	1.363	1.768
r2	0.021	0.008	0.007	0.009	0.012
APEC	Dummy on Reform of				
	Start_t	Contract_t	Close Recovery Rate	Labor Rigidity	Credit Info
Start_t_reform		0.115** (0.053)	0.11 (0.145)	-0.075 (0.070)	-0.063 (0.090)
Contract_t_reform	0.507** (0.233)		-0.059 (0.304)	-0.027 (0.148)	0.242 (0.187)
Close_Recovery_reform	0.068 (0.090)	-0.008 (0.043)		-0.027 (0.056)	-0.008 (0.071)
Labor_rigidity_reform	-0.199 (0.185)	-0.016 (0.089)	-0.115 (0.236)		-0.05 (0.146)
Credit_Info_reform	-0.101 (0.145)	0.089 (0.069)	-0.02 (0.185)	-0.03 (0.090)	
N	101	101	101	101	101
N_g	21	21	21	21	21
F	1.751	1.606	0.237	0.457	0.492
r2	0.084	0.078	0.012	0.023	0.025

Linear probability regression, 1=reform during a given year; 0=otherwise  
Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%; \*\*\*=1%.  
Panel regression with economy fixed effects.  
Conducted for data of 2003-2007.

Table 9 - Are Reforms Associated with Improved Outcomes?

	Investment		Private Credit		Firm Entry Rates		Unemployment (total)		Unemployment (female)		Unemployment (youth)	
	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes
<b>Economy fixed effects</b>												
<b>Start_t</b>	-0.002 (0.005)	-0.008 (0.006)	-0.066*** (0.014)	-0.037** (0.015)	-0.011*** (0.003)	-0.006 (0.004)	0.006 (0.004)	0.001 (0.005)	0.006 (0.005)	0.001 (0.007)	0.008 (0.009)	-0.003 (0.011)
<b>Contract_t</b>	-0.021* (0.011)	-0.043 (0.033)	-0.066 (0.049)	-0.037 (0.096)	-0.005 (0.008)	0.048* (0.029)	0.007 (0.013)	-0.017 (0.060)	0.028* (0.016)	-0.062 (0.079)	0.036 (0.029)	-0.021 (0.125)
<b>Close_Recovery</b>	0.001 (0.002)	0.001 (0.002)	0.008 (0.006)	0.005 (0.006)	-0.002 (0.002)	-0.002 (0.002)	-0.001 (0.002)	-0.001 (0.002)	-0.001 (0.002)	-0.002 (0.002)	-0.001 (0.004)	-0.001 (0.004)
<b>Labor Rigidity</b>	0.008 (0.007)	0.016 (0.014)	-0.051** (0.026)	-0.037 (0.038)	0.001 (0.005)	0.072*** (0.019)	0.009 (0.008)	0.008 (0.028)	0.005 (0.010)	0.012 (0.036)	0.02 (0.017)	0.039 (0.078)
<b>Credit Info</b>	-0.011** (0.005)	-0.009 (0.006)	0.014 (0.015)	-0.004 (0.016)	0.005 (0.005)	-0.001 (0.006)	-0.009 (0.009)	-0.001 (0.013)	-0.012 (0.011)	0.003 (0.016)	-0.036** (0.017)	-0.011 (0.024)
<b>Inflation</b>	-0.000* (0.000)	-0.000* (0.000)	0.00 (0.000)	0.001 (0.000)	0.00 (0.000)	0.00 (0.000)	0.00 (0.000)	0.00 (0.000)	0.00 (0.000)	0.00 (0.000)	0.00 (0.000)	-0.001 (0.001)
<b>Trade/GDP</b>	0.037*** (0.009)	0.059*** (0.017)	-0.017 (0.033)	0.012 (0.045)	0.014** (0.006)	0.034** (0.015)	-0.005 (0.010)	0.00 (0.022)	-0.006 (0.012)	0.01 (0.028)	-0.01 (0.020)	0.03 (0.047)
<b>Political Stability</b>	0.007 (0.006)	-0.001 (0.007)	-0.026 (0.018)	-0.019 (0.020)	0.009 (0.007)	0.011 (0.011)	-0.003 (0.007)	0.00 (0.010)	-0.004 (0.009)	-0.002 (0.012)	-0.002 (0.016)	0.012 (0.021)
<b>Government Efficiency</b>	0.003 (0.009)	0.024* (0.013)	0.017 (0.030)	-0.095*** (0.035)	0.00 (0.005)	0.073** (0.030)	-0.002 (0.011)	-0.005 (0.015)	-0.011 (0.014)	-0.006 (0.020)	-0.008 (0.023)	-0.008 (0.030)
<b>GDP per Capita</b>	-0.003 (0.006)	-0.001 (0.026)	0.199*** (0.022)	0.402*** (0.071)	0.00 (0.000)	0.00 (0.000)	0.00 (0.008)	-0.120*** (0.038)	0.005 (0.010)	-0.163*** (0.051)	0.01 (0.016)	-0.274*** (0.090)
<b>Fuel, year dummies</b>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<b>N</b>	529	529	513	513	207	207	232	232	226	226	188	188
<b>N_g</b>	153	153	150	150	78	78	93	93	91	91	77	77
<b>II</b>	1289,978	1289,978	762,539	762,539	698,781	698,781	722,878	722,878	645,065	645,065	473,88	473,88
<b>F</b>	2.358	2.358	6.723	6.723	4.173	4.173	2.519	2.519	1.958	1.958	2.101	2.101
<b>r2</b>	0.078	0.078	0.2	0.2	0.3	0.3	0.192	0.192	0.16	0.16	0.203	0.203

Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%, \*\*\*=1%. Conducted for data of 2003-2006.



Table 9 - Are Reforms Associated with Improved Outcomes? (Cont.)

	Investment	Private Credit	Firm Entry Rates	Unemployment (total)	Unemployment (female)	Unemployment (youth)
Property_t	-0.001 (0.004)	-0.038** (0.019)	-0.006** (0.003)	0.009** (0.004)	0.013** (0.005)	0.026*** (0.008)
Tax_t	0.000 (0.011)	-0.090* (0.051)	-0.010 (0.009)	0.030* (0.016)	0.039** (0.018)	0.067** (0.027)

*Due to shorter time series, property and tax were run separately and without economy fixed effects.*

*No significant patterns were found for: tax, investor protection, trade or labor regulations and so are not reported here.*

*Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%, \*\*\*=1%.*

*Conducted for 2003-2006.*

**Table 10 - Does the Impact of Regulatory Changes Vary Across Economies? (Sub-indicators)**

**Strong vs Weak Control of Corruption**

Economy FE	Investment		Credit	
	No	Yes	No	Yes
<b>Start_t</b>	-0.003 (0.006)	-0.014* (0.008)	-0.033* (0.018)	-0.004 (0.020)
<b>GoodGov*Start_t</b>	0.003 (0.009)	0.01 (0.011)	-0.079*** (0.027)	-0.064** (0.029)
<b>Contract_t</b>	-0.018 (0.011)	-0.053 (0.034)	-0.086* (0.048)	-0.039 (0.100)
<b>GoodGov*Contract_t</b>	-0.019** (0.009)	0.035 (0.121)	0.097*** (0.035)	-0.184 (0.317)
<b>Close_recovery</b>	0.003 (0.002)	0.002 (0.003)	0.007 (0.007)	0.006 (0.007)
<b>GoodGov*CloseRecov</b>	-0.007* (0.004)	-0.001 (0.004)	0.003 (0.012)	-0.003 (0.012)
<b>Labor_Rigidity</b>	-0.006 (0.008)	0.016 (0.015)	-0.029 (0.030)	-0.032 (0.039)
<b>GoodGov*LaborRigidity</b>	0.033** (0.013)	-0.067 (0.059)	-0.083 (0.052)	-0.212 (0.159)
<b>Credit_Info</b>	-0.014** (0.006)	-0.018** (0.007)	0.002 (0.017)	-0.016 (0.018)
<b>GoodGov*Credit_Info</b>	0.011 (0.011)	0.034*** (0.013)	0.081*** (0.031)	0.061* (0.033)
<b>Economy controls</b>	Yes	Yes	Yes	Yes
<b>N</b>	529	529	513	513
<b>N_g</b>	153	153	150	150
<b>ll</b>		1296.917		772.238
<b>F</b>		2.253		5.709
<b>r2</b>		0.102		0.23

Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%; \*\*\*=1%.

Conducted for 2003-2006.

Table 10 (Cont.)

## High vs Low Income

	Investment		Credit	
	No	Yes	No	Yes
<b>Economy FE</b>				
<b>Start_t</b>	0.013 (0.009)	-0.007 (0.012)	-0.018 (0.028)	0.017 (0.032)
<b>HighY*Start_t</b>	-0.020** (0.010)	-0.002 (0.013)	-0.057* (0.031)	-0.064* (0.035)
<b>Contract_t</b>	-0.018 (0.012)	-0.053 (0.037)	-0.063 (0.052)	-0.086 (0.110)
<b>HighY*Contract_t</b>	-0.002 (0.010)	0.029 (0.081)	0.024 (0.037)	0.059 (0.218)
<b>Close_recovery</b>	0.002 (0.003)	0.00 (0.003)	0.006 (0.008)	0.007 (0.009)
<b>HighY*CloseRecov</b>	-0.002 (0.004)	0.003 (0.004)	0.004 (0.011)	-0.005 (0.011)
<b>Labor_Rigidity</b>	-0.003 (0.011)	0.015 (0.015)	-0.021 (0.035)	-0.033 (0.041)
<b>HighY*LaborRigidity</b>	0.017 (0.013)	-0.081 (0.055)	-0.075 (0.050)	-0.251* (0.148)
<b>Credit_Info</b>	-0.015** (0.007)	-0.024*** (0.008)	-0.013 (0.020)	-0.034 (0.022)
<b>HighY*Credit_Info</b>	0.01 (0.010)	0.032*** (0.011)	0.070** (0.028)	0.069** (0.030)
<b>Economy controls</b>	Yes	Yes	Yes	Yes
<b>N</b>	529	529	513	513
<b>N_g</b>	153	153	150	150
<b>ll</b>		1298.01		772.841
<b>F</b>		2.345		5.768
<b>r2</b>		0.105		0.231

Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%; \*\*\*=1%.  
Conducted for 2003-2006.

**Table 10 (Cont.)**

**Rigid vs More Flexible Labor Markets**

	Investment		Credit	
	No	Yes	No	Yes
<b>Economy FE</b>				
<b>Start_t</b>	-0.002 (0.008)	-0.01 (0.010)	-0.078*** (0.024)	-0.023 (0.027)
<b>Rigid*Start_t</b>	0.00 (0.009)	0.003 (0.012)	0.015 (0.029)	-0.02 (0.031)
<b>Contract_t</b>	-0.018 (0.012)	0.007 (0.047)	-0.068 (0.050)	-0.146 (0.181)
<b>Rigid*Contract_t</b>	0.001 (0.007)	-0.035 (0.062)	-0.024 (0.021)	0.114 (0.210)
<b>Close_recovery</b>	-0.001 (0.003)	0.002 (0.003)	0.007 (0.008)	0.003 (0.008)
<b>Rigid*CloseRecov</b>	0.002 (0.004)	-0.002 (0.004)	0.001 (0.011)	0.005 (0.012)
<b>Credit_Info</b>	0.001 (0.007)	0.011 (0.008)	0.016 (0.020)	-0.007 (0.022)
<b>Rigid*Credit_Info</b>	-0.022** (0.009)	-0.046*** (0.011)	0.003 (0.028)	0.014 (0.030)
<b>Controls</b>	Yes	Yes	Yes	Yes
<b>N</b>	529	529	513	513
<b>N_g</b>	153	153	150	150
<b>ll</b>		1302.699		762.604
<b>F</b>		3.102		5.423
<b>r2</b>		0.121		0.2

Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%; \*\*\*=1%.  
Conducted for 2003-2006.

**Table 11 - Does the Impact of Regulatory Changes Vary Across Economies?  
(Dummy of Reform)**

**Strong vs Weak Control of Corruption**

	Investment		Credit		Entry Rate	
	No	Yes	No	Yes	No	Yes
<b>Economy FE</b>						
<b>Start_reform</b>	-0.001 (0.004)	-0.002 (0.004)	-0.003 (0.009)	-0.003 (0.009)	-0.001 (0.005)	-0.007 (0.006)
<b>GoodGov*Start_reform</b>	0.002 (0.007)	0.004 (0.007)	-0.006 (0.017)	-0.005 (0.015)	0.006 (0.007)	0.010 (0.008)
<b>Contract_reform</b>	-0.004 (0.006)	-0.005 (0.006)	-0.011 (0.014)	-0.006 (0.013)	0.003 (0.009)	0.012 (0.010)
<b>GoodGov*Contract_reform</b>	-0.002 (0.010)	-0.002 (0.010)	0.057** (0.023)	0.056** (0.021)	-0.008 (0.012)	-0.010 (0.014)
<b>Close_reform</b>	0.001 (0.003)	0.001 (0.004)	0.001 (0.009)	0.005 (0.008)	0.005 (0.005)	0.007 (0.005)
<b>GoodGov*Close_reform</b>	-0.004 (0.006)	-0.003 (0.006)	0.021 (0.014)	0.016 (0.013)	-0.006 (0.006)	-0.005 (0.007)
<b>Labor_reform</b>	0.000 (0.005)	-0.001 (0.005)	-0.013 (0.013)	-0.008 (0.012)	-0.002 (0.007)	-0.009 (0.008)
<b>GoodGov*Labor_reform</b>	0.003 (0.010)	0.000 (0.010)	-0.028 (0.025)	-0.041* (0.023)	-0.002 (0.014)	0.001 (0.016)
<b>Credit_reform</b>	-0.004 (0.005)	-0.004 (0.005)	-0.017 (0.012)	-0.018 (0.011)	-0.007 (0.007)	-0.002 (0.008)
<b>GoodGov*Credit_reform</b>	0.006 (0.009)	0.007 (0.009)	0.030 (0.021)	0.036* (0.019)	0.003 (0.010)	0.002 (0.011)
<b>Economy controls</b>	Yes	Yes	Yes	Yes	Yes	Yes
<b>N</b>	382	382	373	373	138	138
<b>N_g</b>	139	139	136	136	75	75
<b>ll</b>		1049.414		724.781		482.992
<b>F</b>		2.401		6.731		0.461
<b>r2</b>		0.169		0.37		0.145

Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%, \*\*\*=1%.

Conducted for 2003-2006.

**Table 11 (Cont.)**

**High vs Low Income**

	Investment		Credit		Entry Rate	
	No	Yes	No	Yes	No	Yes
<b>Economy FE</b>						
<b>Start_reform</b>	-0.002 (0.004)	-0.002 (0.004)	-0.006 (0.010)	-0.007 (0.009)	-0.006 (0.005)	-0.010 (0.006)
<b>HighY*Start_reform</b>	0.001 (0.007)	0.002 (0.007)	-0.002 (0.016)	0.003 (0.015)	0.013* (0.007)	0.014* (0.008)
<b>Contract_reform</b>	-0.004 (0.006)	-0.005 (0.006)	-0.011 (0.014)	-0.006 (0.013)	0.003 (0.009)	0.010 (0.010)
<b>HighY*Contract_reform</b>	-0.002 (0.010)	-0.001 (0.010)	0.053** (0.023)	0.052** (0.021)	-0.007 (0.012)	-0.006 (0.013)
<b>Close_reform</b>	0.001 (0.004)	0.000 (0.004)	0.003 (0.009)	0.006 (0.008)	0.004 (0.005)	0.007 (0.005)
<b>HighY*CloseRecov</b>	-0.002 (0.006)	0.001 (0.006)	0.011 (0.014)	0.013 (0.013)	-0.003 (0.006)	-0.003 (0.007)
<b>Labor_reform</b>	-0.002 (0.005)	-0.003 (0.005)	-0.016 (0.014)	-0.012 (0.013)	0.001 (0.008)	0.000 (0.010)
<b>HighY*Labor_reform</b>	0.008 (0.009)	0.007 (0.009)	-0.021 (0.022)	-0.027 (0.020)	-0.008 (0.012)	-0.017 (0.013)
<b>Credit_reform</b>	-0.004 (0.005)	-0.004 (0.005)	-0.021* (0.012)	-0.020* (0.011)	-0.009 (0.008)	-0.003 (0.010)
<b>HighY*Credit_reform</b>	0.002 (0.008)	0.002 (0.008)	0.038* (0.020)	0.040** (0.019)	0.004 (0.010)	0.000 (0.011)
<b>Economy controls</b>	Yes	Yes	Yes	Yes	Yes	Yes
<b>N</b>	382	382	373	373	138	138
<b>N_g</b>	139	139	136	136	75	75
<b>ll</b>		1049.004		723.216		488.549
<b>F</b>		2.37		6.579		0.726
<b>r2</b>		0.167		0.364		0.212

Standard errors in parentheses. Significance levels: \*=10%, \*\*=5%, \*\*\*=1%.

Conducted for 2003-2006.

# The Ease of Doing Business in APEC: The Impact of Regulatory Reforms

## Part II

### Impact of Regulations on Firm Performance: Evidence from Enterprise Surveys on *de facto* Measures of Regulations\*

**Abstract:** Using firm level data from 100 economies, the paper looks at how regulations are experienced by a wide range of firms. It shows considerable variation exists not only across locations, but also within locations. Formal differences in requirements cannot explain all of it. Rather, enforcement and compliance play critical roles. Comparing the Enterprise Surveys with Doing Business, the general pattern holds that more procedures and longer compliance times are indeed associated with more time spent by managers dealing with officials. However, considerable variation exists around the average relationship, and it is not robust to all the areas of regulation. Looking at the impact of the *de facto* measures on firm performance, the strongest positive association is with the consistency of enforcement. This effect, as well as positive associations of dealing with officials, is reinforced in economies with stronger rule of law. For a regulatory reform agenda to have its desired impact, the broader governance agenda must also be taken seriously.

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent.

## ***Introduction***

Part I looked at the impact of regulations on aggregate economic outcomes. Part II now shifts the focus to variations across firms. In doing so, it expands the analysis in multiple dimensions. First, it explores a broader notion of regulations. While Doing Business captures de jure measures of regulations, what can matter to firms is what they actually experience on the ground, or de facto regulations. This raises issues about enforcement in understanding the impact of regulations, and how large a gap there is in practice between what is on the books and what happens on the ground. It also expands the analysis on whether regulations have differential impact across different types of firms, such as across firms of different size. Finally, it uses information on other dimensions of the business environment to provide insights on the relative importance of regulatory constraints compared to other issues such as infrastructure or access to finance.

This paper uses the Enterprise Surveys, another data collection effort led by the World Bank. Data on 85,000 enterprises in over 100 economies are available, with disaggregated information on a range of regulatory procedures and interactions with officials, as well as indicators of other elements of the business environment (e.g. infrastructure, finance, crime, etc.).

The first section of the paper examines how well the de facto measures of regulations and their implementation correlate with the formal requirements of DB. To begin, the paper examines whether the economies ranked as having longer delays or more procedures in DB, are the ones where it actually takes longer to comply with the regulations. It then looks at the extent of variation in firm experiences within an economy – by location, but also by sector, size, ownership, and performance. The large variations, across firms and even for the same firm over time, underscores that implementation of regulations is significant and worth investigating further in understanding the way regulations impact firms. Indeed, the ES data has a number of variables that address the issue of consistency of implementation. The ES data also show that many firms – in many economies, most firms, -- are active in trying to influence how regulations may or may not be applied. The analysis shows that broader issues of governance matter in how regulations and their implementation affect firms.

The second section of the paper explores how measures of de facto regulations affect firm behavior. This is done in three ways. First, the DB indicators are used to see if they are associated with firm outcomes. Second, using the ES data, the measures of regulations are put into a broader context of the business environment and the range of constraints that can affect the operation and growth of firms. What is of interest is understanding where and for whom are regulations particularly constraining. Lastly, measures of constraints are used to look at differences in economic performance, focusing on employment growth. Overall, this paper provides evidence that regulatory burdens are associated with lower growth. The effects are larger in middle income economies and where governance is stronger. In particular, consistency of implementation contributes to higher firm growth.

Lowering regulatory burdens and inefficiencies is a worthy goal. To maximize the impact of reforms, care must be taken on the implementation of the reforms. Changes on paper are just that. And the broader governance or institutional environment matters in improving implementation.



### ***Data: Enterprise Surveys***

The Enterprise Survey initiative was begun in 2001 in recognition that many lower income economies had very limited information on the performance of firms in the private sector, and certainly very little information that would be comparable to data in other economies.<sup>1</sup> In addition, with the renewed interest in the role of the investment climate, there was an interest in being able to benchmark a range of dimensions across economies. Using a standard questionnaire and sampling methodology, the initiative now covers more than 85,000 firms in over 100 economies. Many economies are now conducting a second or even third round of surveys, so the panel dimension of the data is expanding.

The survey is administered in a face-to-face interview with the senior manager or entrepreneur. It includes some subjective questions about conditions facing the firm. These are followed up with more objective indicators. Thus, managers rank the extent to which electricity is a constraint to the operation of their firm, with the frequency and duration of outages, and the amount of production lost as a result.

A number of regulatory areas are covered. There is a general measure of the overall time senior management has to spend with government officials in dealing with permits, licenses and inspections. Then there are more detailed questions on the frequency of inspections (e.g. tax, labor), the costs or fines associated with them – and whether ‘gifts’ are associated with interactions with officials. The time to get various permits are included, as well as the time needed to clear customs. While the match with areas covered in the Doing Business indicators is not perfect, there is considerable overlap which allows for some comparisons between the two sources of measures of regulations.

#### ***I. How large a gap is there between de facto and de jure measures of regulations?***

The two data sources provide complementary information about regulations. Doing Business gives precise transactions and records the time and cost to comply with each step. The ES do not ask firms what the actual time and cost of each step was. Rather, it asks for estimates of complying with the whole process, acknowledging that many firms may not in fact be in full compliance. The survey information is useful precisely because it asks a range of firms, micro firms to large multinationals. The averages by economy are of interest, but more revealing can be the extent and nature of the variations within economies. This will be explored in more detail below. First, the ES economy averages can be linked with the DB economy indicators to see how well the measures correlate across economies.

##### *(a) Are de facto measures correlated with de jure measures?*

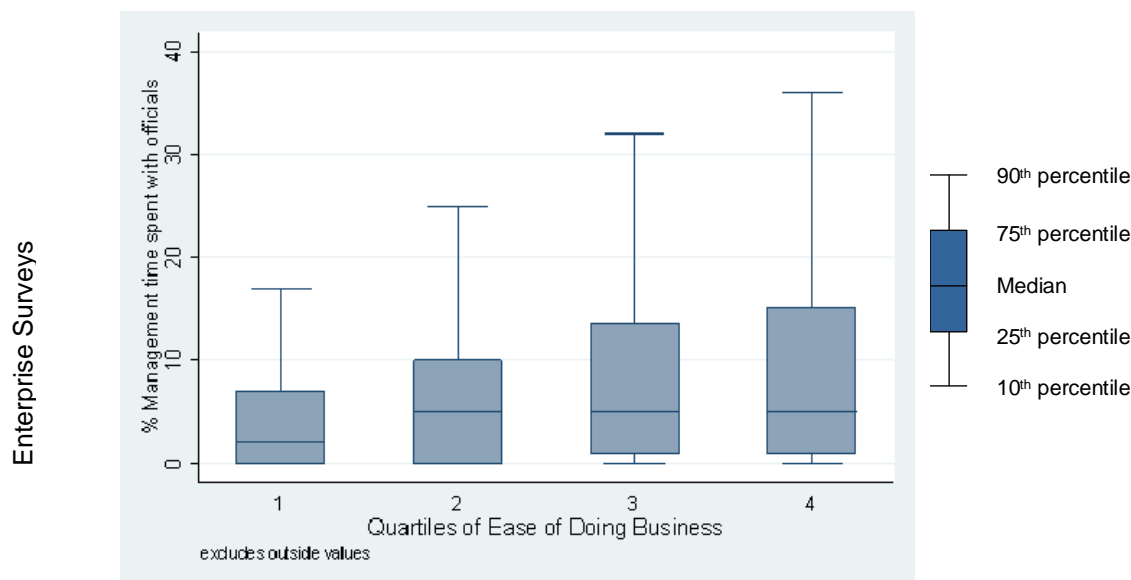
Figure 1 shows that overall, senior managers do indeed spend more time with officials in the economies that DB ranks as having more burdensome regulations. Dividing economies into quartiles based on their overall DB rank, those in the first quartile (i.e.

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<sup>1</sup> The initiative has been called a number of things, Firm Analysis and Competitiveness Survey (FACS), Investment Climate Surveys, Business Environment and Enterprise Performance Surveys (BEEPS), Regional Productivity and Enterprise Development (RPED), the core questionnaire has been standardized across them. This was another motivation within the World Bank, to have a common instrument to allow for more comparisons across economies.

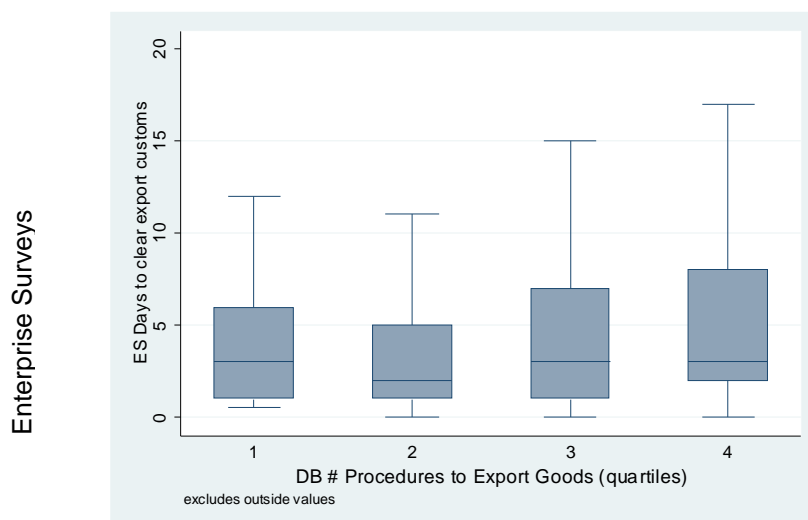
those with the ‘best’ DB ranks) have lower average time spent with officials (although the difference in average levels is not statistically different across quartiles) – but the difference is particularly noticeable at the upper tails. Economies with longer compliance times are the ones with larger outliers in how long things can take to get done.

**Figure 1 - Managers do spend more time with officials in economies DB ranks as having more and longer regulatory procedures**



Looking at some of the individual regulatory areas that ES and DB have in common, there is again a generally consistent pattern. For example, looking at the time to export goods, economies in the top quartile according to DB’s trading across borders index, had shorter times on average – and the distribution is tighter in the lower quartiles (Figure 2).

**Figure 2 - The time to export is higher in economies with more procedures to clear customs**



However, the pattern does not hold for all variables. The time to get a construction permit does not vary systematically with the DB measure. Nor does the time it takes to get a court to enforce a contract dispute. However, as many of the procedures are only carried out by a relatively small subset of the ES samples, the estimates in the ES data can be imprecisely measured.

**Figure 3 - ‘Longest’ delays are substantial everywhere, regardless of formal requirements**

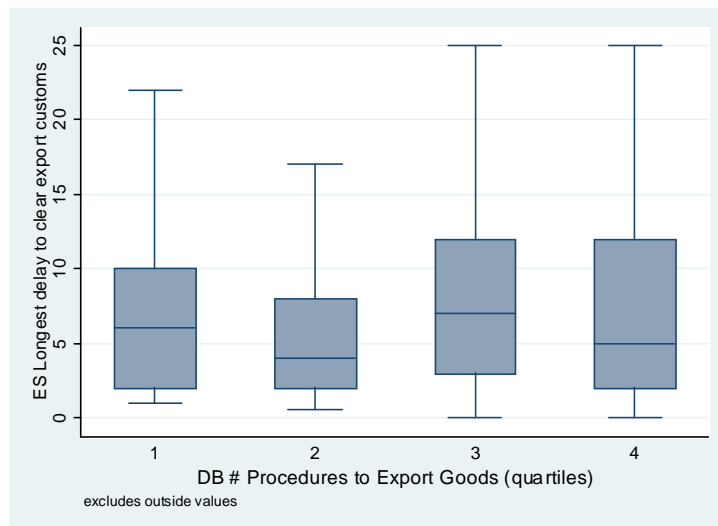


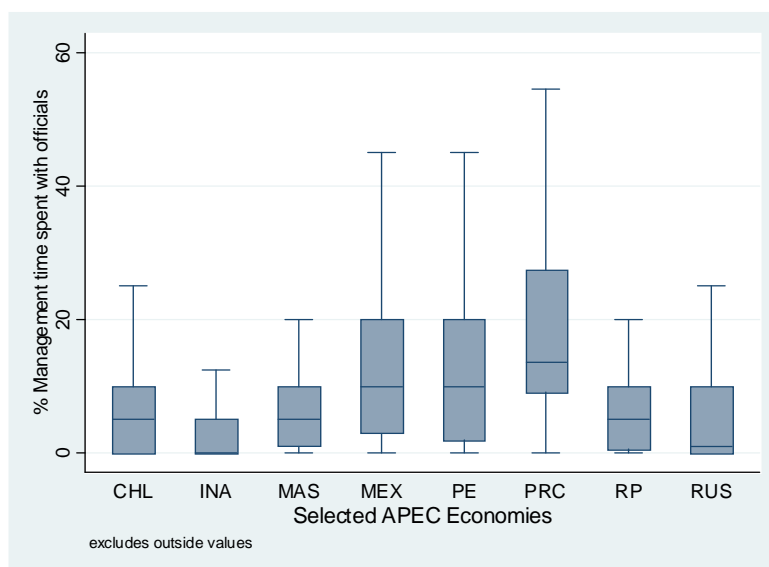
Figure 3 shows a related graph to the previous figure. Whereas the former figure shows the average time a firm experienced in clearing customs, the next figure shows the longest time experienced clearing customs in the previous year. The longest delays can be substantially longer than the average times. And the longest delays are experienced everywhere, even in economies with fewer procedures and formally shorter processing times. This illustrates that implementation matters – and will be discussed in more detail below.

But another clear finding is that there is considerable variation in all of the measures – even in the top quartiles. It is not that all firms have very similar experiences in dealing with regulations and government officials. Some of the variation may simply be measurement error, managers may not remember very precisely how long things took to do, or they may round off their estimates in responding to the questionnaire. This would introduce noise into the data. But that there are a number of consistent patterns that emerge across types of firms makes it unlikely that this is the whole story.

*(b) Variations within an economy are often more significant than differences across economies.*

Figure 4 shows the distributions in time spent with officials for a number of APEC economies. There are certainly differences across economies, but there is also a great deal of variation within each economy. While some firms spend virtually no time dealing with officials – itself an indicator that enforcement and compliance are far from complete – those at the 75th percentile often spend five to ten times more time than those at the 25th quartile. And many spend longer than that.

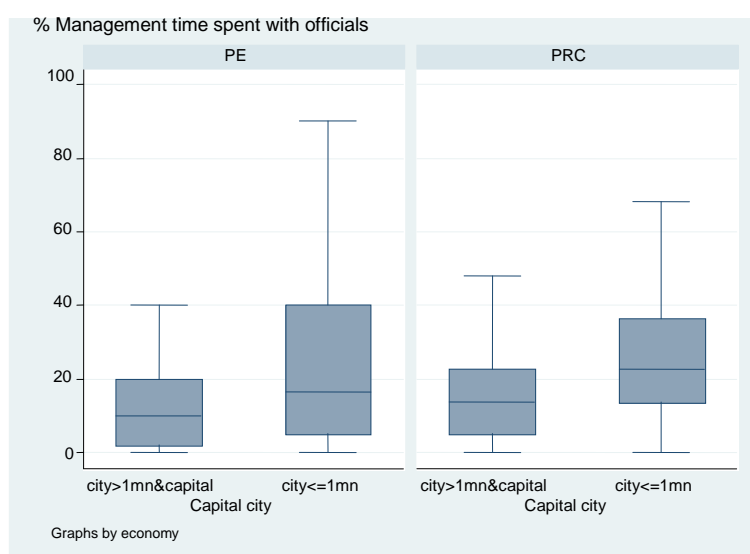
**Figure 4 - Management time spent with officials - varies between and within economies**



The next set of graphs looks at whether there are patterns across firms. A first dimension is location. Are there differences based on the location of the firm? Those in the capital city – or other large city – will likely be located closer to officials, do they then report more or longer interactions with officials? Or, given the greater density of firms, they are better able to avoid substantial interactions and spend less time? Figure 5 illustrates that in China and Peru, there are large differences by location. Firms in smaller cities actually spend more time than their counterparts in the capital or large cities.

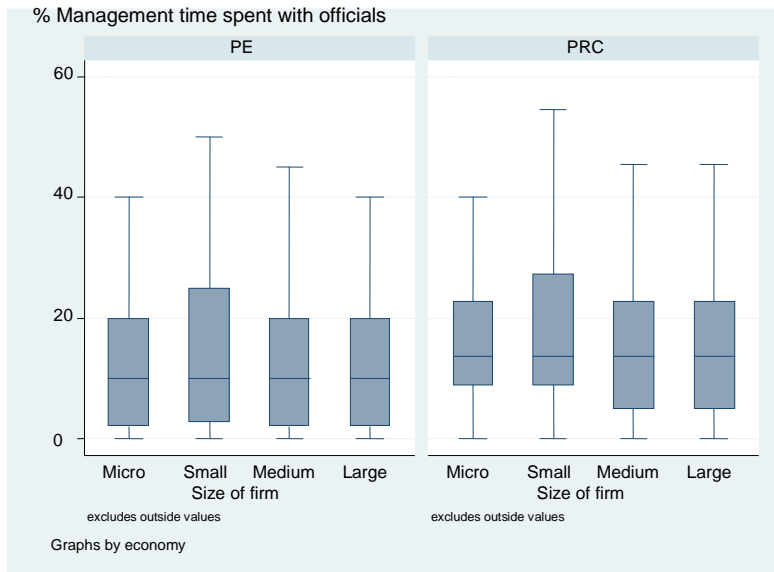
Some of the variation across locations can be an accurate reflection of differences in the local regulations. Indeed, the sub-national Doing Business project demonstrates that within economy variations can be substantial for many of the regulatory areas it covers. But, again, there is still such variation within a location that differences in formal requirements are unlikely to account for it.

**Figure 5 - Management time, by capital.**



Another is by firm type. Do smaller firms spend less time with officials? Again looking at China and Peru, there is wide variation within size class. But in both economies, what is striking is that the largest variation are in the small firms, those with 10-49 employees. As these are the firms often crossing the threshold from informality to formality it may be that they face more need to meet regulatory requirements. However, if some of the time is really red-tape this pattern is worrying in its likely impact of discouraging micro firms from growing.

**Figure 6 - Management time, size of firm.**



Overall, these figures demonstrate that a national aggregated indicator can be quite misleading for any given firm. Some of the variation will be explained by deviations from the tightly defined scenario in the DB examples, i.e. they look at one size-sector-transaction that may apply differently across sectors or sizes of firms. But the extent of the variation appears much larger than what would be expected by formal differences across these dimensions.

Indeed, additional information in the survey raises questions about the consistency of implementation. And this is a big concern for firms.

The Enterprise Survey asks firms if regulations are interpreted consistently (Table 1). Almost half respond that they generally are not, and the vast majority of managers indicate that regulations are not always consistently applied. Indeed, policy uncertainty ranks as one of the top constraints reported by firms.

The ES also show that many entrepreneurs also try to influence outcomes. It is very common, particularly in lower income economies and those with weaker governance, that 'gifts' are part of the inspection or license application process. Many firms report having to pay to help 'get things done.'

**Table 1 - Consistency of enforcement varies widely**

	<b>Percent of management time with officials</b>	<b>Percent of firms that report regulations are interpreted consistently</b>	<b>Percent of firms that believe courts will uphold property rights</b>	<b>Percent of firms that make payments to 'get things done'</b>
Low Income	9.0%	47%	52%	57%
Middle Income	10.6%	41%	55%	30%
High Income	4.7%	53%	71%	23%
East Asia & Pacific	9.8%	56%	69%	50%
Europe & Central Asia	7.1%	41%	50%	38%
Europe High Income	3.4%	57%	75%	21%
Latin America & Caribbean	13.9%	34%	49%	20%
Middle East & North Africa	11.3%	47%	61%	26%
South Asia	10.8%	57%	52%	73%
Sub-Saharan Africa	7.9%	42%	56%	45%

So, firm responses do show that the gap between de facto and de jure can be significant. There is still a question about impact. The de facto measures can be important for this and the results are discussed below. Causation is also an issue, instruments are difficult to find that pass the exclusion restriction. But, one can use averages excluding own response to measure broader environment that the firm operated in.

## ***II. Can regulations help explain firm outcomes?***

This question will be examined in three ways. The first is to use DB indicators to explain the firm average behavior across economies (recognizing from the discussion above that this ignores a large proportion of the variation in the data). The second is to use additional information about other dimensions of the business environment to put the extent to which regulations are constraints into a broader perspective. Lastly, the de facto measures of regulations and other business environment indicators are regressed against firm performance, focusing on firm growth.

### *a) Using DB to explain firm behavior.*

DB and ES can be used together, to see if in economies with fewer delays or lower costs contributes to better firm performance. Causation and omitted variables are still likely to remain concerns, so the results should be interpreted with caution. Figure 7 shows that, controlling for income, economy openness, inflation, and governance, the DB measure of credit information is positively associated with the firms' average share of investments financed by bank loans.

What is interesting, though, is that some of the relationships are not what might be expected. In general, more procedures are interpreted as entailing more red tape and implying more time to complete. However, in the case of contract enforcement, there is a positive association with the number of procedures and the average level of confidence managers report in the court system upholding their property rights (again, controlling for a number of economy characteristics) (Figure 8).

Figure 7 - Firms have higher share of investments financed by banks in economies with higher credit information systems.

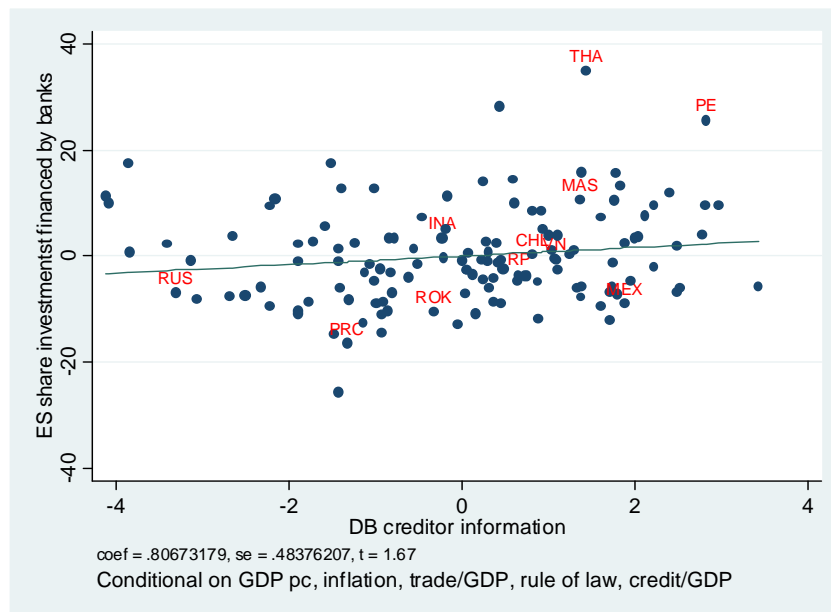
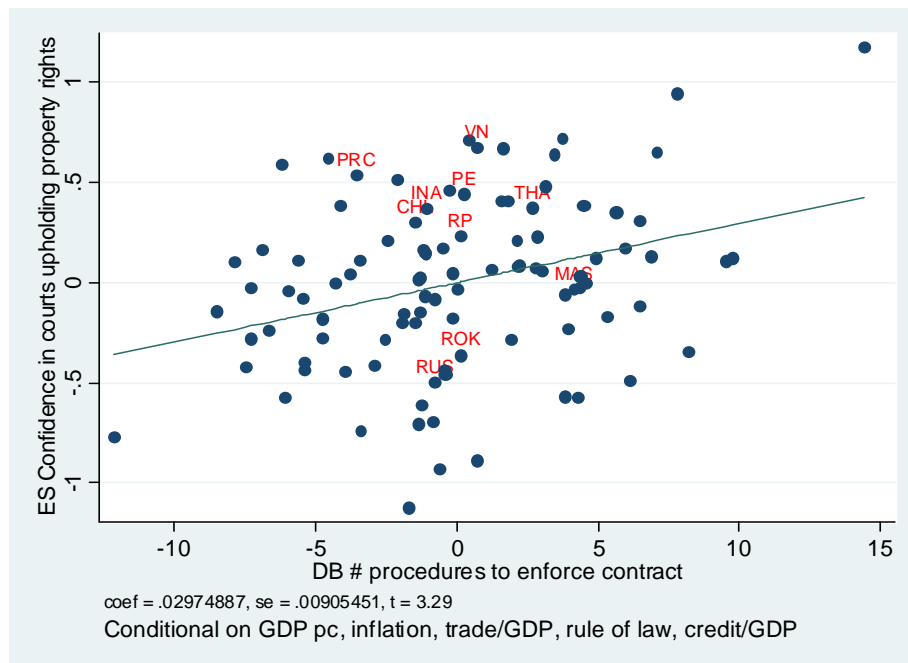


Figure 8 - However, more procedures to enforce contracts is not necessarily perceived as undermining protection of property rights.

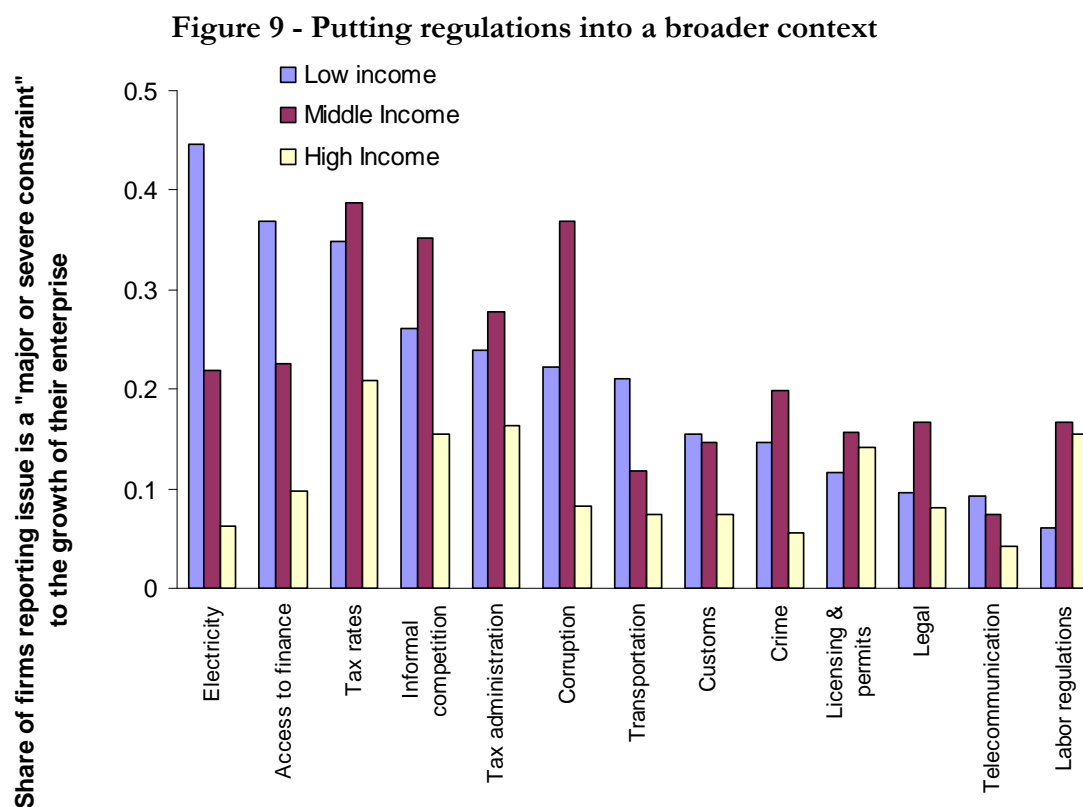


b) *Putting regulations in a broader perspective of business environment issues.*

Because the scope of the ES is wider, it is also a useful tool for putting the relative importance of regulations into perspective. Are regulations seen as more constraining than

access to finance or infrastructure services? Does this vary across economies or across types of firms?

Figure 9 shows how managers respond to the list of potential constraints to the operation and growth of their businesses. They are asked to rank each one on a scale of 0-4 (i.e. from 'no constraint' to 'severe constraint'). The graph shows the proportion in each economy that ranked the issues as 'major' or 'severe'.



Three patterns stand out. First, the extent of complaints decreases dramatically with income. Fewer managers in high income economies report an issue as a major or severe constraint – and this holds across all issues. However, for high-income managers, regulations are among their top constraints. Tax administration, labor regulations and licenses & permits are among their top concerns.

Second, for low-income economies, electricity and access to finance are their top constraints. The severity of these constraints drops most dramatically with income. Regulations are not that high on their list of concerns, particularly labor regulations. Given Doing Business generally ranks low income economies as having some of the greater restrictions on employing workers, this again underscores the need to consider compliance and enforcement.

Third, where the issues of regulations, taxation, governance are reported as most constraining are in middle-income economies. What is interesting is that along with taxes and tax administration, corruption is reported as more of a constraint. So too is the informal sector. It is not necessarily that the formally registered firms that are the basis of the sample are necessarily talking about micro firms. Informality is also associated with non-compliance – and this is an issue that is relevant across the size spectrum. It is in the



middle income economies, though, where firms are more likely to report that ‘firms like theirs’ do not report all of their income to the tax authorities or register all of their workers.

c) *Using de facto measures of regulations to test for impact on firm performance.*

One concern in using the ES data to analyze the impact of regulations (or any other measures of the business environment) on firm performance is endogeneity. It could be that the firm’s performance is what drives the extent of reported constraints. That said, it is not necessarily clear which way the bias might go. Firms that are growing may be more optimistic and report fewer constraints. But it could also be that it precisely the ones that are growing that are bumping up against constraints. The literature often emphasizes the concern with relation to access to finance; more productive firms are more likely to qualify for finance, helping generate the positive association between greater access to finance and better performance. But interaction with officials could well be another. If officials are looking to maximize the payments they can receive, firms that are growing will have the best ability to pay. They are also likely to have a higher opportunity cost of delays and so potentially a greater willingness to pay too.

To mitigate the potential of reverse causation, the location-sector-size average of the indicators are used. These measures are more likely to capture the environment in which similar firms are operating. Subtracting out the firm’s own response thus breaks the link between the firm’s performance and the measure of regulations used to explain it. The same technique is applied to all the other business environment variables too.

The regressions control for a number of firm characteristics, such as age, sector, ownership, export status and location. The various measures of regulations are included, along with the other measures of the business environment to avoid omitted variable bias. The results are strongest for consistency of enforcement. Having clear rules that entrepreneurs know how they will be applied reduces uncertainty. It strengthens the incentive to comply and makes attempts to circumvent the system through ‘gifts’ less effective.

Access to finance is another area that has strong positive associations with firm growth. This is after controlling for possible endogeneity. While this was not always reported as a constraint, the results confirm this is a significant area associated with growth. The results on other measures of regulation are more muted. Management time with officials has a small positive effect, as does bribes.

As with the work in Part I, there are significant differences in the results, however, when one takes into consideration the broader institutional quality of the economy. Allowing for interactions with the ‘rule of law’, stronger patterns emerge (Figure 10). Similar results are obtained using ‘control of corruption’ instead of ‘rule of law.’

The positive effect of consistency is even larger in stronger rule of law economies, as is access to finance. Thus consistency seems to be reinforced where the rule of law is stronger; is not that consistency on its own has as beneficial an impact with the broader environment suffers from weaker government. Access to finance, to the extent that it involves a longer term relationship and risks, the quality of the broader institutional environment can reinforce the ability of firms to access the credit (borrowers will be more willing to extend the credit) as well as face better conditions in which to operate.

There are a number of more surprising results. One is the frequency of inspections. While negative in weak rule of law economies, it is actually positive in stronger rule of law economies. Inspections, if regular and consistent in enforcement, are associated with greater compliance and lower uncertainty – and these in turn are associated with higher growth. The effect with management time is similar, although the magnitude of the effect is smaller.

Another striking finding is the result on bribes. In weak rule of law economies, bribes are associated with higher growth. This would be consistent with bribes helping ‘get things done’ – and such payments might well be necessary. On the other hand, when the rule of law is stronger, the effect of bribes is negative. This could reflect that rather trying to help open doors, bribes may be associated with firms trying to avoid negative outcomes. Or it could be, with recourse to courts, rent-seeking officials can only approach weaker or distressed firms that are not interested in pursuing court remedies.

**Figure 10 - Institutional quality matters**



As a final exercise, we look at the interactions between these results and the Doing Business indicators. We divide the sample into two groups based on their overall measure of the Ease of Doing Business. We test whether the contribution of consistency is more strongly positive where the regulatory requirements cost less and are associated with fewer delays; where costs are high and delays are long consistency of enforcement could actually be harmful to firm growth.

**Figure 11 - Consistency of enforcement and bribes play opposite roles – depending on the costs and delays of official requirements.**

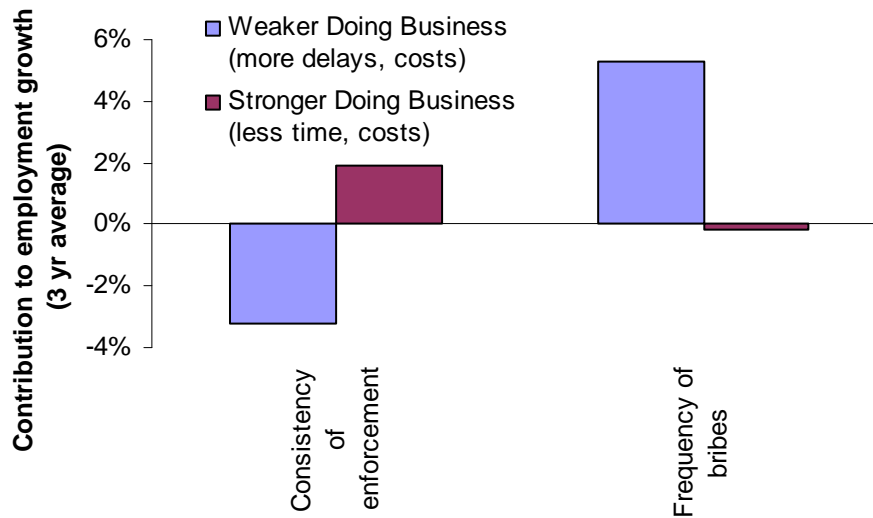


Figure 11 shows the two significant results. First, consistency of enforcement is indeed positive where the Ease of Doing Business is ranked better. On the other hand, it is actually associated with lower employment growth where it is ranked lower. Second, the contribution of bribes differs too. Bribes are associated with higher employment growth – where the official requirements are more burdensome. This would be consistent with a ‘greasing the wheels’ view of petty corruption, that more onerous requirements opens the door to unofficial payments.

### ***Conclusion***

Using the Enterprise Surveys, this paper has shown the importance of drawing on complementary information of enforcement and firm experience in assessing the impact of regulations. The results show that broader governance matters for finding an impact of regulations and reforms. Simply changing formal requirements that are not applied is unlikely to make much difference. Enforcement varies widely -- both across and within economies. Greater consistency of enforcement is needed to close the gap between de facto and de jure regulations. This gap is relatively close in well-governed economies, but remains a challenge in many. Strengthening governance and controlling corruption has beneficial effects directly on firm performance, but also the wider influence of other dimensions of the business environment, so the benefits could be substantial. In pursuing a reform agenda, these broader institutions need to be strengthened too if specific regulatory reforms are to have the desired effect.

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## The Ease of Doing Business in APEC: The Impact of Regulatory Reforms

### Part III: Case Studies\*

**Abstract:** This paper contains eight in-depth case studies to examine the significant factors shaping individual reform efforts—the 2005 Company Law in China; Customs and Border-Related Reforms in Korea; Real Estate Industry Reforms in Malaysia; Business Registration in Mexico; Secured Transactions in Peru; Credit Reporting Systems in The Philippines; Tax Administration in Thailand; and Land Titling in Vietnam. National competitiveness is a prime motive for initiating regulatory reforms. Complementary reforms in other parts of the economy were important in supporting successful regulatory change. Changing the mindset of officials is the most difficult challenge of public administration reform, especially moving public agencies toward a service orientation. The alignment of incentives with goals requires simultaneous action on several fronts, including information, education and communication programs on top of changes in remuneration. IT has proven to be very effective in addressing governance issues by permitting the transparent and parallel processing of transactions and reducing the scale of abusive bureaucratic intervention. Finally, extensive and continual consultation with all affected parties, backed up by a systematic monitoring and evaluation mechanism, help make regulatory reforms effective, yet flexible enough to cope with changing needs.

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent.

## **The Ease of Doing Business in APEC: The Impact of Regulatory Reforms**

### ***Overview of Case Studies***

Parts I and II of this report contain mainly quantitative analyses of the impact of regulatory reforms. They relate the information collected from the World Bank's Doing Business and Enterprise Surveys databases to measures of desirable aggregate outcomes. They also assess cross-economy, sectoral, and temporal variations and the interactions of regulations with other aspects of the business environment. A general lesson from the analysis of these parts of the report is that interactions among different regulatory clusters are important, but also that enforcement is a key determinant of the effectiveness of regulatory reforms.

Part III of this report presents case studies of the design, implementation and effect of reforms in eight economies.<sup>1</sup> They are based upon inputs provided by experts familiar with the evolution of specific regulatory reforms in each of the economies. They provide an in-depth analysis of reform initiatives and provide insights that are unavailable from an assessment of quantitative indicators alone. However, they are not unrelated to the analysis contained in Parts I and II, which demonstrated the importance of interactions within an economy. Case studies permit us to go beyond recognition of such interactions to a deeper assessment of the nature of the interactions. They also provide a historical view of the motivations for specific regulatory changes, the forces that shape the design of reform initiatives, the twists, turns and compromises made in their shape and implementation, and their effects on a broader set of outcome indicators than those normally covered by studies limited to quantitative indicators. As such, they offer extremely valuable complementary information for impact evaluations and, most importantly, for learning from experience. The knowledge spillovers from regulatory experience can occur within an economy, for example from an initial to subsequent regulatory reform areas, or across borders.

Each of the case studies focuses on an area of regulatory reform covered by the Doing Business and Enterprise Survey indicators. The case studies describe the pre-reform situation, the motivation for reform, the type of reforms attempted, implementation issues, including political economy considerations, and an evaluation of the effect of the reforms. Interestingly, there are some general patterns that emerge from the case studies, and these are described in this overview.

- The desire to improve national competitiveness is the main motive for regulatory reform among the APEC economies covered by the case studies. This is seen in the documents that promote reforms, key pronouncements by leaders, and major performance monitoring benchmarks introduced into reform programs. Collectively, and with virtually no exceptions, the information, education and communications (IEC) programs supporting reform efforts refer to advances made by neighboring economies,

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<sup>1</sup> 2005 Company Law in China; Customs and Border-Related Reforms in Korea; Real Estate Industry Reforms in Malaysia; Business Registration in Mexico; Secured Transactions in Peru; Credit Reporting Systems in The Philippines; Tax Administration in Thailand; and Land Titling in Vietnam.

the imperatives of rapid globalization, and the ability to compete for trade and investment. However, the desire to be competitive has taken at least three distinct forms.

- Economies in transition from one economic system to another (for example, China, Vietnam) have perforce opted for root-and-branch reforms to phase out frameworks that were no longer relevant to their changing circumstances. They have sought to modernize their business environments by drawing extensively upon the laws, other institutions, and practices of the more advanced market economies within APEC. China revised its corporate laws to accommodate non-state owned enterprises and to accelerate economic growth by easing the entry of new businesses into sectors dominated by government enterprises. Vietnam revised laws to provide access to land to the rapidly emerging class of entrepreneurs and non-state firms, including foreign enterprises that appeared after its economy-wide liberalization.
  - Economies that had experienced a crisis took regulatory initiatives of an ameliorative or precautionary nature. They seized the opportunities provided by such crisis for forging new reform coalitions as well as for undertaking major regulatory overhauls. Thailand introduced economy-wide public administration reforms after the Asian Crisis but emphasized revenue administration reforms. This was because it had to meet an immense need for increased revenues to fill the spending gaps left by its collapsed private sector and to service the huge debts it had incurred distress borrowing during and after the crisis. The Philippines introduced the first of its credit registration reforms following a crisis in the domestic money market that threatened the stability of the banking sector. In both cases, the benchmarks for reform initiatives came from international experience, and the importance of remaining competitive in relation to other economies was used to motivate the reforms.
  - Several economies had narrower development objectives in mind when initiating reforms, but the theme of national competitiveness was paramount. Korea, for example, entered into a period of massive reform of its Customs and border-related administration, with the important objective of becoming the logistics hub for Northeast Asia. Peru's reform of the framework for secured transactions was initiated by a study that showed the vast gap that existed in the bank credit that was available to its business sector, compared to the situation in its neighboring economies.
- More often than not, the need for regulatory change—specific or comprehensive—was identified and emphasized by those most affected by the regulations; Governments seldom initiated reforms on their own. Households in transition to becoming entrepreneurs, small firms attempting to grow, and other domestic and foreign investors with specific aims would be the first to propose reform. The reason this is significant is because the amount of “voice” available to such groups varied greatly among the economies, yet was sufficient to help initiate reform. An implication of this observation is that the empowerment of non-Government actors and their participation in the design of critical economic policies can be a powerful tool for regulatory reform.
  - The case studies support the findings of Part II of the report regarding interactions and spillovers among different areas of reform in an economy. Individual reforms seem to be more effective when they are embedded within a broader program. Clusters of

coordinated reforms seem to have a greater effect than the sum of individual, disparate initiatives. Even if this were not so, the interconnectedness of finance, business behaviors, institutions, and real resource flows in an economy makes it difficult to limit the ambit and instruments of regulatory action. This is true, especially, when reforms are undertaken within federal political structures (Malaysia, Mexico), but applies as well to unitary states such as China. The importance of scale economies in coordination drives policymakers towards broader, rather than narrower, regulatory change. This observation contrasts with the “binding constraint” view that has been put forward by an influential group of development analysts, which supports addressing narrow constraints in a sequential manner. Experience shows that while a single constraint may hold back an economy, its resolution depends on designing and implementing simultaneously a cluster of related reforms.

- Perhaps the most important general lesson from the case studies is that there is need to narrow the gap between laws/regulations and their enforcement. The big challenge here is to change the mindset of officials, chiefly from a “ruling and administering” mode to a services orientation. While changes in organizational structures and the legal framework are seldom easy, changes in the behavior of bureaucrats ultimately determine the effectiveness of regulatory reform. Such changes are affected by the quality of leadership, including a broad group of champions for reform, active IEC programs, and staff training. Above all, they require a sharp change in incentives, a combination of better service conditions as well as better measurements of performance. As demonstrated well by Thailand’s reforms of the operations of its revenue department, it is useful to put in place a robust monitoring and evaluation system that covers not just physical targets and outcomes, but also behaviors. It is a well known aphorism in development economics that “what gets measured gets done”.
- Finally, modern information and communication technology (ICT) is a major enabler of effective regulation. Its first role is as a facilitator, demonstrated in seven of the case studies in Part III, with the most dramatic effects visible in the Customs and border-related reforms in Korea, the revenue reforms in Thailand, and the credit reporting systems reform of the Philippines. However, beyond facilitation, ICT has played a vital role in governance, especially in economies with low bureaucratic remuneration, weak incentives and poor culture of accountability, and excessive deference to power and position. ICT permits the design of regulatory systems and processes that limit the use of discretionary power by bureaucrats, thus reducing the scope for the corruption and preferential treatment that is the bane of many regulatory regimes.



## The 2005 Company Law of China\*

### *Introduction*

Since the early 1980s, China has introduced a series of economic reforms that opened the domestic market to external trade and capital, increased the role of market signals and decentralized resource allocation in the economy. Accompanying this process of opening, liberalization and devolution was a set of institutional reforms—laws, regulations, and implementing and regulatory agencies—to support economic transactions efficiently, while recognizing the diversity of size, ownership and function of different sectors of a large and increasingly complex economy. After 1994, China’s institutional reforms accelerated rapidly. Within the broad strategy of building a “socialist market mechanism,” the Chinese government undertook SOE reforms that essentially privatized medium and small state owned enterprises (SOE) and transformed large SOE into corporations. The Chinese government also changed its attitude and policies toward private firms, from resisting to encouraging, realizing that the domestic and foreign private sectors were the engine of growth and a major source of employment.

In a little more than a decade after 1994, due mainly to these reforms, the landscape of the Chinese economy changed drastically. Even though China did not follow a wholesale privatization strategy, continuing SOE reforms have substantially reduced their share in the whole economy. A large proportion of the remaining SOE became corporations, with a mixed ownership structure. Some listed in China’s two stock exchanges (Shanghai and Shenzhen) or in overseas stock exchanges. Meanwhile, from being only a fringe of the economy in the early years of the reforms, the private sector experienced tremendous growth and has become a major force. Moreover, as China opened up further after WTO accession in 2001, foreign direct investment into China has flourished, and foreign firms or foreign ownership in Chinese firms is visible in many industries.

This case study examines changes in the Company Law to accommodate as well as to promote the economic transformations that were taking place in China. It focuses on entry regulations, and offers insights into legal and regulatory changes in periods of transition from one economic system to another, in the context of modern day globalization. Specifically, it describes the processes through which radical changes can occur through incremental reforms in a system characterized by incomplete market institutions, relatively weak private sector interest groups or organized entrepreneurial clusters, but a strong and development-oriented decision-making apparatus.

### *Motivation for the reform*

China’s original Company Law was passed by the Standing Committee of the Eighth National People’s Congress in December, 1993, and took effect on July 1, 1994. This was a basic step the Chinese government took in building a “socialist market mechanism,” the overall reform strategy adopted after Deng Xiaoping’s famous tour to the south in 1992. The original Company Law specified the legal status and rights of enterprises of various

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or of the government of China.

ownership types, and provided basic legal guidance for setting up and organizing companies and corporations.

It became increasingly apparent that the original Company Law did not fit the fast changing reality of the Chinese economy. There were two minor revisions of the Company Law in 1999 and 2004. But, in order to sustain and increase the competitiveness of the “socialist market economy”, the Chinese government realized that major revisions of the Law were badly needed. *First*, the Company Law enacted in 1994 put too much emphasis on reforming SOE, neglecting other types of firms that were also market participants. *Second*, the original Law contained many burdensome regulatory requirements, leaving too much room for bureaucratic intervention, which seriously hindered market efficiency. *Third*, as the Chinese economy became more open to the world, some clauses of the original Company Law were in conflict with international standards, and new issues had come up, which needed addressing in the Company Law.

On June 16, 2003, at their annual planning meeting, the Standing Committee of the National People’s Congress made revising the Company Law a priority. In the summer of 2004, several high-level on promoting the growth of non-state sectors made it clear that the Chinese Government aimed to create a fair, competitive environment for non-state firms. Specifically, China would reform the laws and regulations that hindered the development of non-state sectors, with a focus on entry regulations. On February 24, 2005, the State Council issued “Several Opinions for Encouraging and Guiding the Development of Non-State Sectors,” which called for eliminating institutional obstacles on non-state sector development, to give equal status to all market participants and to create fair competition in the market economy.

### ***The new Company Law***

On October 27, 2005, the Standing Committee of the Tenth National People’s Congress passed the Company Law of 2005, which took effect on January 1, 2006. This Law made several important revisions to the old Company Law. It retained just 20 of the 230 clauses contained in the old Law. The following discussion describes and assesses the nature of reforms for “starting a business.”

#### ***Pre-2005 regulations***

In the old Company law,

- the upper limit on the share of intangible assets in the total registered capital of limited liability companies was 20 percent;
- the minimum registered capital for limited liability companies was RMB500,000 for manufacturing and wholesale firms, RMB300,000 for retail firms, and RMB100,000 for technology, consulting and services firms;
- the minimum registered capital for corporations was RMB10 million;
- the registered capital had to be paid up in full at the time of registration;
- only cash, physical assets, intellectual property rights and land rights (where intangible assets were subject to the 20 percent upper limit rule) could be used as registered capital; financial assets and other intangible assets could not be used as registered capital.

These regulatory requirements for entry were quite stringent and rigid, especially for start-ups, technology and services firms, and small and medium enterprises (SME). Considering China's per capita income (less than \$1000 for most of the 1990's and still less than \$3000), these requirements represented high entry barriers for ordinary citizens who wanted to establish businesses. Even in 2005, when the per capita income had increased significantly compared with the earlier years of economic reform, the minimum registered capital amounted to 9.5 times per capita income.

### ***Reforms to “starting a business” regulations***

The Company Law of 2005 substantially loosened the regulatory requirements for entry.

- The new Law requires that the share of monetary capital in total registered capital must be at least 30 percent, which implies that the share of intangible assets in total registered capital can be as high as 70 percent.
- For all limited liability companies, the minimum registered capital fell sharply, to RMB30, 000.
- The minimum registered capital for corporations fell from RMB10 million to RMB5 million.
- The new Company Law allows owners of companies to pay in just 20 percent of the registered capital at the time of registration, and pay up the entire registered capital within 2 years of registration. For investment companies, owners can pay up the entire registered companies as much as 5 years after registration.
- The new Company Law allows using tradable non-monetary assets, such as stocks, financial assets and other intangible assets, to count as registered capital.

To comply with the new Company Law, the State Council revised the “Regulatory Rules of Company Registration” and, accordingly, the National Business Administration Bureau (which is in charge of company registration) issued revisions to the “Administrative Rules of Company Registered Capital”. Both took effect on January 1, 2006. These rule changes aimed to ease the process of company registration and reduce registration costs.

- The new Company Law and the associated changes in regulatory rules do not change the number of steps needed to register a company.
- To reduce the time it takes to register a company, the regulatory rules allow registration in person, by mail or by electronic filing, and specify the maximum time the registration agencies can take to respond to inquiries and applications.
- The new Company Law and the associated changes in regulatory rules reduced registration fees, as shown in Table 1 below:

In the area of “starting a business,” together with other measures, the Company Law reform of 2005 made noticeable progress in easing the entry process and reducing entry costs for businesses in China. This is seen, for example, in the survey results on Chinese firms in the Doing Business Database of the World Bank. The Database presents four variables to measure the ease of “starting a business”: number of procedures and number of days it takes to register a company, registration costs (as a proportion of per capita income), and the minimum registered capital (as a proportion of per capita income). Table 2 presents the results for Chinese firms.

**Table 1 - Change in Regulatory Rules**

Registered capital	Old Regime	New Regime
Less than 10m	0.1%	0.08%
More than 10m	Excess over RMB10 million, 0.05%	Excess over RMB10 million, 0.04%
More than 100m	Excess over RMB10 million, no fee	Excess over RMB10 million, no fee

**Table 2 - Ease of Starting a Business in China**

Year	Procedures (number)	Time (days)	Cost (% of per capita income)	Min. Capital (% of per capita income)
2005	13	48	13.6	946.7
2006	13	35	9.3	213.1
2007	13	35	8.4	190.2
2008	14	40	8.4	158.1

As seen in Table 2, the Company Law reform of 2005 did not change the number of procedures to register a company, but reduced the registration time from 48 days in 2005 to 40 in 2008. Registration costs, as a share of per capita income, also fell, from 13.6 percent in 2005 to 8.4 percent in 2008, a 38 percent reduction. The most significant effect of the Company Law reform was on the minimum registered capital, which fell from almost 9.5 times of per capita income in 2005 to less than 1.6 times in 2008.<sup>1</sup> In 2008, the Government added a procedure—“obtaining capital verification reports from an auditing firm”—to the registration requirements. This additional procedure takes a day to complete, and the procedures for “obtaining a registration certificate” takes 5 days compared with just one day previously, extending the total time it takes to register a company from 35 (during 2006 and 2007) to 40 days.

Even though the Company Law reform of 2005 made substantial progress in loosening regulatory burdens for starting a business, China is still lagging in this area compared with other APEC economies. Table 3 from the Doing Business Database of the World Bank makes the cross-economy comparison.

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<sup>1</sup> Note that per capita income rose sharply during this period, so the table overestimates the absolute reductions in costs. For example, the total registration fee actually increased by RMB240 between 2007 and 2008, exactly at the rate of increase of per capita income, leaving the cost relative to per capita income unchanged from the previous year. The minimum registered capital requirements did not change, but the relative cost decline because of the rise in income.

Table 3 - APEC Economy Rankings in Doing Business Indicators 2009

Economy	Starting a Business					Ease of Doing Business Rank, Aggregate
	Rank	Procedure (number)	Time (days)	Cost (% of income per capita)	Min. capital (% of income per capita)	
New Zealand	1	1	1	0.4	0	2
Canada	2	1	5	0.5	0	8
Australia	3	2	2	0.8	0	9
United States	6	6	6	0.7	0	3
Singapore	10	4	4	0.7	0	1
Hong Kong, China	15	5	11	2	0	4
Thailand	44	8	33	4.9	0	13
Chile	55	9	27	7.5	0	40
Japan	64	8	23	7.5	0	12
Russia	65	8	29	2.6	2.2	120
Malaysia	75	9	13	14.7	0	20
Papua New Guinea	92	8	56	23.6	0	95
Vietnam	108	11	50	16.8	0	92
Mexico	115	9	28	12.5	11	56
Peru	116	10	65	25.7	0	62
Chinese Taipei	119	8	42	4.1	177.4	61
Korea	126	10	17	16.9	53.8	23
Brunei	130	18	116	9.2	0	88
China	151	14	40	8.4	158.1	83
Philippines	155	15	52	29.8	6	140
Indonesia	171	11	76	77.9	74.2	129

It shows that China is ranked 151 in the world in terms of ease of starting a business in 2009; a sharp contrast to how much China has progressed in building the socialist market economy in other dimensions. China has a stringent minimum capital requirement, while most APEC economies have no such regulatory requirement. China also needs to reduce the number of procedures, which correlates closely with the number of days it takes to register a company. China currently requires 14 procedures, while the median of all APEC economies is eight.

The “Doing Business 2008 China” report of the World Bank lists the 14 procedures and the time it takes by each procedure as follows. Table 4 presents the information. As seen in Table 4, the procedures are cumbersome in terms of both the number of steps and the number of agencies involved. There is room to streamline the process even more. Another direction for improvement is to reduce the total time it takes by parallel processing some of the procedures and speeding up those that currently have high time costs (procedures 4, 7, 9 and 11).

**Table 4 - Registration Procedures and Time in 2008**

No:	Procedure	Time to complete (days)
1	Obtain a notice of pre-approval of the company name	1
2	Open a preliminary bank account; deposit fund in the account and obtain the certificate of deposit	1
3	Obtain capital verification report from an auditing firm	1
4	Obtain registration certification “business license of enterprise legal person” with SAIC or local equivalent	5
5	Obtain the approval to make a company seal from the police department	1
6	Make a company seal	1
7	Obtain the organization code certificate issued by the Quality and Technology Supervision Bureau	5
8	Register with the local statistics bureau	1
9	Register for both state and local tax with the tax bureau	10
10	Open a formal bank account of the company and transfer the registered capital to the account	1
11	Apply for the authorization to print or purchase financial invoices/receipts	10
12	Purchase uniform invoices	1
13	File for recruitment registration with local career service center	1
14	Register with Social Welfare Insurance Center	1

### ***Political economy of the reform process***

The reform process of the Company Law of 2005 is interesting from the political economy point of view. Clearly, easing regulatory burdens and promoting a fair competition environment for all market participants are socially desirable goals. However, decision-makers sometimes do not make socially efficient institutional changes, especially if their time horizons are short. Unfortunately, bad institutions are often quite persistent, especially in many developing economies. It is critical, therefore, to embed specific reforms within a longer-term vision regarding institutional evolution that keeps pace with economic needs and domestic capacities.

Why and how did this regulatory reform succeed? The modern economics of regulation does not view regulatory changes as simply a process of pursuing the public interest, as did the traditional economists such as Pigou (1938). Rather, it views regulatory changes as a political economy process in which regulators and interest groups interact in a complicated way to pursue diverse interests, for example, the capture theory advanced by Tullock (1967), Stigler (1971) and Peltman (1976), and the toll-booth theory proposed by McChesney (1987), De Soto (1990) and Shleifer and Vishny (1998). As a case that is representative of China’s regulatory reforms, the Company Law reform of 2005 shows how various groups brought different experiences and interests to bear and exert influence *via* different channels to add particular components to strengthen the package of reforms. This process is as complicated in China as elsewhere, as China’s market-based institutions are not fully developed as yet.

No regulatory reform in China can succeed without the central government's resolve to address the pertinent problems of the old regime. The Company Law of 2005 is no exception. The outstanding economic performance of the 1990s proved that building the "socialist market mechanism" was the right direction for the economy. Facing the new economic reality of a dynamic economy with mixed ownership types in an era of globalization, the Chinese government realized that promoting a fair competition environment for all market participants was critical to improving the efficiency and competitiveness of the Chinese style market economy. On March 15, 2001, the Ninth National People's Congress passed the "Tenth Five-Year Plan," which laid out a strategy for further economic reforms. These included additional changes in the SOE sector (essentially privatizing small and medium SOE and transforming large SOE into corporations) and promoting non-state enterprises, especially SME, services and high technology firms. Since then, the Chinese government has stressed the importance of non-state enterprises and SME in promoting growth, employment and international trade in several policy pronouncements. Thus, eliminating institutional barriers and reducing regulatory burdens for SME and non-state enterprises became an important policy priority for the Chinese government.

The Company Law reform of 2005 was successful also because it was an important part of the Chinese government's overall legislative reform to build the "socialist legal system" with Chinese characteristics to provide the legal foundation for the "socialist market mechanism." On March 14, 2006, the Tenth National People's Congress passed the "Eleventh Five-Year Plan," which called for "overall efforts in legal construction." Among a bundle of legal reforms that were passed around the same time as the New Company Law (including the Bankruptcy Law, Securities Law, etc.), the Property Rights Law, which was passed by the Tenth National People's Congress on March 16, 2007 after 13 years of deliberation was the most significant. For the first time since the Chinese Communist Party took control of the economy in 1949, private property rights were recognized and protected. Thus, the Company Law reform of 2005 was undertaken at a time when the economy and the Government were ready to fully embrace a rule-based competition-driven market mechanism, which paved the way for its successful passage.

However, the central government's commitment and the benign environment for reform did not mean that the reform process was easy. To the contrary, the process of Company Law reform was quite complicated, requiring inputs from numerous experienced groups, each with their specialized viewpoints on the direction of reforms needed by the economy. The results of the reform process reflected adherence to the longer-term vision for developing the Chinese economy, application of the state-of-the-art lessons from regulatory reforms around the world, and a balance between the views of the various expert groups involved in proposing such a radical change in the business environment.

The regulatory burdens and entry barriers of the old Company Law affected private enterprises and entrepreneurs the most. Naturally, therefore, they pushed for reform. However, unlike in other market economies, private enterprises and entrepreneurs in China did not have well functioning organizations representing their collective interests, such as industrial associations that could exert influence on the legislature through lobbying. Thus, in the case of the Company Law reform, some entrepreneurs took the initiative to make

their voices heard and made individual efforts in lobbying the legislative body in China. Examples included:<sup>2</sup>

- Well-known entrepreneurs such as Wang Wenjin (Chairman of Yongyou Software), Li Dongshen (TCL CEO), Dong Weiping (Chairman of Hanzhou Baida Group) had made public appeals to revise the Company Law since 2002, and submitted their proposals to the National People's Congress. Mr. Wang Wenjin even organized a group of legal scholars to draft a new Company Law and send it to the National People's Congress.
- During the meetings of the National People's Congress and the National Committee of the Chinese People's Political Consultative Congress (CPPCC) in March 2004, other entrepreneurs such as Guo Guangchang (Chairman of Fuxin High Tech Group), Zhao Linzhong (Chairman of Zhejiang Furen Group) and Lai Guiyong (Chairman of Xiamen Youngquan Group) submitted various proposals to revise the old Company Law. They criticized particularly strongly the regulatory requirements on registered capital and other stringent requirements to set up a company, as well as restrictions on firms' organization and investment.

Such lobbying efforts raised awareness of the problems in the old Company Law among the public and legislators. During the meetings of the National People's Congress and the CPPCC in March, 2004, 601 members of the National People's Congress and 13 members of the CPPCC proposed bills to revise the old Company Law. This was the first time such a large number of legislators collectively proposed legal changes in China. This provided a strong favorable signal to the Chinese Government to act quickly to reform the Company Law. As broad consultation has been a hallmark of Chinese economic reforms, accounting for its relevance to the problems being addressed as well as its widespread acceptance across an economy as large and complex as China, this episode demonstrates that several channels exist for eliciting the views of affected groups. The challenge for all regulators is to ensure that such views find expression, and are considered seriously in the formulation of regulatory regimes.

Legal scholars and lawyers played an important role in reforming the Company Law, serving as a bridge between public opinion and the relevant decision makers, and serving as an advocate for the public interest. Some legal scholars were directly involved in the revision of the Company Law. For example, the Working Committee for Company Law Revision of the Standing Committee of the National People's Congress had an advisory board of 10 members, seven of whom were legal scholars. During the reform process, the law schools of universities and research centers held many conferences and forums to discuss issues related to the old Company Law and to propose revisions. Legal scholars, government officials and practitioners often attended these meetings and the media reported the most important debates on reform issues.<sup>3</sup> Lawyers were also active in the private-public dialogue. In 2001, Qin Bin, a lawyer in Beijing, proposed revisions to the old Company Law mainly aimed at protecting small shareholders, and put his proposal on the Internet, which attracted much attention and stirred active discussion. In March, 2004, Qin Bin and several other lawyers submitted a proposal to revise the old Company Law to the

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<sup>2</sup> See "New Forces in Legislature Reform: Interest Groups Lobby the Company Law," *Shangwu Zhoukan* (Business Week), April 30, 2005.

<sup>3</sup> For example, during a conference held in Tsinghua University in 2004, some participants proposed to eliminate the registered capital requirements, which certainly caught the attention of the media (hence the general public).



Standing Committee of the National People's Congress. Through their research and legal practice, these experts understood the problems of the old Company Law and thus served as an intermediary between the Government and entrepreneurs and affected private parties. In doing so, they helped the reformers to hear the voices and protect the interests of both entrepreneurs and the public.

The call by private entrepreneurs and scholars to ease regulatory burdens was not without resistance. As in other economies, making a successful transition from a standard regulatory and implementation agency to a service-oriented mind set, while not easy, is a crucial component of the reform process. Ministries with the relevant regulatory responsibilities were critical players in China's reforms. Compared with private entrepreneurs and legal scholars, they had tremendous advantages in influencing the regulatory reform process in China's institutional context. China's regulatory changes usually start with the State Council, and ministries with the relevant regulatory responsibilities are all entitled and required to participate in the discussions and drafting of the new law. Differences of opinion were resolved through compromises at the technical levels. Technical groups would send draft legislation to the Standing Committee of the National People's Congress for formal legislative review only when there were no major differences in viewpoints among them. Thus, ministries that had relevant regulatory responsibilities were direct participants in the regulatory reform process and had the institutional channels and means to define and advance their interests.

Ministries and regulatory agencies often had extensive information and complex interests in the process of regulatory change. Understandably, they scrutinized carefully and defended hardily proposals that changed their existing regulatory powers in ways which, from their own experience, they considered to be ineffective. More important, however, they also internalized the central government's broader intentions with regard to the reform process. In addition, certain ministries and government agencies needed to represent the interests of various social or economic groups. For example, the Ministry of Finance and Ministry of Commerce were often supportive of policies that would encourage foreign investment, while the Department of Labor typically advocated policies that benefited workers. Given the complexity of these interests, it was not surprising that different ministries and regulatory agencies often had different views of the direction of reforms. The output of the regulatory reforms needed to take into account these different professional interests and strike a balance, which was the main reason why some reforms took more than a decade to complete (e.g., the Property Rights Law, the Anti-Monopoly Law).

In the case of the Company Law reform of 2005, a number of ministries were directly involved, including the National Bureau of Business Administration, the Ministry of Finance and Commerce, the National Commission of Development and Reform, the Commission of Securities Regulation, and the Commission of State Assets Management. However, ministries and government agencies usually did not publicly advocate their positions, because they had direct access to the policy making process and, possibly, as with government agencies in every economy, they did not want to start public debates about their performance. Thus, the public statements of the relevant government agencies tended to be about general principles, such as "improving regulatory efficiency." This did not mean that they did not engage in exchanges with private entrepreneurs, scholars and other participants of the reform process. Representatives of government agencies often participated in conferences and forums about how to reform the Company Law.

Sometimes they even sponsored or organized conferences to engage in dialogue with other concerned parties.

During the reform of the Company Law, the different groups contested a number of technical issues. The following describes several of the contested issues and the nature of their resolution.

- On the issue of the regulatory requirement for registered capital, even though the new Company Law of 2005 greatly reduced the threshold, the requirement of RMB30,000 was still more than twice the per capita income in 2006 (Table 1). It was also the most important factor accounting for China's relatively low international rank in the "Starting a Business" category (Table 2). Some private entrepreneurs, scholars and legislators proposed to eliminate the requirement on registered capital, as in the leading APEC economies, but met with strong resistance from government agencies. Thus, the final decision in the new Company Law to require RMB30,000 as the minimum registered capital represented a compromise between the demand of private entrepreneurs to ease regulatory entry barriers and the interests of regulatory agencies to maintain regulatory power to ensure the sound development of the market.
- Another example of compromises was on the special treatment of solely state owned companies. As a general principle of the reform, all market participants, regardless of ownership, were to be treated equally to foster a fair competition environment. However, the Commission of State Assets Management argued that, due to the special characteristics of the Chinese economy, SOE needed to have special treatment. As a compromise, the new Company Law retained some special treatments for solely state owned companies.
- Debates about permitting the establishment of sole proprietor limited liability companies also drew a lot of interest. The opposing view was that business and personal assets would be difficult to separate in such companies, which would hurt the interests of debt holders. Thus, certain regulatory agencies were concerned that it would be difficult to regulate such companies in terms of liability claims. A compromise helped overcome this objection. Five regulatory requirements were added for one person limited liability companies including (i) a registered capital threshold of at least RMB100,000, which had to be paid in full during the registration process; and (ii) a person could have just one such company.<sup>4</sup>
- There were quite different opinions in the beginning about the regulation and degree of worker participation in the management of companies. The Federation of Unions of China, some legal scholars and other groups interested in worker rights advocated strong regulations requiring worker representation in company management, such as a certain number of seats in the board of directors of companies. On the other side of the debate, many economists and entrepreneurs and certain regulatory agencies were against this extreme view of "stakeholder management", fearing efficiency losses and regulatory complications from complex corporate governance. The New Company Law specified worker rights in companies in several important areas, such as the right to organize and to bargain collectively, and at least 1/3 of seats in the

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<sup>4</sup> For more details, see "Expert View: The New Company Law Represents Interests of Stakeholders," China Youth Daily, October, 28, 2005.

supervisory boards of companies to be held by worker representatives. However, although the Law says that companies can have workers on the boards of directors, this is not mandatory.

### ***Impacts of the Company Law Reform of 2005 on Ease of “Starting a Business”***

The new Company Law of 2005 significantly eased the regulatory requirements on “starting a business,” by reducing the registered capital requirement and lowering the registration fee and speeding up the registration process (Table 1) in registering a limited liability company or a corporation. One expects that registration of limited liability companies and corporations would increase as a result of the entry cost reductions. Did the new Law achieve that goal?

The following table from the 2007 Annual Statistics of the National Commission of Business Administration documented the registration by domestic non-private firms for 2005 and 2006. One striking fact was that the numbers of all types of enterprises (SOE, Collectives, Partnerships, Others) declined from 2005 to 2006, except the number of companies (including limited liability companies and corporations). From Table 5, the total number of state-owned limited liability companies increased from 1.255 million to 1.329 million, an increase of 5.92%. This clearly shows that as the new Company Law made it easier to register a company, enterprises are more likely to choose to register as limited liability companies.

**Table 5 - Total Registration by Domestic Non-Private Firms**

		<b>SOE</b>	<b>Collective</b>	<b>Partnership</b>	<b>Companies</b>	<b>Others</b>	<b>Total</b>
<b>Number (thousand)</b>	Year 2005	795	1,207	194	1,255	46	3,496
	Year 2006	717	1,094	187	1,329	45	3,373
	Growth Rate (%)	-9.77	-9.34	-3.59	5.92	-2.00	-3.54
<b>Total Registered Capital (thousand)</b>	Year 2005	446,578	74,777	15,803	1,087,593	9,739	1,634,491
	Year 2006	464,332	70,149	17,534	1,245,249	9,974	1,807,239
	Growth Rate (%)	3.98	-6.19	10.96	14.5	2.42	10.57

Definition: SOE are state-owned enterprises that are not registered as limited liability companies; collective firms are enterprises whose assets are collectively owned; non-private partnerships are cooperative firms owned by employees; and companies in the domestic non-private firms are state-owned limited liability companies.

To see the effect of the new Company Law from another angle, Table 6 below (also from the 2007 Annual Statistics of the National Commission of Business Administration) compared the total registration of domestic non-private firms from 2001 to 2006. The third column shows that the growth rate of the number of company registration experienced a steady decline from 8.65% in 2002 to 2.93% in 2005. But this trend was reversed in 2006, with the growth rate rising sharply at 5.92%. Evidently, the ease of registering a company brought by the new Company Law reform was a driving force behind the trend reversion. From the last column of Table 6, the share of companies in the total registration of domestic non-private enterprises in China increased steadily from about 20% in 2001 to almost 40% in 2006.

**Table 6 - Total Registration of Domestic Non-Private Firms from 2001-2006**

Year	Total (thousand)	Companies (thousand)	Growth Rate	Share
2001	4,832	992		20.5%
2002	4,445	1,077	8.65%	24.2%
2003	4,124	1,158	7.52%	28.1%
2004	3,998	1,219	5.27%	30.5%
2005	3,496	1,255	2.93%	35.9%
2006	3,373	1,329	5.92%	39.4%

The next table presents the effect of the new Company Law on the registration of domestic private firms in 2005 and 2006. Over these two years, while proprietary firms and partnerships increased 13.32% and 2.84%, limited liability companies and corporations increased much faster, at the rates of 16.85% and 48.48%, respectively. In numbers, there were 560,000 more limited liability private companies and 564 more private corporations in 2006 than in 2005. Thus, private entrepreneurs were clearly quite responsive to the regulatory changes of the new Company Law by registering their new firms as limited liability companies or corporations. Accordingly, the total registered capital of limited liability companies and corporations saw remarkable increases at rates of 24.35% and 44.82%, respectively. The increase in entry by private entrepreneurs also led to more employment. As Table 7 shows, employment of limited liability companies and corporations increased about 14% from 2005 to 2006, faster than employment increase of proprietary and partnership firms.

**Table 7 - Total Registration by Domestic Private Firms**

		Proprietary	Partnership	LLC	Corporation	Total
<b>Number (thousand)</b>	Year 2005	869	128	3,303	0.957	4,301
	Year 2006	985	131	3,863	1.421	4,981
	Growth Rate (%)	13.32	2.84	16.95	48.48	15.81
<b>Employment (thousand)</b>	Year 2005	9,309	1,957	46,811	163	58,241
	Year 2006	10,193	1,883	53,601	186	65,863
	Growth Rate (%)	9.49	-3.8	14.51	14	13.09
<b>Total Registered Capital (thousand)</b>	Year 2005	34,161	6,291	567,758	5,101	613,311
	Year 2006	40,028	6,836	706,033	7,388	760,285
	Growth Rate (%)	17.17	8.68	24.35	44.82	23.96

Definition: Proprietary firms are private, unlimited liability firms with one natural person as the sole owner; private partnerships are private, unlimited liability firms with two or more natural persons as owners; LLC are private limited liability firms with two or more natural persons as investors or with one natural person holding controlling shares; corporations are private, corporated firms with five or more natural persons as investors or with one natural person holding controlling shares.

### ***Overall lessons of reform***

The Company Law reform of 2005 in China significantly reduced the regulatory requirements on starting a business. It slashed the requirement of registered capital, reduced the registration fee and speeded up the registration process. As a result, entry by domestic non-private firms and private firms saw a substantial increase after the new Law took effect on January 1, 2006. Along with it, investment and employment also increased, which helped China to maintain high economic growth and to increase its overall economic efficiency and competitiveness.

The main reason this regulatory reform could be successfully carried out was the central government's commitment to promote fair competition and increase the competitiveness of the Chinese economy. Because of the remarkable economic growth of the 1990's and the China's entry to WTO, the Chinese government had settled the ideological debate between the planned economy and the market economy, and was fully committed to the overall strategy of building the "socialistic market mechanism." With the real economic landscape of a dynamic economy with firms of different ownership types competing in domestic and international markets, the Chinese government realized that promoting fair competition market environments was a key to sustain economic growth and increase China's competitiveness.

Another reason for the success of the Company Law reform of 2005 was that private entrepreneurs and scholars acting as advocates of public opinion managed to influence the outcome of the regulatory reform by actively participating in the reform process. They utilized all sorts of institutional channels within China's political and institutional system to gain the support of public opinion and advocate their positions. They even organized legislators to propose bills to revise the old Company Law. In the case of this regulatory reform, entrepreneurs and their advocates, even without the ability to organize themselves into legal lobby entities, became a driving force of the reform and showed that citizen groups could have their voices heard and their interests protected in the regulatory reforms in China.

The Company Law of 2005 inevitably represented compromises between the interests of various players involved in the reform process. The final outcome may not have been ideal from the social efficiency point of view, but was pragmatic and made significant progress in easing entry and reducing entry cost for entrepreneurs. When new economic realities in the future make it likely, there will be a new round of reform to keep pace with China's rapidly evolving market economy. The case of the Company Law of 2005 in China revealed a rather typical path of how China progressed from a restrictive planned economy to a dynamic and open market economy.

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## **Korean Customs and Border-Related Trade Reforms\***

### ***Introduction***

Trade has always been crucial to the Korean economy, both qualitatively and quantitatively. Numerous studies remark that Korea's development was due to international trade. From the mid 1970s, trade volumes (the sum of exports and imports) were almost consistently above 60% of the GDP, and in recent years have reached more than 80%. While many describe Korea's growth as being export-led, the importance of imports is often underappreciated.<sup>1</sup> Korea is not a major producer of natural resources, and until the late 1980s, it could probably be considered a low-capital and low-technology economy as well. Thus, Korea has always depended on foreign imports for raw materials and capital equipment. As a result, it has always been interested in reducing trade-related costs.

This case study examines how Korea endeavored to reduce regulatory burdens for customs clearance. There were two main pillars for reducing customs related regulatory burdens for Korea: reform of existing laws and regulations; and the adoption of paperless trade and e-trade, which prominently includes e-clearance.

### ***Motivation for reforms***

As Korea accelerated the liberalization of imports in the late 1980s and early 1990s, there was recognition of the need to streamline import and export clearance as well. The anticipated completion of the GATT Uruguay Round provided impetus for streamlining customs clearance procedures. A major reform of the import clearance system was completed in July 1996. The goal of the reform was to de-regulate and facilitate the customs clearance procedures.

Another factor that has played an important part in motivating customs reform was the generally bad reputation of the Korea Customs Service (KCS) up to the early 2000s. Foreign governments as well as Koreans often complained that import clearance in Korea was inefficient and inconvenient<sup>2</sup>

While customs reform began earlier, the Asian financial crisis accelerated the reform process. There was consensus after the crisis that the productivity of the Korean economy needed to be improved. As part of that effort, the Government ordered a massive regulatory reform program in 1998 and 1999. KCS was required to cut the number of regulations they enforced by one-half, and make sure that the remaining regulations had clear a legal basis.

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or of the government of Korea.

<sup>1</sup> Lawrence and Weinstein (2001) found that, while the results are not statistically significant, imports had a stronger impact on Korea's growth than exports.

<sup>2</sup> KCS (2001) notes that, in a 2001 survey, KCS was ranked first in terms of perception of corruption, along with the National Tax Service, The Prosecutor's Office, and the National Police Agency.

Reform of customs procedures was greatly accelerated by Korea's desire to make the economy the "economic and logistics hub" of Northeast Asia. However, in order to make this possible, there was a need for considerable streamlining of the customs procedures. Thus, the government's strategy of turning Korea into a regional hub also motivated KCS and other border control agencies to reform the customs clearance system dramatically.

Another factor is the rise of IT and e-government in Korea. In order to improve government efficiency, and probably in part to show off Korea's status as a global leader in the use of IT, the government announced a large initiative to establish an "e-government," in 2003. One of the first projects pursued under this initiative was to create a system for "e-clearance." Korea had already begun to use IT tools such as an Electronic Data Interface (EDI)/Value Added Network (VAN) in customs clearance, but the e-clearance initiative forced KCS and other border agencies to expand the use of IT tools for customs clearance, and gave strong incentives to KCS and other border control agencies to reform the customs clearance process. During this stage, KCS completed its internet portal site and the single window, and established an internet clearance system between traders, KCS and border control agencies.

Since 2003, Korea has been working on "e-trade" to link traders and government with other private trade-related institutions such as customs brokers, freight forwarders, trading companies, transport and warehouse operators, banks, and insurers. The objective is to create a comprehensive electronic trade network, where firms can carry out all stages of trade related transactions (e.g. negotiation, private and public paperwork, financial transactions, customs clearance, logistics) through this one single electronic network, accessible through the Internet. This effort is a private initiative, but with government support. The "e-trade" initiative strives to link "business-to-business (B2B)" transactions to the current "business-to-government (B2G)" and "government-to-government (G2G)" network, so that traders as well as all related private and government parties need to use only a single network to file paperwork and be informed.

### ***Regulations and Reforms***

As stated, the efforts to reduce regulatory burden in customs clearance took place through two main channels: regulatory reform (including deregulation) and the introduction of e-trade.

### ***Regulatory Reform in Korean Customs Clearance***

#### ***Pre-2000***

In 1995, Korea modified the Customs Act to reduce costs and adopt international standards. It completed a major reform of the import clearance system in 1996 moving from a permit to a self-declaration system, with KCS moving toward a post-entry investigation for cargo clearance. During these reforms, the pre-clearance payment of duty was also replaced by a post-clearance payment system. Thus, pre-arrival import declarations and deferment of payments, with limited or no deposits, became possible. Korea introduced the on-dock immediate delivery system in 1998, which allowed an



importer to unload and release imported goods simultaneously at the time of entry.<sup>3</sup> Such reforms considerably accelerated customs clearance procedures.

Most notably, self-declarations replaced the import permit system, and KCS introduced a new application procedure for the immediate release of cargo shipments. Previously, importers could only make an application for cargo releases after the goods had arrived, but the new system allowed submissions even before the cargo arrived. If approved, importers could transport the goods to their destination immediately after entry into port.<sup>4</sup> The 1996 reform marked the beginning of the general use of pre-arrival clearance and post-entry auditing in Korea.

Korea's general drive to reform its regulations in 1998 greatly aided customs reforms. As part of the regulatory reform process, Korea established the Regulatory Reform Commission, which examined all submissions for new regulations and submissions for revisions in the existing regulations. RRC required regulatory impact analysis (RIA) with all submissions. The ministries submitting requests for new regulations or revisions were required to examine benefits and costs as well as to examine alternative (non-regulatory) means to achieve the goals of the proposed regulation. The Government also tasked RRC with examining existing regulations for possible elimination, revision or reform.<sup>5</sup> Finally, RRC maintained a regulatory registry. If a regulation did not have a legal basis, and if the regulation was not included in the registry, it was not legally valid. In addition, the Government required each ministry to cut the number of regulations by one-half.<sup>6</sup> KCS and other ministries responsible for border controls were no exception. According to RRC (1999), many of KCS' regulatory reforms measures during this time dealt with reforming the regulations dealing with bonded transportation and bonded warehouses.<sup>7</sup>

### ***Post-2000:***

In 2003, responding to the rapid growth of the Chinese economy and seeking to capitalize on its location advantages, Korea launched an initiative to make itself a financial and logistics hub for Northeast Asia. However, in order for this to materialize, Korea needed to improve its customs clearance system, since transportation costs in Korea were still higher than in many advanced economies (Figure 1).

The higher cost was due partly to the large number and complex nature of laws and regulations for customs clearance. According to KCS (2004), there were 55 laws dealing with import and export clearance, covering 4810 items<sup>8</sup>. Large due to these laws and regulations, clearance typically took 9.6 days. From the arrival of cargo at port to the warehouse took 2.3 days, then it took 7.2 days from entry into the warehouse to applying for an import registration (due in part to the time needed for inspection and testing—inspection for food items took 1.6 days, inspections for plants took 1.4 days, and testing for medicine took 2.4 days). After finishing the inspections, however, getting permission to

<sup>3</sup> Republic of Korea (1998) and OECD (2000) p. 221

<sup>4</sup> Republic of Korea (1998)

<sup>5</sup> The responsibility for examining existing regulation was shared by RRC and the Regulatory Reform Task Force between 2004 and 2008, and is now shared between RRC and the President's Council on National Competitiveness.

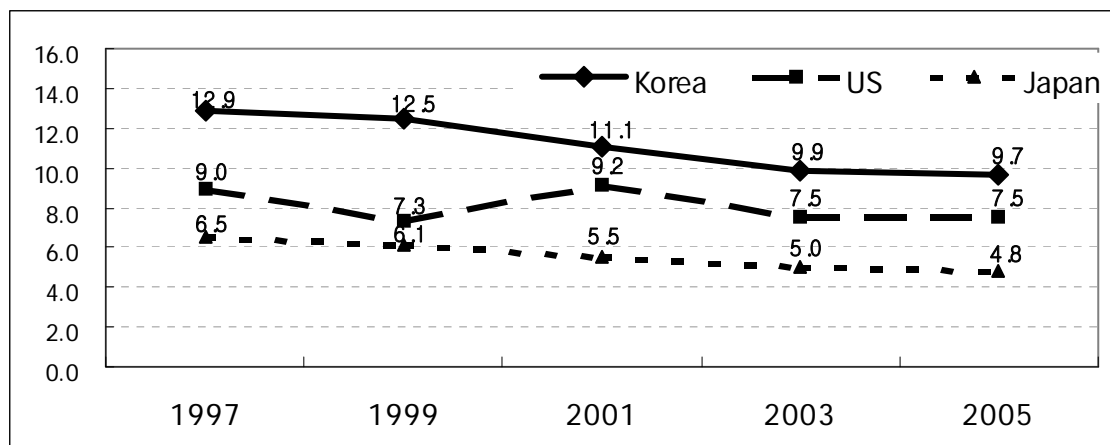
<sup>6</sup> Details on Korea's regulatory reform are available in OECD (2000) and OECD (2007).

<sup>7</sup> RRC (2000) pp.381-385

<sup>8</sup> To help importers keep up with all the necessary laws and regulations, Korea maintains a "unified list" of import related laws and regulations.

import the cargo took only 1.5 hours. The Government deemed the 9.6 days taken for clearance to be too long.

**Figure 1 - Transport Costs as Percentage of Sales for Firms**



Source: KCS (2007) p. 26

A task force of 172 people—headed by the Commissioner of KCS and the President of the Korea Institute for International Economic Policy (KIEP, a government-funded research institution—examined the problem.<sup>9</sup> The task force set out to benchmark the systems of advanced economies, approach the reform from “the customer’s” point of view, examine the entire system without preconceptions and re-engineer the organization, the laws and the process, and pay attention to local and global trends for customs administration. The goal it set was to reduce the time taken for customs clearance from 9.6 to 4.5 days. To achieve this goal, 36 concrete tasks were set in February 2004. They achieved their goal by December 2005. The reforms included the following measures:

- Making tax payments easier: KCS allowed 875 traders with good records to pay taxes monthly rather than after each transaction, and allowed firms to self-assess taxes.
- Introduction of 3S (Slim, Specialization, Service Oriented) Program: KCS drafted standardized implementation manuals, and responsibility was pushed down the bureaucratic structure, so that people actually on the ground could make more decisions (“slim”). In addition, 660 specialists were utilized (“specialization”). Finally, KCS strengthened administrative guidelines to reduce the perception of corruption and made more information available to the public in 147 areas (“service orientation”).
- Setting time limits for customs clearance – For regular goods, owners had to clear and accept cargo within 15 days; they had to clear within five days all goods available for on-dock immediate delivery.
- Establishing a one-stop service center to resolve problems associated with delays in clearance at five major ports and airports.
- Consulting services to 202 firms that had experienced delays in clearance.

<sup>9</sup> Members included representatives from industry (e.g. Korea International Trade Association, Korea Federation of Small and Medium Enterprises, Korea Chamber of Commerce, and foreign chambers of commerce), academia, NGOs, high level and working-level customs officials, and customs-related organizations (e.g. Korea Customs Brokers Association, Korea Customs Logistics Association).

**Table 1 - Savings from Reduction in Clearance Time (Won billion)**

Items	Savings
Reductions in warehousing costs	320.2
Increased cargo processing capacity at ports	1249.1
Streamlining the process for cargo in transit and transshipments	17.3
Increased volume of cargo in transit and transshipments	148.2
Increased availability of empty containers, lessening the need for “excessive imports”	73.9
Increased use of automatic notification procedures for cargo unloading	231.6
Streamlining the process for express consignments	1.2
24 hour, around-the-clock clearance at Incheon International Airport	54.0
Elimination of fees for arrivals outside normal working hours	1.6
Reduction in warehousing (storage) fees	83.2

Source: KCS (2006)

Because of these reforms, KCS was evaluated as the best government agency in December 2005—a dramatic change in the public perception of KCS. As seen in Table 1, KCS estimates that the reduction of clearance time from 9.6 days to 4.5 days had an economic benefit of 2.2 trillion Won.

Several other benefits resulted from the reforms.<sup>10</sup> Korea reduced the number of items subject to import/export verification requirements from 4810 in 30 laws to 4114 items in 26 laws. The pre-clearance requirement verification was limited to drugs, firearms, and items in directly relevant to public health/safety and the environment. Korea also broadened thresholds for clearance of express goods and cargo. For simplified clearance the threshold was raised from US\$600 to US\$2000, and for list-clearance (based on consignment lists forwarded by express courier operations), the threshold was raised from US\$60 to US\$100. Korea also simplified unloading procedures by increasing automatic acceptance of unloading declarations from 60 to 98 percent.<sup>11</sup>

Further, it introduced a one-stop transportation system for sea/air transshipment cargoes that needed speedy transportation to the airport after port arrival. The one-stop service handled all procedures for unloading, transporting, warehousing, and loading aircraft, and waived bonded transportation declarations. Tax payment procedures were improved. Companies with good compliance records received monthly payment, self-audit and other incentives, including self-correction without penalties if completed within three months. Drawback procedures attempted to encourage efficient and lawful declaration practices. X-ray screening equipment replaced manual physical inspection, reducing inspection time per container from 4-5 hours to 10 minutes.<sup>12</sup>

In all, customs clearance reforms in the 2000s led to a reduction of burdens associated with customs clearance. With the exception of the introduction of e-trade (explained in the next section), it is unlikely that any single or small number of these changes in procedure led to a significant reduction in the burdens associated with customs clearance. However, taken together, these measures resulted in substantial reductions in costs and burdens.

<sup>10</sup> Noted in OECD (2007)

<sup>11</sup> OECD (2007) pp.107-108

<sup>12</sup> OECD (2007) p.108

### ***E-Clearance and E-Trade***<sup>13</sup>

The introduction of IT to cargo clearance procedures in Korea can be roughly divided into two stages. The *first* stage covered preparation for Customs Clearance Automation (1980s-1992), EDI Customs Clearance Automation Six Year Plan (1992-1997), establishment of the Paperless Customs Clearance System (1997-2001); and the Plan for Establishment of Infrastructure for Information Technology and Knowledge Management (2001-2003). The *second* stage of e-trade in Korea began in 2003. The goal of the second stage is to build on the accomplishments of the first stage and establish an e-trade system that uses IT at every stage of the cargo clearance procedure, encompassing not only government-business (traders) transactions, but business-business transactions as well.

#### ***First Stage***

In 1993, KCS started developing an Electronic Data Interchange (EDI) to promote paperless trading, trade computerization and automation. EDI for export clearance was introduced in November 1994, for import clearance in July 1996, and for customs duty drawbacks in July 1997. KCS linked its computer network to the quarantine inspection agency in May 1998. The system expanded in 1999 to cover electronic fund transfers for payment of duties, and the export automatic trade system was on-line in 2000. After 2001, electronic VAT payments are also possible.

EDI operated as a “value-added network (VAN)” which linked KCS and government agencies with large traders and customs brokers. Thus, only those firms and customs brokers with access to the VAN-EDI could take advantage of the network. However, even this limited access to EDI brought improvements to cargo clearance procedures.

OECD (2000) comments that, as of 1999, the EDI customs system had reduced paperwork and increased the efficiency of the Korean customs system. As of 1999, EDI covered over 70 percent of import/export clearance procedures and customs duty drawback transactions. It helped reduce clearance times from 8.5 to 3.5 hours for imports, and from 4 hours to 4 minutes for exports. KCS and MOHW (Ministry of Health and Welfare) were linked in 1998, and links with other border control agencies were initiated. However, the report commented that there were still substantial delays for laboratory inspections.<sup>14</sup>

The KCS estimated that the new system contributed substantially to reducing the time and costs involved in the distribution of imported/exported goods. Republic of Korea (2000) reported that, in 2000, 96 percent of exports, 12 percent of imports, and 33 percent of drawbacks have been completed utilizing the electronic paperless clearance system, and the total time required for processing, from the submission of a declaration to acceptance by relevant authorities, was reduced from 2 hours and 50 minutes to 45 minutes.<sup>15</sup>

According to Sohn and Yoon (2001), as of 2001, all of the procedures for customs clearance, such as export and import declaration, as well as logistics, such as submission of the bill of lading and notification of arrivals and departures, were automated. They cite a KTNET report that the use of EDI saved 81 percent of export related paperwork costs,

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<sup>13</sup> This sub-section summarizes Yang (2008)

<sup>14</sup> OECD (2000) pp.221-222

<sup>15</sup> Republic of Korea (2000) pp.1-2

and 79 percent of import-related paperwork costs, resulting in yearly savings of 578 billion Won. A KITA report states that Samsung Electronics estimates that its ordering times were reduced from ten to two days, and that it had saved US\$800 million.<sup>16</sup>

However, until November 2000, fearing the possibility of illegal transactions, KCS limited the number of firms that could use paperless trading for import clearances to 352 enterprises in good standing. Consequently, paperless procedures covered just 12 percent of all transactions. KCS then increased the number of eligible firms to 2589, and the coverage of paperless trading rose to 30 percent.<sup>17</sup> As the Internet became more prevalent in the late 1990s, submission of paperwork through the Internet was allowed. Thus, currently customs brokers and traders can submit information directly to KCS on the Internet. In 2008, many firms and brokers still use the VAN/EDI network, but many more also access the e-trade system through the Internet.

EDI was also used to select cargo for customs inspection. By July 1996, Korea had established an EDI-based Cargo Selectivity System, which used data and risk management principles to prioritize goods for inspection. The system exempted low-risk items from inspection, but targeted high-risk items for close inspection.<sup>18</sup> This system also covers travellers and vessels, to detect articles such as prohibited chemical substances.<sup>19</sup>

### ***Second Stage***

In the second stage, under Korea's "e-government" effort to utilize the information network to facilitate government business and relationships between the public and Government, the KCS has further improved its e-customs and internet portal systems, building an efficient e-clearance system. In addition, Korea International Trade Association (KITA), a private organization, with support from government agencies, has initiated efforts with government support to link other trade-related transactions to the e-clearance system, in order to establish a "e-trade" network.

KCS has been pursuing the goal of "e-Customs, u-Customs, World Best Customs 2012+." The second term, "u-customs", stands for "ubiquitous customs." KCS defines "invisible and ubiquitous customs" as a "customs service which is not noticeable to the eye, but is efficient and available to its customers at any time and at any place."<sup>20</sup> During this stage, KCS completed its internet site, and established an internet-based customs system, the UNI-PASS. KCS representatives state that the expansion of the internet system has led to a sharp reduction in use of EDI system.

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<sup>16</sup> Jeong (2005)

<sup>17</sup> Sohn and Yoon (2001) p.73

<sup>18</sup> As of 2008, customs inspectors can override the decisions made by the cargo selectivity system. If an on-the-ground customs inspector feels that inspection is warranted, he can assign a cargo for inspection even if the cargo selectivity system indicated that the cargo does not need to be inspected. On-the-ground inspector can also override the decisions made by the selectivity system to stop an inspection suggested by the selectivity system, but in this case, the inspector requires an approval from his supervisor.

<sup>19</sup> Republic of Korea (1998) p.4

<sup>20</sup> [http://www.customs.go.kr/kcsweb/user.tdf?a=user.board.BoardApp&c=2002&seq=850&ctx=&board\\_id=GPB\\_NEWSDATA&mc=](http://www.customs.go.kr/kcsweb/user.tdf?a=user.board.BoardApp&c=2002&seq=850&ctx=&board_id=GPB_NEWSDATA&mc=)

Korea began building an internet-based single window for submission of documents in 2004<sup>21</sup>. Between August 2004 and July 2005, eight government agencies, which included KCS, Korean Immigration Service, National Quarantine Station, among others, formed a task force to examine the requirements to establish a single window. At the same time, from August 2004 to February 2006 the government contracted private suppliers to build the appropriate infrastructure and software. In March 2006, the single window opened. Since then, the Korean government has expanded the number of agencies participating in the single window from the initial eight to twelve; as of 2008, a total of fourteen agencies, including KCS, Korean Food and Drug Administration, National Veterinary Research & Quarantine Service, and the National Fishery Products Quality Inspection Service are linked to the internet single window. According to KCS, over 40 percent of the current traders use the single network

The use of the KCS internet portal and the single window is expanding to include not only traders, but also firms in trade-related industries. Transportation and logistics businesses such as forwarders, bonded warehouses, bonded transporters and carriers are using the KCS network. As of 2008, 20 percent of all freight is processed through the KCS network, and the number is reported to be growing quickly.<sup>22</sup> Also, KCS and IATA are pursuing an “e-freight” project, where forwarders, customs brokers and traders can file manifests, bills of lading, invoices, packing lists and other documents electronically. KCS is also adopting RFID technology to process freight in bonded areas, so that cargo can be processed electronically, and up-to-the-minute information can be received through the KCS internet clearance portal site.

During the second phase, Korea has also pursued development of an “e-trade” system which encompasses not only “B2G (business to government)” and “G2G (government to government)” transactions, but also “B2B (business to business)” transactions. Korea has been pursuing e-trade since the late 1980s. In 1991, the Ministry of Trade and Commerce (currently renamed the Ministry of Knowledge Economy) signed an “Agreement on Trade Automation” with the Korean Customs Service (KCS). In 1991, Korea International Trade Association (KITA), a private organization composed of traders, which often acts as an intermediary between traders and the government, funded the establishment of the Korea Trade Network (KTNET), which was to build e-trade infrastructure and operate e-trade services. In the same year, KCS designated KTNET as the sole Trade Automation Service Provider. Since then, KTNET has been the primary e-trade infrastructure operator and service provider, and it has played an important part in establishing e-trade in Korea.

The effort to establish a comprehensive “e-trade” network is a private initiative with support from the government resulting in a unique government-business partnership. As part of the effort to become the regional logistics hub, Korea established the National e-Trade Committee in 2003 to pursue the goal of ubiquitous trade. The committee was responsible for setting the agenda for the adoption of e-trade, and was chaired by the Prime Minister. Committee members included the ministers from public agencies and private organizations such as KITA and Korean Federation of Banks. Under the leadership of the Committee, KITA established the Korea Paperless Trade Center in 2005, and the Korea e-Trade Facilitation Center. In the Center, six working groups were organized, dealing with: Platform; Law; Finance; Logistics; Marketing and Global (cooperation).

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<sup>21</sup> While the EDI system did act as a de-facto single window, it had not been internet-based, so it was not available to a large number of traders.

<sup>22</sup> By number of cases

These working groups were able to work out the details of the e-Trade network which eventually became the UTradeHub.

In 2004, KTNET introduced the CTradeWorld portal website. Through this site, KTNET offered four e-trade services to firms and customs brokers: eTradeFrame, eCustomsFrame, eLogisFrame, and eTradeInfo. The first three services are designed to foster paperless trading at various stages of international trade.

In order to provide a legal basis for e-trade, Korea enacted the 'e-Trade Facilitation Act' in 2005.<sup>23</sup> The Act gave a legal basis to ten important trade documents in electronic form. These include the certificate of origin, letter of credit, local letter of credit, letter of guarantee, delivery order, insurance policy, import license, export license, trade approvals and purchase confirmation. Thus, the Act gave equal status to paper and electronic forms of these documents. Despite this, some documents are not yet in use. For example, while use of an electronic certificate of origin is legal, it is not in use because of the absence of international agreements.

Following the recommendations and decisions of the National e-Trade Committee, MOCIE authorized the construction of UTradeHub website and electronic network. KITA was given the task of building the network, which would be a network open to all traders, and run by KTNET. KITA and KTNET are private organizations, but the public sector has also cooperated, supported, and often provided funds for this endeavor, and the result is a unique private-public cooperative effort. The UTradeHub seeks to use IT for all stages of trade, from negotiating between firms, financial arrangements and payments, insurance, logistics, inspection and quarantine, as well as customs procedure. Thus, the network ties in the internet customs clearance network linking traders and government agencies, to additional networks linking firms, banks, insurance companies, transportation companies and customs brokers to allow "ubiquitous e-trade.". The system provides real-time information on the status of cargo and paperwork, and allows submission of electronic paperwork in real-time. The system delivers paperwork automatically to all parties that require it, and it provides real-time assistance if needed. Because the system files and stores all paperwork electronically, the government expects the submission of counterfeit forms to be eliminated. The UTradeHub came on-line in late July 2008.

### ***Future Reforms***

Since 2005, the focus of customs procedure reforms may have shifted from regulatory reform to e-trade. However, in May 2008, KCS announced 17 reform initiatives covering additional customs regulations. These reforms include easing the requirement for bonded warehouse operators, reducing inventory reporting requirements for bonded warehouses with good records, and streamlining the clearance process by using RFID tags. Korea is also working to get other economies and economies to use e-clearance and e-trade. Many Korean traders, banks and brokers using e-trade have expressed frustration with the delays they encounter in working with slower foreign trade partners.

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<sup>23</sup> This legislation was a substantial revision of the "Trade Automation Facilitation Act" which was originally introduced in 1991.

### ***Political Economy of the Reform Process***

Korea's customs reforms since the 1990s were relatively non-controversial, and proceeded smoothly. There were few anti-reform forces of significance. There are several reasons why the reforms proceeded relatively smoothly.

*First*, trade is a crucial part of the Korean economy, so it was always recognized that customs clearance processes had to be efficient, especially for exports. From the 1990s, there was a growing recognition that customs clearance for imports had to be made more efficient as well. From 1990s, Korea recognized that limiting imports would reduce consumer welfare, and that a protected domestic market and reduced competition would potentially reduce the productivity of Korean firms.<sup>24</sup>

*Second*, Korea's efforts to join the OECD, the Uruguay Round negotiations, and complaints by Korea's trading partners played a part in reforms of its import clearance system.

*Third*, the reputational problems of KCS, both domestically and internationally, made it amenable to customs reform. In a report to the President in 2004, KCS referred to a 2001 survey ranking it highest in terms of the prevalence of corruption. It also ranked 21<sup>st</sup> of 24 agencies in terms of public satisfaction with the services it provided. Additionally, in an IATA survey, KCS ranked 15<sup>th</sup> out of 28 in terms of satisfaction with services provided at major airports. In the late 1990s and early 2000s, the US National Trade Estimate Report on Foreign Trade Barriers often cited difficulties in import clearance as one of the most serious bilateral trade problems with Korea. Importers often cited the lack of transparency and inconsistent implementation of laws and regulations as problems.<sup>25</sup> Such complaints prompted reforms in import procedures. Because of the reforms, the public considers KCS one of the most efficient official agencies, regularly ranked at the top of evaluations of government bodies.<sup>26</sup>

*Fourth*, in the aftermath of the Asian financial crisis, there was increased awareness that Korea needed strong reforms to make its economy more efficient. These reforms included additional market liberalization measures and public sector reforms to raise government efficiency and lower the burdens on businesses. KCS, known as one of the most bureaucratic of government agencies, could not escape this pressure for reform.

*Fifth*, the 1998-99 regulatory reform forced all Korean government ministries, including KCS to reduce the number of regulations. The number of regulations implemented by KCS fell steadily, from 156 in 1998 to 51 in 2008.<sup>27</sup>

*Sixth*, as Korea became one of the most IT-intensive and "wired" economies in the world, the Korean government adopted IT and e-commerce tools for its use. In 2003, Korea formally began pursuing the goal of establishing "e-government." Using IT and e-

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<sup>24</sup> Most accounts of Korea's development recognize the 1980s and 1990s as period of trade liberalization. For example, see Sohn, Yang and Yim (1999)

<sup>25</sup> One complaint was that KCS refused to accept any document that had erasure marks or "white-outs." The submitted paperwork had to be pristine. Another common complaint was that there seemed to be no rules or guidelines on what additional information was required, or in deciding which shipments would be subject to inspection.

<sup>26</sup> KCS (2004) p.22

<sup>27</sup> KCS is not responsible for all border controls, but the reduction in KCS regulations show the effort to reduce the regulatory burden associated with customs procedures.



commerce tools for customs procedures became the centerpiece of this initiative. Thus, KCS and other border control agencies were actively encouraged to use IT to streamline its operations and make customs procedure easier.

*Seventh*, Korean attempts to become the logistics hub for Northeast Asia provided the right incentives for KCS and other border control agencies. As the Chinese economy grew in late 1990s, there was considerable concern about being eclipsed by its neighbor. Many observers worried that Korea would be caught in a bind, shut out of the high-tech, high value-added product segments dominated by Japan as well as the lower tech, labor intensive goods market captured by China. One way Korea could survive would be as a regional logistics and financial hub. In this scenario, a land route from the Korean port city of Busan, would go through South and North Korea to China. This logistics channel could be linked to Russia and ultimately to Europe as well, creating a trans-Asia-Europe route and Korea would act as a node for the movement of goods to and from China. To make this idea work, Korea would have to streamline its customs procedures.

*Eighth*, once Korea started to use indicators and benchmarks to measure the level of services provided by KCS and other government agencies, meeting the goals set by the benchmark economies became an end by itself. Thus, KCS and other agencies seem to take considerable pride in meeting or exceeding the goals set by the benchmark economies. Such preoccupations have also provided strong incentives for reforms.

The eight factors listed above provided strong incentives for KCS and other border agencies to reduce regulatory burdens associated with customs procedures. Measures such as “e-government” and the “logistics hub” had the strong support of Presidents, so KCS continually had pressures to reform from the very top. Also, on major initiatives, KCS and the other border control agencies consulted extensively with the private sector. Arguably, this factor may have been the most important one in supporting implementation, as it forced KCS to look at customs clearance from the traders’ and the users’ points of view. As KCS began to look at traders, customs brokers and the private sector as “customers”, rather than segments of the economy that needed to be regulated, the use of EDI, paperless trading, pre-entry processing and post-entry auditing were expanded. Instead of looking at traders and private sector with suspicion, a spirit of cooperation grew between KCS and the traders. This growth in trust played a crucial part in Korea’s reform of customs clearance.

### ***Impact of the Reform***<sup>28</sup>

It was not until the late 1990s, when KCS expanded its EDI to encompass the Internet, that the use of electronic paperwork and e-trade truly took off. The establishment of the CTradeWorld e-trade Internet site seemed to have been especially helpful in getting firms to use e-trade. Table 2 shows the rapid growth in the use of EDI. In addition, according to KCS (2007), the Internet portal utilization rate for submission of paperwork grew from 3 percent of total submissions in October 2005 to 32.8 percent by December 2005.<sup>29</sup>

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<sup>28</sup> This section draws from Yang (2008).

<sup>29</sup> KCS (2007) p.29

**Table 2 - Use of EDI for Import Clearances**

Year	2001	2002	2003	2004	2005	2006
<b>Entry</b>	6,931	8,286	9,121	10,023	11,498	13,381
<b>Exit</b>	7,353	8,783	9,704	10,698	12,263	14,261

*Note: Based on entry and exit of cargo to bonded storage area*

*Source: KCS (2007) p.28*

**Table 3 - Economic Effects of KCS Uni-Pass e-clearance System  
(billion Won)**

Categories	Savings
Reduction in costs and time consumed	690.0
Savings from introduction of internet and single window	19.9
Savings from reduction in clearance processing time	1214.2
Reduction in costs related to warehousing; port and airport infrastructure	1156.2
Other economic effects	798.2
<b>Total</b>	<b>3878.5</b>

*Source: 2006 Customs Information Review*

The introduction of e-clearance and e-trade in Korea has speeded up processing times and lowered costs for Korean firms significantly. According to KCS, the introduction of the UNI-PASS electronic clearance system has reduced the import clearance time from over 2 days in early 1990s to 1.5 hours, export clearance time from over 1 day to 1.5 minutes, duty drawback processing time from over 2 days to 5.2 hours, and duty payment from over 4 days to 10 minutes. In the 2006 Customs Information Review, the National Information Society Agency (NISA) estimated that the positive economic effect from KCS UNI-Pass e-clearance system would reach more than 3.8 trillion Won. Table 3 shows one set of estimates of the cost savings and economic effects.

The integration of B2B transactions with the current B2G e-clearance system will likely produce additional cost savings. According to a 2006 estimate by Hyundai Economic Research Institute, UTradeHub will save Korean firms approximately 2.6 trillion Won per year. A breakdown of these cost savings is in Table 4.

**Table 4 - Expected Cost Savings and Economic Effects of e-Trade  
(billion Won)**

Categories	Amount
<b>Increases in productivity</b>	294.7
Savings in manpower costs	238.1
Savings in paperwork printing costs	5.1
Savings in paperwork delivery (mailing costs)	51.5
<b>Savings in associated expenses</b>	2,107.8
Savings in freight storage costs	1353.5
Savings in inventory related costs	754.3
<b>Savings due to elimination of overlapping investment in information technology</b>	<b>179.8</b>
<b>Total Savings</b>	<b>2,582.3</b>

*Note: Hyundai Research Institute estimates from Feb. 2006 at the request of MOCIE and KTNET.*

*Source: Ministry of Knowledge Economy (formerly MOCIE) press release, 2008.7.30*

Table 5 lists the change in clearance time for Korea ports between 2004 and 2006, while Table 6 lists time required for customs clearance overall between 1999 and 2005. Table 7 lists the recent results as recorded in the World Bank's Doing Business Indicators. As seen, none of these tables shows a dramatic improvement in the reduction of time required for clearance, but they do show steady progress. Thus, regulatory reform in customs clearance has become institutionalized and routine. Such steady progress may be better than a single dramatic improvement, which often stops after one or two years.

**Table 5 - Clearance Time in Korean Ports (hours)**

Year	Total Hours	Port arrival - Warehouse	Warehouse - Notification	Notification - Acceptance	Acceptance - Warehouse Departure	Warehouse Departure - Handover to Owner
2004	111.7	12.6	57.8	0.3	17.8	23.2
						70.4
2005	110.2	12.9	57.5	0.3	16.5	23
						70.4
2006	101.8	11.6	51.8	0.2	16.0	22.2
						63.4

Source: KCS (2007) p.27

**Table 6 - Time Required for Customs Clearance**

	Arrival - Entry	Entry to Declaration	Declaration to Acceptance	Arrival to Acceptance
1999	n.a.	n.a.	3 hrs 10 min	n.a.
2000	n.a.	n.a.	2 hrs 44 min	n.a.
2001	n.a.	n.a.	2 hrs 30 min	n.a.
2002	n.a.	n.a.	2 hrs 03 min	n.a.
2003	2.3 days	7.2 days	1 hr 32 min	9.6 days
2004	1.6 days	3.9 days	1 hr 48 min	5.5 days
2005	1.4 days	2.9 days	1 hr 40 min	4.4 days

Source: OECD (2007) p.107, based on data submitted by KCS

**Table 7 - Doing Business Indicators for Korea in Export and Import Procedures**

	2006	2007	2008	2009
Documents to Export	5	5	4	4
Signatures to Export	3	n.a.	n.a.	n.a.
Time to Export (days)	12	12	11	8
Cost to Export (US\$)	n.a.	780	745	767
Documents to Import	8	8	6	6
Signatures to Import	5	n.a.	n.a.	n.a.
Time to Import (days)	12	12	10	8
Cost to Import (US\$)	n.a.	1040	745	747
Rank	n.a.	28/175	13/178	12/181

Source: World Bank, *Doing Business*, various editions

While Korea has made steady reductions in regulatory burden associated with customs procedures, most firms seem to be unaware of these improvements. A major reason is that most Korean firms tend to “out-source” work dealing with customs clearance to customs

brokers. Thus, they have little direct experience with customs clearance. The Korean Customs Brokers Association estimates that brokers carry out about 93 percent of all export transactions and 98 percent of all import transactions, even though Korea does not legally require the use of a customs broker.<sup>30</sup> Most traders say that they use customs brokers because it is cheaper than maintaining a full staff to deal with customs procedures. Customs procedures often require technical knowledge of various laws and regulations. Further, there are few cases where the physical inspection of cargo is required and a company representative must be present. Most firms simply provide the documents that brokers require, and the brokers check the paperwork and file them with KCS using the electronic network.

Conversely, customs brokers, generally have very favorable views on the recent reforms. The use of EDI and the Internet, as well as the reforms listed above, allows customs brokers to make their operations more efficient, and take advantage of economies of scale, thus lowering the costs of their services to traders. One broker interviewed stated that he has more than 400 clients. However, because the paperwork for most import and export transactions takes only minutes, he is able to process hundreds of transactions each week. The cost for routine import clearance processing is only around US\$20 per transaction. While the margin for each transaction is low, brokers can earn high incomes due to volume, which stems from the use of e-trade and regulatory reform measures.<sup>31</sup> Thus, even though most firms may not realize it, regulatory reform and the introduction of e-trade in customs clearance have yielded significant effects to them.

### ***Overall Lessons of Reform***<sup>32</sup>

Korea's experience yields several useful lessons. *First*, and most important, there is a need to build up trust between the regulatory agencies (i.e. border control agencies) and the private sector. As we saw, KCS initially limited the use of EDI/VAN to "trusted" traders and brokers. However, limiting the use of EDI defeated its purpose of reducing the overall time and burden associated with customs clearance.

*Second*, reforms require close cooperation between the regulatory agencies and the private sector. Private-public partnerships, which engage in substantial in-depth discussions about reforms, can greatly help the reform process by allowing the most burdensome problems to be dealt with first, and making sure that the reforms are genuinely helpful to the private sector.

*Third*, when considering the adoption of e-trade, it is important to adapting IT to customs procedures, rather than merely replacing paper forms with electronic forms. In the case of Korea, while e-trade has significantly reduced clearance times and costs, transportation costs are still higher than in Japan or the US. Moreover, changes in the legal and regulatory framework must accompany the adoption of IT and e-trade. In other words, it is vital to redraft laws and regulations so that e-trade and IT tools can be used most effectively.

The usefulness of e-trade will increase exponentially, when more economies join the e-clearance and e-trade networks. However, in order for economies and economies to

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<sup>30</sup> From interviews with representatives of the Korean Customs Brokers Association, which took place in January 2008.

<sup>31</sup> For more details, see Yang (2008).

<sup>32</sup> This section draws on conclusions in Yang (2008)

participate in the e-clearance and e-trade system, they must agree on various standards and procedures. These include not only IT-related standards, but agreements on laws, regulations, formats and certifications. Thus, economies should be encouraged to use international standards for documents and data as set by WCO and UN. Through discussions in APEC, member economies have made major contributions to setting regional standards for e-trade.

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## **Reform of the Real Estate Industry in Malaysia\***

### ***Introduction***

A number of factors motivate government regulation of the real estate industry. There is, *first*, the paramount concern with public safety. The Government has a duty to regulate development and construction as they can pose significant hazards to the general population, as demonstrated by high-profile building collapses around the world and in Malaysia.<sup>1</sup> A *second* reason is the management and control of land use to reduce negative externalities (such as traffic congestion, pollution, etc.) and to ensure orderly provision of social infrastructure. *Third*, regulations are necessary to accommodate social and political objectives and preferences. Examples include the preservation of heritage buildings, the imposition of a national cultural policy and general aesthetics.

Nevertheless, regulations may also inhibit economic growth, by either their nature or their implementation. In Malaysia, excessive regulations are a barrier to efficient business operations, reducing the attractiveness of the investment climate for domestic and foreign investors. The fact that more manpower has to be deployed to deal with these regulatory requirements often means longer delays and higher costs to businesses. Delays in securing approvals also add to uncertainty and detract from investment decisions. When economies are competing intensely to attract investment, simplifying regulations has been at the forefront of efforts to improve the delivery system. Malaysia has made the improvement of its public sector delivery system one of the pillars of the National Mission in the 9th Malaysia Plan (9MP) (2006-2010).

The objective of this study is to assess the regulatory reforms introduced by the Government recently by comparing the changes made against feedback received from some industry participants. These views should be considered to be indicative, rather than definitive. Four reforms, in particular, are focused upon, *viz.* the establishment of One Stop Centres (OSC), the introduction of Certificates of Completion and Compliance (CCC), the creation of the post of Commissioner of Building (COB) and the launching of the 'Build-Then-Sell' (BTS) concept. The OSC and the CCC are measures to expedite the approval of property development permits and occupancy of completed buildings. The post of COB was created to deal with matters associated with maintenance and shared responsibility and amenities for the occupants of multi-storey buildings, while the BTS concept serves as a means for property developers to overcome the problem of incomplete or abandoned projects.

The study analyses the reasons behind the reforms and their effectiveness to date. The reforms are barely two years old. In most cases, implementation capacity is either newly established or still being worked upon. Teething problems have inevitably risen and

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or of the government of Malaysia.

<sup>1</sup> In Malaysia, examples are Highland Towers, where a condominium block collapsed in 1993, and the Government tourism complex in the State of Perak, which collapsed in 2007. See: "12-Storey Apartment Block Collapses" *New Straits Times*, 12 December 1993, and "Complex that collapsed was never viable" *New Straits Times*, 17 November 2007.



procedures have had to be refined. Public awareness of the new measures is also still far from complete.

### ***Motivations for Reform***

The recent property sector reforms undertaken by the Ministry of Housing and Local Government were driven by both internal and external factors. The strongest push for these reforms came from the internal factors. However, reforms targeted for the internal sector have a direct positive impact on external industry participants.

#### ***Internal Factors***

The construction sector is an important contributor to national output, contributing 3 percent of GDP and employing 6.6 percent of the total labour force in 2007, with large multiplier effects. In 2008, there were 63,465 contractors participating in the property industry in Malaysia. In 2007 the property industry was building 6,745 construction projects, valued at about RM 88 million.<sup>2</sup> According to the president of the Master Builders Association of Malaysia, fluctuations in the construction industry impact more than 140 related industries (Business Times, 5 November 2008). Therefore, an efficient property industry will help grow the economy and expand related industries such as building materials, furniture and textiles.

Complaints by the public regarding the property sector come from two groups: property developers and buyers of houses. The grievances by the two groups are channeled through their respective associations, such as the Real Estate and Housing Developers' Association (REHDA) and the National House Buyers' Association. These complaints are normally made during dialogues with the relevant ministries and government departments. The mass media is also an important channel for airing their complaints and, since it is a public forum, the complaints have encouraged the Government to take action to protect its reputation.

Complaints from investors and property developers are a primary motivation for improvements in the delivery system of the Malaysian real estate sector. Long delays in processing applications, uncertainties over approvals, inefficient processes, and opportunities for abuse at the local authorities' level have been among the criticisms raised by property developers. The slow and tedious approval processes have a big impact on the financial positions of developers, as they normally have to pay financial compensation if projects are delayed. This penalty provision is stipulated in the Property Sales and Purchase Agreement, according to which developers have to pay daily fines for late delivery, even if the delays result from the slow approval processes of a local authority.

Equally serious are the grievances of buyers of houses, and these fall into four main areas:

- Abandoned housing projects, because developers are unable to finish them due to financial or work difficulties. This has caused hardship to house buyers because they still have to service their housing loan repayments even though the houses are incomplete and abandoned.

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<sup>2</sup> Source: Construction Industry Development Board (CIDB), Malaysia

- Delays in taking occupancy of completed houses because of the late issuance of Certificate of Fitness for Occupation (CFO). In some cases, buildings are occupied despite non-issuance of CFO.
- Safety of houses, because of uncertainty in the criteria and processes for issuing the CFO.
- Problems related to the use and maintenance of common property in apartments or condominiums.

Most of the criticisms of excessive regulations which lead to delays in approvals and the ensuing higher cost property development are directed at local authorities. It is only natural, therefore, that most of the reforms to simplify and/or reduce unnecessary regulations are targeted at the level of local authorities.

### ***External Factors***

An important reason for the reforms is the Government's commitment to make Malaysia an attractive investment location. International benchmarks, such as the World Economic Forum's *Global Competitiveness Report* and the International Management Centre's *World Competitiveness Yearbook*, are monitored constantly by the Malaysian Government, which would like to improve the economy's standing in these benchmarks. The World Bank's *Doing Business, 2009* survey is another carefully watched benchmark. In 2008, Malaysia ranked 20<sup>th</sup> out of the 181 economies that participated in terms of the overall 'Ease of Doing Business' category. Malaysia performed poorly, however, in the category of 'Dealing with Construction Permits' where it ranked 104<sup>th</sup>, lower than other neighboring economies such as Singapore (2<sup>nd</sup>), Thailand (12<sup>th</sup>), Brunei (72<sup>th</sup>) and Indonesia (80<sup>th</sup>).

The effects of excessive regulations were also studied in a 2005 World Bank Study.<sup>3</sup> According to the study, companies in Malaysia faced considerable uncertainty regarding the length of time required to complete bureaucratic procedures, especially the time required to obtain a license from the Land Office for construction work. In comparison, an import permit is relatively easier to obtain. As such, the motivation for reforms came from both internal and external sources. Apart from responding to complaints by the public and the players in the real estate industry, the Government strongly believes that the reforms are necessary to attract more investment (foreign and domestic), to increase competitiveness, and to improve efficiency. Although Malaysia recorded an 11-year high FDI inflow of US\$8.4 billion in 2007, the economy is keen to capitalise on more investments. Recent news reports, however, note that investors have been discouraged by governmental red tape.<sup>4</sup> The 9MP also notes that enhancing the public service delivery system is crucial to improving the use and cost efficiency of public sector funds, and to address actual and perceived corruption in the public and private sectors.

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<sup>3</sup> World Bank (2005), *Malaysia: Firm Competitiveness, Investment Climate and Growth* (Washington DC)

<sup>4</sup> See, for example: 'Malaysia's Drive for Investment Loses Traction', *International Herald Tribune*, 26 December 2007

### ***Regulations Prior to Reforms***

Property development companies have to deal with all three levels of Government—Federal, State, and the local council—on both technical and policy-related matters, so without simplified procedures the process can be extremely time-consuming.

### ***Regulations related to an application for a construction permit***

An application for property development involves a total of 17 departments. Five of these departments belong to the Local Authorities (LAs) and the remaining departments fall under the administration of the State and Federal Governments. Four main departments are involved in processing and approving property development applications. These include the Planning, Building, and Engineering departments under the LA, and the Land Office under the State Government. The remaining 13 departments consist of external technical departments that must review proposals and provide their recommendations before final approval is given. The post-reform process involves the same number of departments as that prior to the reforms, except that the channels for processing the approvals have been simplified.

Before the introduction of the OSC, developers had to get permissions and recommendations from the external technical departments prior to submitting the application to the Land Office and LA's departments of Planning, Building and Engineering. Once positive recommendations from the external technical departments were obtained, applications for planning permission, building plans, road and drainage and earthworks could be approved within two months. However, additional steps were required for approval from the land office. A recommendation paper had to be submitted to the Land and Mines Director, after which the decision on land use would be made by the members of the State Executive Council (EXCO). Once the State EXCO gave their consent, the State Land Office would issue an approval.

The State Land Office, through the District Land Office, would process two applications involving land development. They were (1) conversion and subdivision, and (2) surrender and re-alienation. The Land Office would examine the status of the land within a 50 day approval period.

Planning permissions were used by the LAs to ensure that property development was consistent with both national and local development goals, as expressed in the various laws and plans of the economy. At the local level, this was governed by the *Town and Country Planning Act 1976 (Act 172)*, which introduced a uniform system of laws and controls for town and economy planning to ensure that proper development took place in all local planning authority/council areas in Peninsular Malaysia. Subsection 19 of the Act prohibited any person from starting, undertaking, or carrying out development unless Planning Permission was granted.

Planning permission, being a development function undertaken at the local level, is guided by Local plans. However, the Local plan is nested within the State Structure Plan, which in turn also took into consideration the Federal Government's development plans, namely the National Urbanization Policy and the National Physical Plan. In the state of Selangor, for example, this included the State Structure Plan and the local implementation of Agenda 21.

Building plans had to be submitted to the LA's Building Department for comments and approval. The average processing time with the building plan application is 50 days. The earthworks plan was submitted to the Engineering Department of the LA, and approval would be given based on feedback from external technical departments, which usually took another 50 days. The Department of Engineering under the LA was given the responsibility to approve the application with regard to roads and drainage. Approval was based on expert opinions from other technical departments. The approval process would take 50 days, if no amendments were needed to the plan.

### ***Certificate of Fitness for Occupation***

Completed development projects must meet the rules and regulations regarding standards to ensure they are safe for occupation. The State and Federal Governments set the framework for certification, while the implementation of these acts and final certification of safety are carried out by the LAs. In the past, the main instrument to ensure building safety for occupation was the Certificate of Fitness for Occupation (CFO). Under the *Uniform Building By-laws 1994* (UBBL), no one could occupy any part of a building unless the CFO or temporary CFO was issued. Apart from the UBBL, other legislation that developers needed to take into account in order to obtain a CFO included the *Housing Development Act 1966* (Control and Licensing), the *Strata Title Act 1984*, the *Registration of Engineers Act 1967* and the *Architects Act 1967*.

The conditions for CFO issuance were:

- Acknowledgement from the person submitting the plan i.e the professional in Form E...of the application, that he/she has supervised the construction of the building and that it is built according to the code set under the UBBL.
- Inspection of the building by LA officers
- Adherence to the conditions imposed by the LA when approving the building plans pertaining to basic amenities such as access roads, landscape, parking space and drainage.
- Verification from the internal and external technical departments on compliance with UBBL. Verification had to be completed before submission was made to the Building Department of LA.

The application for a CFO had to be made by the same person that submitted the plan and supervised the construction of the building. Once the conditions were met, the Building Department under the LA would release the CFO. The municipal council would have a period of up to 14 days to decide whether they would accept or reject the application for the CFO. If the municipal council accepted the application, within 14 days CFO must be issued or deemed to be issued-

### ***Properties under Strata Titles and Common Properties***

Rapid urbanization growth has made it increasingly important that land in prime areas is utilized to its fullest potential. One way in which this has been achieved is by building high-rise buildings or other buildings that can house or occupy a large number of people

and businesses. This has resulted in a rising number of properties that have strata titles and are common in nature. Under the *Strata Title Act 1985 (Act 318)*, buildings that have at least two stories on alienated land and held as one lot under a final title can be divided into parcels, with each parcel issued with a strata title.

Common property in a building complex is treated according to the same principles of public property, where every tenant of a building has the rights to fully utilize it. However, with strata titles, there is a lack of incentives to use the common property well and to maintain or repair it if it is broken. To overcome such problems, the Government now requires that the responsibility to maintain and manage the common property is assigned to an agent or a body. Guiding the appointed body are several acts including the *Housing Development Act (Control and Licensing) 1966*, *Housing Development Rules (Control and Licensing) 1989* and *Strata Title Act 1985*.

The *Strata Title Act 1985* allows for the establishment of a Management Corporation (MC) at each building with strata titles. This, however, does not prevent principal-agent related problems from occurring. There are a number of common problems faced in ensuring proper maintenance and management of common properties. The first is non-payment of building maintenance charges. There have been many cases where an MC has experienced financial difficulties owing to non-payment by owners/tenants who argue that their MC is not fulfilling its responsibilities in maintaining and managing the common properties. In particular, this situation has affected a number of low-cost flats where non-maintenance by the MC has resulted in deteriorating living conditions.<sup>5</sup>

Principal-agent problems in maintenance and management can be traced to the lack of clarity in the demarcation of duties and responsibilities between the developer and the strata title owners. In addition, the actual period for which the developer is responsible for managing and maintaining the building was not specified, although it was stated that this was to be undertaken under the registration of strata titles. The time frame for the issuance of strata titles differs by State and circumstances, as it involves a prolonged process with no specific legal provisions or regulations to manage this.

The enforcement of laws and regulations pertaining to the maintenance and management of buildings and common property falls under two Ministries, *viz.* the Ministry of Natural Resources and Environment and the Ministry of Housing and Local Government (MHLG). Apart from problems of coordination and assigning responsibilities in enforcing laws, there are also issues of inadequate logistical and manpower capacity, particularly in view of the increasing number of high-rise housing developments.

### ***Abandoned Housing Projects***

Another problem affecting the property sector, and particularly house buyers, is that of abandoned housing projects. The common practice on housing projects in Malaysia is to first sell the ownership of a house after which housing developers will build the house using the money received from buyers and financial institutions. The housing developers here benefit as they do not need a large amount of capital before embarking on a new project. The problem of moral hazard arises in the sell-then-build arrangement, as developers have an incentive to behave irresponsibly while the buyers lose out. House

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<sup>5</sup> See, for example: 'Flats unhealthy for society', *New Straits Times*, 5 November 2008

buyers have to face a double penalty as they still have to service their loans with the banks while their houses remain unfinished. Before the introduction of the BTS concept, the Government addressed this problem through the Syarikat Perumahan Negara Berhad (National Housing Corporation), which would revive abandoned housing projects as one of its main objectives.

A housing project is considered abandoned when (1) construction and development works on site have stopped for 6 consecutive months, regardless whether this falls within or outside the delivery date agreed under the Sales and Purchase Agreement, (2) developers admit they are unable to finish the project and (3) a Building Inspector concludes that a developer is unable to fulfil its responsibilities.

### ***The Reforms***

Since April 2007, the MHLG has introduced several reforms in the delivery system of the property sector in Malaysia. The reforms aim to improve the property development processing and approval system at all levels of the Government. The changes include speeding up the processing of development proposals, replacing the certificate of fitness for occupation system with a more effective system, and introducing a new law that deals with the issues on maintenance and management of buildings and common properties

The reform involved four initiatives, viz. (1) the introduction of OSC in all LAs in Peninsula Malaysia to facilitate and speed up the application processes for the development of proposals, (2) the introduction of CCC to replace the Certificate of Fitness for Occupation (CFO), (3) the introduction of the *Building and Common Property (Maintenance and Management) Act 2007*, along with several other amendments of legislation to allow the appointment of COBs and (4) the launching of the BTS concept.

### ***OSC***

The OSC expedites approvals for development proposals submitted to the LA through simultaneous processing. Submissions of development proposals to the OSC will be distributed to the relevant departments within the LA and also to relevant external technical departments. In this way, the OSC is viewed as a way both to reform the system of development permits issuance and to enhance the delivery system within the LA.

The objectives of the OSC are:

- To coordinate and facilitate the approval process for land development, planning permission, building plans, engineering plans;
- To reduce the processing time and expedite the process for development proposals application under the BTS concept within 4 months and under the more common Sell-Then-Build (STB) concept within 6 months; and
- To standardize the procedures and process for development proposals applications under the provisions of the *National Land Code 1965*, the *Town and Country Planning Act 1972* and *Streets, Drainage and Building Act 1974*.

The role of the OSC is to coordinate and monitor development proposals and other applications, inform the decision on approval of development proposals to the applicant, make recommendations on the land development application to the State's Land Office and prepare periodic reports. For more effective implementation, an OSC is established at

every local council. The OSC does not cover Sabah and Sarawak due to issues pertaining to local land laws in those states.

The daily administration of OSC is the responsibility of the appointed Secretariat. In most LA, a special department is set-up for the purpose of administering the OSC. The functions of the OSC secretariat are to:

- Receive and check applications for land development, planning permission, building plans and other related plans from the applicant
- Examine whether applications comply with the basic requirements or conditions imposed
- Distribute the development proposal application to the relevant departments for processing and other technical agencies for comments and reviews
- Monitor applications that have been distributed to technical department/agencies
- Inform the OSC committee on all the applications received
- Receive any feedback on problems and issues from technical agencies
- Collect and coordinate recommendation papers by the planning department, building department and engineering department and pre-computation plans for approval by the OSC Committee
- Distribute the decision of the OSC Committee Meeting on the approvals for planning permission and pre-computation plan to the Land Office for applications under 124A and 204D National Land Code
- Act as the Secretariat of the OSC Committee meetings in setting the dates of meeting, ensure that meetings be held twice a month and prepare minutes of meetings as well as feedback for distribution
- Collect all OSC Committee Meeting decision papers for presentation to the Full Council Meetings
- Distribute official decisions to the applicants, persons who have lodged objections and technical departments/agencies.

A committee, chaired by the head of the LA, is established to peruse, deliberate and decide on an application. This committee meets twice a month and makes decisions on applications made.

The MHLG made a commitment that the processing of development proposals would be done in 4 months or 6 months (which is on par with other developed economies). For this purpose, fast-lane processing for development projects was introduced. The projects that qualify for fast-lane processing are High Impact Projects approved by the National Investment Committee, under the supervision of Economic Planning Unit, foreign direct investments, government projects and projects under the BTS concept. Under the OSC, processing will take no more than four months as applications related to land matters,

planning permission, building plans and engineering plans are being submitted complete and simultaneously, hence, processed concurrently.

Before commercial and residential properties can be erected, they must receive development approval, which involves four stages: (1) application for land matters; (2) application for planning permission; (3) application for building plans; and, (4) application for engineering plans-

The applications processes above are governed by their respective legislations, namely the *National Land Code 1965*, *Town and Country Planning Act 1976* and *Street, Drainage and Building Act 1974*. Because of the involvement of multidisciplinary legislations, different departments are responsible for the applications. Land matters are covered by the District Land Office or Department of Land and Mine under the jurisdiction of each State Government. The remaining applications are under the Planning Department, Building Department and Engineering Department of the respective LA.

The concurrent approach in processing development proposal applications provides the developers with several alternatives in submitting the proposals to the LAs. The available alternatives for concurrent application are shown in Table 1. The processing timeframes for applications differ according to the way the applications are submitted along with the nature of the development proposals. If a project that is under the fast land scheme is submitted under Alternative I, the average application time will be less than four months, while projects categorized under ordinary STB concept even under Alternative I will be decided in 6 months. For development proposals, the processing time for applications submitted under Alternative II or III will depend on the time allocated for each process and the date of submission. These alternatives aim to increase both the flexibility and effectiveness of the LA delivery system. The alternatives also provided developers greater room for better compliance with the buildings code and environmental standards.

**Table 1 - Alternative Methods of Submission to the OSC**

Alternative I	Concurrent processing for all 4 applications, i.e. applications for land matters, planning permission, building plan and earthworks plan and road and drainage plan
Alternative II	Concurrent processing for a combination of 3 applications. For example: <ul style="list-style-type: none"> <li>• Application for land matters, planning permission and building plan; or</li> <li>• Application for planning permission, building plan and earthworks plan</li> </ul>
Alternative III	Concurrent processing for a combination of 2 applications For example: <ul style="list-style-type: none"> <li>• Application for land matters and planning permissions; or</li> <li>• Application for planning permission and building plan; or</li> <li>• Application for building plan and earthworks plan; or</li> <li>• Application for planning permission and earthworks plan</li> </ul>

High Impact Projects are considered fast lane and the approval process for these projects is 4 months, provided the developer concurrently submits under Alternative I and the submission complete. The following are the applications that could be submitted one by one or in any 4, 3 or 2 combination: (1) Simultaneous application for subdivision and conversion (Section 124AA *National Land Code*) or application for surrender and re-alienation (204D *National Land Code*); (2) application for planning permission; (3) application for building plan approval, (4) application for the engineering plans-



Under the concurrent approach for BTS, High impact projects, foreign investment and government projects, the application process will take 92 days, but if the application falls within an area with a gazetted local plan, the processing time frame will be reduced significantly to 67 days.

In the case of ordinary development projects such as the usual STB properties, approval is guaranteed by the Government to take less than 6 months. The steps in the applications processing equal to the number for fast lane projects, however, the processing time is longer. The ideal processing time for this is 142 days (4 months and 22 days) while for areas that have local plans, the suggested time frame is 91 days (3 months 1 days).

### **CCC**

CCC replaces the Certificate of Fitness for Occupation (CFO) in ensuring a building safe for occupation. The difference between CCC and the CFO is that the responsibilities to verify the building's safety will be in the hand of the professionals even though in both systems the professionals are held responsible and liable for the safety of the building. Under self-certification by the professionals on the CCC system, self-regulation by the professional will be the key to ensure this concept is a success. Here, professional bodies such as the Board of Architects and Board of Engineers play a great role in ensuring its members run their practices credibly and professionally. At the same time it reduces the excessive bureaucracy at the LA. The CCC system is an extension of the previous system of approval, which catered for individually built detached houses or bungalows. In the 1999 amendments to the UBBL, for buildings like bungalows, the professional architect or registered building draughtsman as the Submitting Person is given the authority to issue the CCC.

The underlying principle of the CCC is that the professionals represent the persons most knowledgeable and possess the required expertise on the specific project. Accountability in the matter of health and occupancy safety under the CFO system is in the hands of the professionals, not the LAs. One of the problems that CCC tries to address is regarding the notice of vacant possession in residential property. Under the CFO system, buyers cannot occupy their homes because the delay in the issuance of CFO which ties directly to the issuance of notice of vacant possession. In some cases, LAs issue temporary CFOs for occupants of the building if there is a necessity for it since the actual CFO cannot be issued due to premature certification by the professionals or other problems developers might face with several technical departments. With the CCC system, the notice of vacant possession will be issued in parallel with the issuance of CCC. Hence, the said building safety has been verified and the premises can be occupied.

The issuance of the CCC will be done by the Principal Submitting Person (PSP). There are three types of PSP, depending on the nature of the development projects. The PSP can be an architect, an engineer or a draughtsman. For an architect to be considered as the PSP for a development projects, the project requires intensive design input. At the same time, the architect must be registered under the Board of Architects Malaysia. On the other hand, if the project has high engineering input then the role of PSP will fall to the hands of an engineer registered under the Board of Engineers Malaysia. The registered Building Draughtsman will be the PSP if the development project involves building a bungalow that does not exceed two floors in height and 300 square metres in total built-up floor area. In

all cases, the PSP will only issue a CCC after all the parties concerned are satisfied with the building construction. Building construction must adhere with the law and technical conditions imposed by the LA in the approval of the Planning Permission Building Plan and Engineering Plan.

Responsibility of the PSP will be in the compliance of provisions of the related legislations and the technical conditions imposed by the LA. Non-technical matters are the responsibility of the developer and the LA without involving the PSP. The decision to separate technical and non-technical matters was made by the Cabinet in June 2006 as the technical conditions are directly related to the safety and stability of the building being erected and are within the control of the professionals.

The technical conditions under the responsibility of the PSP can be classified into three main categories, namely:

- The technical conditions within the building that relate to the health and safety aspects of the building like fire prevention.
- The technical conditions outside of the building but within the development areas that relate directly to the building and development. Example, the development concept of community living would require the incorporation of the elements of open spaces complete with landscaping and recreational facilities that support such a concept
- Technical conditions outside the project area that are linked directly to the related development like access road and utility infrastructure both outside the project area.

Non-technical conditions are imposed by the LA, in line with the State Government policies to fulfil various socio-economic development needs.

The certification process done by the PSP is divided into 21 stages based on 21 building components. The certification process is done through 21 G Forms which required the persons responsible for the component mainly the professional who designs and the contractor or trade contractor who construct to verify that the requirements for each stage are met. Apart from the G Form, submission of several other forms must also be made by the PSP. According to the By-law 25 of the UBBL, PSPs can issue the CCC using Form F subject to the following conditions:

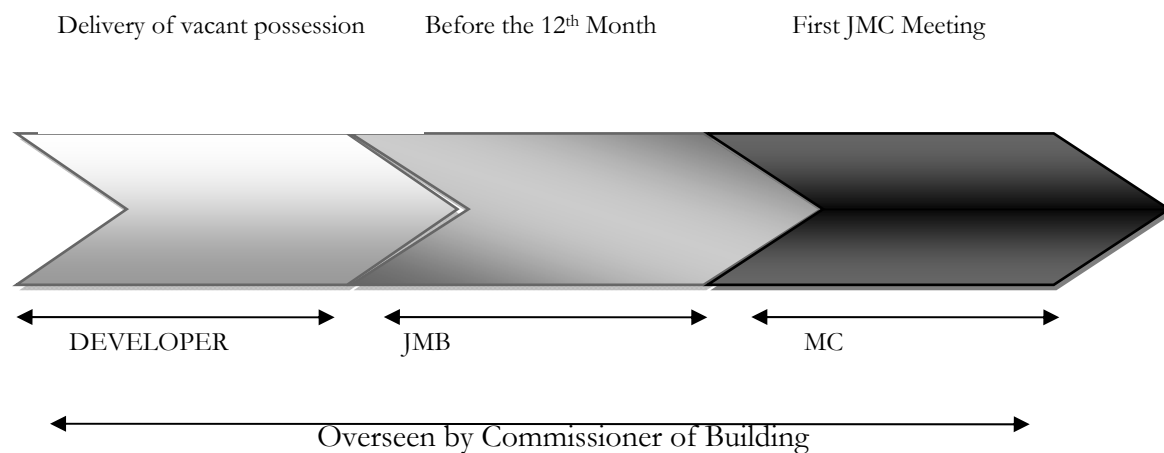
- When all the technical conditions imposed by the LA have been satisfactorily complied with;
- When Form G1 to G21 in respect of stage certification as set out in the Second Schedule have been duly certified and received;
- When all the essential services, including access roads, landscape, car parks, drains, sanitary, water and electricity installations, fire hydrants, sewerage and refuse disposal requirements and fire lifts, where required, have been provided; and
- When Form F certifies that the PSP has supervised the erection and completion of the building has been constructed and completed in accordance with Act 133, the UBBL and the approved plans.

Within 14 days, the PSP must deposit a copy of the CCC along with the copies of Forms G1 to G21 to the OSC at the LA, Board of Architect Malaysia or Board of Engineer Malaysia. It should be noted that CCC is only applicable for projects of which the building plans are submitted to LA after 12 April 2007-

### **COB**

The COB is a position created at the LA to oversee the implementation of the new *Building and Common Property Act (Maintenance and Management) 2007* (Act 663). The purpose of the Commissioner is to overcome the problems involving residential and commercial properties with strata titles. The appointment of the COB will be done by the State Governments as they will decide the qualifications and the number of officers that deemed enough to assist the COB.

The diagram below explains the phases in the maintenance and management of buildings and common property once the building with strata title is completed.



The responsibilities of the COB can be divided into three phases according to the interval before the establishment of the Management Corporation (MC); namely during the initial phase (after building is completed), the interim phase (12 months from the delivery of vacant possession) and the final phase (where the MC for a building is established). In Phase I, the developer is given 12 months from the date of delivery of vacant possession to conduct a meeting to form the Joint Management Body (JMB). In Phase II, the JMB aims to provide a mechanism for the developers and the purchasers to be jointly responsible for managing and maintaining buildings before it is handed to the management corporation (MC). One of the roles of the COB is to monitor that the responsibility of maintaining and managing the building is passed on smoothly from the time the building is finished to the management by the management corporation.

The COB is also given the power to enforce the Act 663 under Sections 38, 39 and 40. This includes:

- Rights to enter any building, land or premises for the purpose of carrying out inspection or investigation to determine whether any offence under the Act 663 has been committed, or any necessary work as required by the LA or any repairs or urgent work related to the said building, land or premises.

- Rights in exercising the power of investigation under Section 38, the COB may hold investigative interviews with any person supposed to be acquainted with the facts and circumstances of the case.
- To fine any offence against Act 663 or any regulations made under this Act.

### ***BTS***

The BTS concept is a measure introduced by the MHLG to reduce the risk of housing projects being abandoned, which could cause hardship to house buyers. Risk of non-completion is eliminated with the BTS concept as only houses that have CFO/CCC can be sold to the public.

The BTS was introduced in June 2006 with the aim that the well-capitalized developers to front this concept. However due to lacklustre interest from the developers, the Government in April 2007 re-launched it with incentives. BTS does not replace the earlier Sell Then Build (STB) concept that is basically the core of the housing industry in Malaysia but serves as an alternative for both house buyers and developers.

Under the BTS concept, developers are obliged to complete the houses and once the CFO/CCC of the houses is released, the developers can sell the houses. In this way, house buyers only pay the housing loan instalment after they have moved in the new houses. In the past, if there was a delay in the completion of houses or if housing projects were abandoned, house buyers would still have to service their housing loan instalment even though they had yet to occupy the houses.

There are two ways how the BTS concept is implemented: (1) Complete BTS, where developers will only sell houses that are completed and compliance with the CFO/CCC or (2) Partial BTS (10:90), where house buyers will have to pay 10% of the house value as deposit for booking and sign the Sales and Purchase Agreement. The house buyers will have to pay the remaining 90% after the houses are completed with CCC/CFO certification.

As incentives for the developers to use the BTS concept, the incentives introduced by the Government are (1) exemption on Deposit on Housing Developer License worth RM 200,000 and (2) exemptions on low cost houses quota in housing projects. In exchange developers are allowed to build mid-low cost houses and sell them at higher prices. The Government ensures that LA will process application for development proposals like application for conversion and subdivision, layout plan and building plan within four months.

### ***The Political Economy and Effectiveness of Reforms***

Three of the four reforms administered by the MHLG focus on the delivery systems of LAs. Under the 9MP, the Government has promised to undertake measures to strengthen the three main entities which are the district office, the land office and LA, all involved with the application for building permission. The performance of district office, land office and LA will be enhanced through organisational restructuring, re-engineered processes, human resource development, deployment of information and communication technology and streamlining the roles of responsibilities of agencies involved.

Efforts to streamline and improve the operations of LA with regard to property sector have been pushed by the Government. The effort under the OSC is in line with the policy “No Wrong Door”, whereby there exists a single point of entry that enables the public to get multiple services from different government agencies in an integrated manner. PEMUDAH or the Special Taskforce to Facilitate Business was established in February 2007 as a concerted cross-ministerial and private-public sector initiative to alleviate burden in the government regulations. This taskforce is co-chaired by the Chief Secretary to the Government of Malaysia and the President of the Federation of Malaysian Manufacturers. As for now, the PEMUDAH monitors the implementation of OSC and CCC and offers feedback and new measures to improve on the initiatives.

## **OSC**

### ***Why certain choices were made***

The implementation of an OSC at each town/municipal council was decided by the Federal Government. Previously, the various departments and agencies acted relatively independently of each other and non-standard practices were the norm. Each of them had their own Client Charter and ways of doing things. As different laws and enactments existed in each State, the procedures among LAs varied, and developers had to be familiar with the peculiarities of each LA. LAs also had the tendency to impose, at their own discretion, requirements that had to be fulfilled.

Initially, there was some concern given the apparent Federal ‘intrusion’ into an area that was the jurisdiction of State Governments. The changes also significantly reduced the power and removed the discretionary power of the members of key committees and were therefore not surprisingly unwelcomed. Two of the most powerful committees were those involved in planning (responsible for issuing development orders) and building (responsible for approving building plans). These committees were reduced to four councillors whereas before there could have been six or more. This clearly decreased the number of councillors who could earn meeting allowances but, more importantly, by virtue of the stipulated deadlines and monitoring procedures that were set, they also had their power significantly diluted. In order to prevent deliberate delays by non-attendance of meetings, a maximum of two absences were tolerated before the decision-making power over applications reverted to the OSC.

Obviously, none of the departments and agencies took kindly to the changes that were forced upon them. Strong ‘top-down’ pressure had to be applied to ensure that the changes were properly and consistently executed. LAs that were considered to be deliberately slow in implementing the reforms were privately pressured, often times publicly in the media, and, in selected cases, there was the threat of “adoption,” meaning that there would be close scrutiny and involvement in their operations.<sup>6</sup> Eventually, as the establishment of OSC reflected the strong commitment of the Government to improved service delivery, the changes were supported by adequate resources from the federal Government and the secondment of Federal officers.

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<sup>6</sup> See, for example: ‘Deadline for setting up one-stop center’, *New Straits Times*, 9 May 2007, pg 17

### ***What implementation problems were faced?***

Implementation also varies across LAs as not all of them have enough manpower to establish and operate what is in effect an entirely new department. Where OSC secretariat staff is sufficient, they do not always have the skills and experience and have to learn on-the-job.

OSCs themselves have drawn attention to problems faced by them in the implementation of the new system. These include lack of utilization of the various submission alternatives, lack of readiness on the part of external technical departments and lack of understanding by developers on OSC's operations and procedures.

In terms of alternatives for application submissions, the OSC system has provided developers with an avenue where construction permits can be done easily. However, based on visits to selected local councils, simultaneous submission is rarely used. One of the weaknesses in the alternative submission choices that emerged from interviews was the risk that one of the application plan or layout needed to be amended thereby affecting the draft and layout of the other plans submitted at the same time by the developer. If there are any amendments on the applications, developers have one week to one month to amend the submitted plans. This exercise can be considered highly unfavourable to the developers in term of time and cost. Due to this risk most developers would prefer to do submission under the Alternative II and Alternative III. The OSC has certainly quickened the processing of applications with regard to the approvals and comments from the LA's technical departments. There is, however, a lack of coordination with external technical departments such as the Fire Department and the State Land Office. These problems will have to be addressed if there are to be any further improvements to the OSC.

### ***How they are addressed***

The implementation of an OSC at each town/municipal council was decided by the Federal Government in order to improve delivery system of local authorities. To ensure the efforts of improvement being done continuously and seriously, the PEMUDAH requires submission of report on applications made through every OSC every month. The PEMUDAH also has taken another step by adopting several OSCs operating in crucial local authorities. Currently the OSCs under the purview of PEMUDAH are Local Council of Ampang Jaya (MPAJ) and City Hall of Kuala Lumpur (DBKL)<sup>7</sup>. A star rating system has been developed and implemented by the Department of Local Government and MHLG in 2008.

Several improvements have also been made on the behalf of the Ministry. The guidebook on the operation of OSC is in its second edition and many improvements have been included in this new edition. To overcome the shortage in manpower at the OSC level, the MHLG has recruited technical officers of planning, architecture and engineering background to operate on OSC level around Malaysia. This is helped by the creation of several positions in OSC like urban planner and technical assistants in planning, architecture and engineering.

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<sup>7</sup> See, for examples: 'Chief Secretary pays surprise visit to MPAJ', *The Sun*, 2 November 2007 and 'PEMUDAH adopts KL City Hall to it more people-friendly', *The Star*, 29 September 2008

Based on the statistics gathered by the ministry's tracking system, 32,121 applications were received as of 15 August 2008, comprising 18,531 building plans, 10,240 Development Orders, and 273 incomplete applications. Over 86% of the building plans submitted to the OSCs were approved within 38 days, while 75% of the applications for Development Orders were issued within 45 days. At the Federal level, the pilot project for online submission was initiated in October 2008 for a 7 selected town councils which see a large number of applications. Online submissions will cover all stages of submission mainly the submission, processing and the status of application. The Department of Local Government and MHLG recently have developed and implemented a star-rating system for the Local Governments around Peninsular Malaysia.

### ***Responses and Feedback***

The private sector's perception of the reforms still appears to be uncertain. A number of property developers continue to express less than complete satisfaction with the speed, transparency and accountability of the procedures, while other problems, such as high fees imposed by LAs for hoarding/indication boards continue to be a concern for many. Many have commented that decisions from technical committees, especially external ones, still leave something to be desired. A simple survey done by the Real Estate and Housing Developers Association (REHDA) on 14 members recently revealed some of these dissatisfactions with the implementation process of the OSC. It should be noted that the views expressed are indicative of some of the issues surfaced by developers that bear watching, but are not representative enough to draw full conclusions because developers are not the direct players to OSC while their agents who are the professionals play the major role in making sure applications fulfil all submission and technical requirements and are ready to be submitted.

*Firstly*, they reported that OSCs have added consultation services before the submission of applications so that no amendments and corrections will need to be made after applications are submitted. However, there is a lack of coordination exists between those who are doing the consultation at the OSC level and those who are finally giving out the technical comments at various technical departments. Complaints by developers mostly focused on how they managed to fulfil the technical checklists at the OSC level initially but were later told that amendments were needed after the applications had been distributed to other technical departments for comments. This practice by the LA costs developers time and money as they will have to hire consultants to amend their plans according to the specifications of the technical departments.

*Secondly*, the developers sampled also complained that apart from having to amend their plans and applications, they also have to do it in a limited time period given by the LA. The time period given for the developers to amend their plans varies according to the technical departments. It usually has to be done in one to three months based on the LA's discretion.

*Thirdly*, the developers sampled are also not satisfied with the requirement that they have to start construction work within one year after they receive the approval from the LA. They consider this to be burdensome as they need to seek financing quickly, which is difficult and may be costlier.

The results from the survey conducted by REHDA show that some developers are dissatisfied with the effectiveness and timeliness of the OSC, and feel that the creation of OSC does not make any difference to the application process for development work. The lack of coordination with the external technical departments is pushing the developers to approach these departments independently for manual processing of documents to ensure that their applications get the proper approval times. Delays in approval still occur at the LA but some unethical practices have been revealed. In all, the implementation of OSC at LA has been received cynically by the industry.

### **CCC**

The aim of the CCC is to increase the credibility of the professionals (architects/engineers/draughtsman) by making them act responsibly and be accountable. The replacement of CFO with CCC is intended to reduce irregularities that might surface in the certification of building safety. The survey conducted by REHDA shows that the effectiveness of the CCC system is still doubtful. On implementation by the local councils based on interviews conducted with the LA officials, it is still too early to measure the impact of the implementation of CCC certification system, as only 90 CCC have been released over the past year.

Despite lack of real evidence to measure the effectiveness and timeliness of the CCC certification system, several weaknesses have been pointed out during interviews conducted with the PEMUDAH secretariat, LA officials and housing developers.

The PEMUDAH secretariat believes that restructuring the industry with the introduction of CCC system will be costly. Increasing competition among the professionals might work to the benefit of large and prestigious architectural firms. The housing developers interviewed expressed their dissatisfaction with the checklists in the CCC system, which consist of 21 forms and 42 signatures, as this translates into a long process. The LA officials interviewed worried that there might exist potential abuses within the system as the architects/engineers appointed as PSP are chosen and paid for by the developers. The LA officials interviewed also felt that more vigilant monitoring by the LA and Professional Bodies is needed to ensure that the PSPs comply with the UBBL.

Until July 2008, only about 90 CCC had been issued according to the Ministry of Housing and Local Government. Table 10 shows the breakdown by PSP and type of development. Based on the interviews conducted, most respondents agreed that the effectiveness of the CCC rests in the hands of the professional bodies to regulate its members and to keep updating the current membership record. Most respondents also viewed that record for the professional bodies' memberships must also be made available publicly so both developers and buyers are well informed. DBKL has taken the initiative to publish the names of accredited architects/engineers in its website in order to facilitate selection process in PSP for the developers and increase transparency.

The benefits from the introduction of CCC are to increase employment opportunities for professional architects and enhance the credibility of professionals (architects/engineers/draughtsman) as well as their professional bodies (Board of Architects/Board of Engineers), In accordance with the aim of Government to encourage private sectors to self-regulate themselves.



## **COB**

The *Building and Common Property (Maintenance and Management) Act 2007* [Act 663] was enacted due to increasing problems faced by dwellers living in properties with strata titles. While there is no doubt that the *Act* attempts to address problems of common property, it does not do so fully. Problems with common property have surfaced in low cost flats where the occupants have to deal persistently with undesirable living conditions<sup>8</sup>.

The creation of the Commissioner of Buildings under the *Act* is supposed to address problems related to common property. However, based on the interviews conducted, its effectiveness is still in question with regard to (1) limited number of COB (one for each LA, although other officers can be delegated to assume the functions but rarely are) and (2) lack of legal empowerment to ensure problems can be resolved. Furthermore, the *Act* describes in Part VI section 25-30 the standard qualifications for the appointment of the Management Agent (MA), someone who can act like the COB with a limited remit at each property with strata titles, but MHLB is still to complete the regulations needed to implement the *Act*. As an example, the city with the largest density of high rise buildings, Kuala Lumpur, does not have a single Management Agent appointed by City Hall.

The Ministry of Housing and Local Government tried to address problems associated with building and common property through the publication of a guidebook on the *Building and Common Property (Maintenance and Management) Act 2007*. However despite that the COB's duty and responsibilities are still unclear to the public. Problems on common property especially at low-cost housing areas are still unresolved despite the *Act*.<sup>9</sup> Currently there are efforts by the MHLG to do stocktaking on the problems and to come out with solutions.

## **BTS**

The idea behind the introduction of BTS is to help home buyers so the risk of being cheated is eliminated. The concept has not been greeted with enthusiasm by developers for several reasons:

- Developers need to have huge capital to initiate projects
- Difficulties in getting financing from financial institutions
- Greater risks to the developers in terms of rising material costs, capital shortage and leave small room for errors for each correction or amendment will cost the developers.

The BTS concept actually favours the wealthy buyers. The elimination of risk commands a huge risk premium that translates into a higher selling price. Due to this, developers are more interested in taking on luxurious housing projects that cater to high-end buyers. At the same time the BTS concept has been fully utilized by the State-related companies that have a large capital base.

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<sup>8</sup> See, for example: 'Flats unhealthy for society', *New Straits Times*, 5 November 2008

<sup>9</sup> See, for example: 'CoB appointments on councils should be full-time', *The Sun*, 12 August 2008

Based on information from interviews, real estate developers seem to feel that the BTS scheme depends fully on the participation of financial institutions. Without the involvement of the financial sector, the smaller developers cannot fully participate in the BTS. Despite complaints on abandoned housing projects from house buyers, the number of abandoned projects in a year amounted to only 2 percent of the total. Developers interviewed said that the problems of abandoned housing projects should be tackled separately rather than to rely on the BTS. The current mechanism of Syarikat Perumahan Negara Berhad and the appointment of other solvent companies to take over the abandoned housing projects will be more feasible and effective. From the interviews conducted with housing developers, they feel that the Sell-then-Build scheme has been a successful one. The current level of house ownership for Malaysia has been achieved through the Sell-then-Build concept. Developers felt that by initiating the Build-then-Sell scheme, future house ownership levels will be affected, and on the supply-side it will move the better small developers out of the market.

### ***Case: Kuala Lumpur City Hall***

Kuala Lumpur City Hall or Dewan Bandaraya Kuala Lumpur (DBKL) is one of the largest Local Governments in Malaysia and can be considered to be the best candidates for a case study. DBKL is unique in that unlike other town and municipal councils, it has its own enabling legislation, the *Federal Capital Act 1960*, and is answerable to the Ministry of Federal Territories rather than the Ministry of Housing and Local Government.

DBKL has become the frontline of the implementation process and can be considered a model for other municipal/town councils. Its OSC was officially established in July 2007 and is administered by the Department of City Planning, with the full involvement of other technical departments. Initially, the OSC was run by temporary appointees from the technical departments. Since September 2008, however, the OSC has a team of permanent officers. Members of the OSC secretariat consist of landscape architects, engineers, architects, quantity surveyors and town planning experts. The experts are placed in the Secretariat to help the initial process of development proposal submission, particularly in the consultation period, making sure that the initial checklists are being followed by the developers.

The OSC Secretariat in DBKL has developed a system of submissions with a few changes made in processes. The improvements have been made in the form of the classification of projects and timeframe, the submission alternatives and the submission processing flow chart. It has, for example, shortened the approval timeframes compared to those adopted by other town and municipal councils.

The benchmark set by the DBKL on development proposals is a higher success rate, especially for small-scale projects. DBKL aims to ensure that the submission process is as fast and smooth as possible, provided there are no irregularities in the application. There are cases where development approvals for small-scaled projects were given one day after submission to the OSC. A distinct feature that has been added is the consultation with the developers before the submission of the development proposals. The consultation sessions consist of determining the classification of the development proposals, the alternatives available on the submission, and a preliminary check on plans and layout by related technical departments.

Apart from in-house consultation services, the OSC of DBKL has added several other items before the approval process can be completed. For DBKL, developers have to go through two additional committees before the applications are brought forward for approval. Here, developers have to conform to the requirements set by the Technical Planning Committee (as Kuala Lumpur already has a draft for its development) and the Development Adjustment for Environmental Sensitivity Committee. The DBKL believes these two committees are important in ensuring sustainable development for the city of Kuala Lumpur. Another notable feature that makes the approval process at DBKL faster is its in-house technical department. Other local councils in Malaysia have to rely on their respective district departments of Public Works under the Ministry of Works as these local councils do not have the same mandate as DBKL as it is located in a federal territory.

DBKL's OSC has also introduced two additional alternatives for submission of development proposals *viz.* (1) subsequent applications for individual submission for Planning Permission, Engineering Plan and Building Plan, and (2) basic approval (involving changes of zoning) and, in environmentally sensitive areas, changing zone usage, population density/population ratios and building heights. (For statistics on alternative-track submissions, please refer to Table 13.)

DBKL has not only made amendments to the OSC template given by the MHLG but it also employs other tools to further improve the existing system. The City Planning Department has come out with written guidelines to help the public with the submission of development process and the guidelines are available from the City Hall or on its website (<http://jprb.dbkl.gov.my>). Additionally, the Department has all zoning and land use information uploaded to its website. Property developers are expected to comply with the zoning requirements set by the city of Kuala Lumpur.

DBKL feels by maximizing efficiency during the processing of applications, developers can start their construction work quickly, and assessment taxes on the finished buildings can be collected quickly. At the same time, developers feel that the fast approval system will help them get their return faster. The role of the DBKL here is to facilitate development process in Kuala Lumpur that is in line with the aspiration of Kuala Lumpur to be a world class city while at the same time try to prevent any irregularities that may have harmful impacts on environment, culture and society. If the processing time is the only consideration, the DBKL OSC can be considered as success.

The officials interviewed from DBKL feel that there are, nevertheless, still areas for improvement. The website for DBKL and its City Planning Department for example, are only available in Bahasa Malaysia. This can be considered a bottleneck for investors and developers from foreign economies. Efforts are being made to translate the website into English. DBKL officials also felt that there is also lack of publicity on the effort done by the DBKL. Despite its efforts, there are still complaints on its 'slow' processing system. Record from DBKL also shown that after 15 months of operation, there has still been no submission of applications under Alternative I to the DBKL. They feel that the main reason for the lack of utilization of the services is the high cost, in terms of both time and financial costs, which the developers have to incur simultaneously

On the CCC, because the PSP is appointed by and paid for by the developers themselves, there is an incentive for the PSP to be biased towards developers. To counter any irregularities that may exist, DBKL officials take the initiative to monitor the construction

with the spirit of check and balance. The officers are required to conduct construction site inspections and issue notices to the PSP in case there are irregularities and non-compliance. While the PSP is the person that certifies the safety of the building for occupancy, DBKL officials can still block the issuance of CCC if there is proof that PSP does not comply with the regulations. In making the CCC effective, the DBKL has taken the proactive role of conducting surprise site visit once every three months. This is to ensure the CCC issued later complies with the UBBL and will not cause any problem in the future.

Officially, the Mayor of the Kuala Lumpur is the COB for Kuala Lumpur. His appointment as the COB started in July 2007 but the responsibilities were delegated to the Department of Property Assessment and Management. Properties that will be under the responsibilities of COB are gated communities, service apartments, condominiums, SOHO, flats, town houses, shop houses, shopping complexes, business premises, office complexes or any other property that have strata title.

Currently there are 2,256 Management Corporations (MC) in Kuala Lumpur and 443 Joint-Management Bodies (JMB). Both MC and JMB must submit audited account to the COB to identify strata properties. The DBKL is in the process of recording strata properties under the JMB or the MC for residential units. List of strata properties for other types of property will be tabulated after the residential-related strata properties list is completed. DBKL also has taken a proactive approach in handling problems that emerged from the implementation of the Building and Common Property Act (Maintenance and Management) 2007. Currently, on average, the DBKL receives 40 to 50 written letters each day for every party involved (developer/owner/resident association/JMB/MC). Problems recorded thus far include:

- Disruptions to the JMB/MC meeting
- JMB/MC financial problems due to outstanding maintenance fees that the owners feel are too expensive
- Problems on maintenance account managed by the developer
- Problems on lack of effort in maintenance by the JMB/MC

Apart from identifying common problems, officers representing the COB have attended several Annual General Meeting of JMB/MC. The officers' presences are invited by either buyers' association or the JMB. If there are any rumours that there will be a heated and hostile meeting, the officers will be there to monitor the proceeding of the meeting. Since the creation of COB in DBKL, officers representing COB have attended 48 JMB/MC meetings. This is considered unrepresentative, as there are more that 2000 JMB/MC in Kuala Lumpur and it mostly can be attributed to lack of manpower to monitor proceedings of the meeting. The existing manpower is stretched thin as they have to be in meetings even on the weekend. One way to overcome limited human resources under the Act is to appoint Management Agent for the property. However, as for now, a Management Agent is yet to be appointed for any property with strata title.

## ***Conclusion***

The driving force behind property reforms in Malaysia has been a combination of domestic and external pressures. On the domestic front, dissatisfaction by property developers and

house buyers has been a significant impetus to government actions. The need to stay competitive and attract FDI has also been a strong incentive for the Government to be responsiveness to the private sector and the Malaysian public. Efforts to improve processes relating property development were mooted quite some time ago, but significant progress was only made recently. This study highlights some useful lessons:

- Not surprisingly, a great deal of political will is required to reduce/remove entrenched interests and ensure that reforms are realised. Property development approval procedures, building works and the outcome of the property sector involve and impact a wide range of grass-root participants and the general public. Many of these participants have micro views of the sector and the macro objectives of creating an efficient and productive property sector that can help the growth of the national economy is often overlooked. It is important that the Government demonstrates a strong political commitment to build an efficient and transparent system. Top-down monitoring and evaluation has been a key component to ensuring that the 103 OSCs throughout Peninsula Malaysia continue to place high priority on performance. The role of PEMUDAH in particular, co-chaired by at least the Chief Secretary to the Cabinet and a senior captain of industry, has assisted immeasurably in this regard.
- Making reforms work requires active goal setting and management. In Malaysia, there is the further complication that land is a state matter which requires passing certain Federal laws and amending numerous others. Drafting all the necessary pieces of legislation is no mean feat, and strong leadership and concentrated effort are called for. In this regard, the Ministry of Housing and Local Government has contributed greatly in paving the way for reforms. While still very much at the early stages and although not without their detractors, the reforms seem to have shown clear initial successes. This has been most notable for the OSC and, to a more limited extent, CCC. On-going efforts will need to be made to ensure that these are sustained and that the remaining problems being addressed by the COB and BTS are progressively resolved. These successes will, no doubt, be further reinforced with the star-rating appraisals of LA and expedited by on-line submissions and tracking of plans by the private sector.
- Consultation prior submitting the approval application is an important element of the approval process. Although this consultation is not a formal requirement of the process, it can greatly assist the applicants because many minor ambiguities can be clarified early. In this way, the approval processing time can be shortened.
- Availability of clear and comprehensive information will certainly reduce the time needed to complete the approval application forms and meet the necessary approval requirements. In this ICT age, availability of web-based information is often considered a norm. The Malaysian Government has introduced on-line processes in many areas including procurement and university entry application. The next stage of reform for the property sector can consider extending the use of on-line processes.
- Although, the reforms have placed greater responsibility on the professionals such as in the CCC process, the Government still has an important role in ensuring that the welfare of the society is safe guarded. In this regard, strict professional codes of conduct should be adhered to and the Government should retain some supervisory role so that the process is not left entirely to market forces.

## **Business Registration Reform in Mexico\***

### ***Introduction***

In 2002, through a Presidential Order, Mexico started implementing a business registration reform that simplified municipal procedures for obtaining an operating license significantly and that reduced registration time. Moreover, it streamlined the registration process and created a one-stop-shop solution for completing federal and municipal procedures. The reform was spread across municipalities by a federal agency, COFEMER. This required extensive coordination with state and municipal government, implying that the implementation progressed slowly. As of December 2008, the reform had reached only 137 of 2,445 total municipalities in Mexico, but these 137 municipalities generate over 50 percent of Mexico's GDP. The reform has led to an increase in business creation and employment, also leading to an increase in competition. In particular, wage earners are more likely to open new firms due to the reform, while informal businesses are not more likely to register after the reform. Most of the new business created are relatively small (under 5 employees), perhaps due to the fact that larger business that will operate as corporations still require the assistance of a notary public in the registration process, which leads to delays and increased costs.

### ***Motivation for the Reform***

This case study discusses a recent business registration reform implemented in Mexico. The Mexican name of the reform, *Sistema de Apertura Rápida de Empresas* roughly translates to Rapid Business Start-Up System and it will be referred to in this note by its Mexican acronym: SARE.

The Mexican government implemented SARE as part of a larger effort to simplify regulation in order to improve competitiveness and foster economic activity. A plan for reviewing and simplifying the national regulatory process had been in place since the 1989 and was made operational in 2000 through the Federal Administrative Procedures Law. This law created the *Comisión Federal de Mejora Regulatoria* (COFEMER), a federal agency charged with proposing reforms for simplifying existing laws and regulations and with ensuring transparency in the drafting of federal regulations. COFEMER is a technically and functionally autonomous agency of the Ministry of Economy and is also charged with providing technical support for state and municipal regulatory improvement programs<sup>10</sup>.

SARE was one of the first reforms proposed by COFEMER. The agency recognized the need for business registration reform after the results of a 2000 study by a local think tank, the *Centro de Estudios Económicos del Sector Privado* (CEESP), documented that it took 56 days on average to legally open a business in Mexico. According to cross-economy data collected by Djankov et al (2002), around the year 2000, the world average was 48 days for registering a business, putting Mexico above the average. COFEMER was concerned about the potential negative effects on employment and economic activity that this regulatory burden could have, particularly in terms of discouraging the creation of micro, small, and

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or of the government of Mexico.

<sup>10</sup> More information on COFEMER can be found on their website <http://www.cofemer.gob.mx/>

medium size enterprises. Moreover, COFEMER had a general interest in simplifying entry regulation to provide a more predictable and efficient business environment in order to stimulate investment.

### ***Previous Regulations***

Being a federal economy, Mexico has three layers of government: federal, state, and municipal. In order to legally start operating a business, firms generally have to complete procedures at the federal and municipal level<sup>11</sup>. Table 1 below lists the federal and municipal procedures required to open a business. Firms in Mexico can operate under either of two different regimes: as a person with entrepreneurial activity or as a corporation. As explained below, additional procedures apply to corporations.

### ***Federal Registration Procedures***

At the federal level, all firms have to obtain a tax payer number, and for some firms processes involving Commission for Security and Hygiene and registration with the Ministry of Labor and Social Provision are also required. If the firm will operate as a corporation, it also needs to incorporate the business, which consists of obtaining an authorization for the company name from the Ministry of Foreign Affairs, notarizing the company deeds, and registering the company deed at the Public Registry of Commerce. These last three procedures are may be carried out personally or by a public notary. Depending on the firms, it may have to go through additional step before being allowed to operate legally. For example, firms with employees need to register them with social security. Firms that will generate dangerous residues need to notify the Secretary of Environment and Natural Resource of these residues. Firms in specific industries may need to obtain special permits and/or register with additional federal agencies.

### ***Municipal Registration Procedures***

At the municipal level, all firms are required to obtain an occupancy permit and an operating license. Depending on the municipality, there may be additional procedures for certain industries. An example of an additional procedure is obtaining a letter from the police for businesses that will sell alcoholic beverages. Municipalities make their own legislation for opening a business, and the required procedures vary widely from municipality to municipality. This was particularly true before the reform. Table 2 shows that the average number of days it took to complete municipal registration procedures before the reform was 30.1. However, there was large variation in this number across municipalities, going from a minimum of 2 to a maximum of 60. Similarly, the number of municipal procedures ranged from 1 to 27, with an average of 7.9. Firms had to make 4.2 office visits on average, with a minimum of 1 and a maximum of 10. In line with these numbers, a 2000 OECD report mentioned that many municipal regulations in Mexico were quite discretionary. Another goal of SARE was thus to homogenize procedures across municipalities and to clearly establish all the necessary steps, thereby also emphasizing transparency and accountability.

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<sup>11</sup> In some states, firms also need to complete state level procedures.

**Table 1 - Overview of Mexican Registration Procedures**

	<b>All firms</b>	<b>Corporations</b>	<b>Additional procedures</b>
<b>Federal</b>	<ul style="list-style-type: none"> <li>Obtain taxpayer number</li> </ul>	<ul style="list-style-type: none"> <li>Obtain authorization for company name from Ministry of Foreign Affairs</li> <li>Notarize company deeds</li> <li>Register at the Public Registry of Commerce (done personally or by a notary public)</li> </ul>	<ul style="list-style-type: none"> <li>Register employees with Social Security</li> <li>Notify Secretary of Environment and Natural Resources if generating dangerous residues</li> <li>Other possible procedures, depending on industry</li> </ul>
	<ul style="list-style-type: none"> <li>Integrate Commission for Security and Hygiene in firm and register with Ministry of Labor and Social Provision, depending on firm's activities</li> </ul>		
<b>Municipal</b>	<ul style="list-style-type: none"> <li>Obtain occupancy (land use) permit</li> <li>Obtain operating license</li> </ul>		<ul style="list-style-type: none"> <li>Other possible procedures, depending on industry</li> </ul>

Source: COFEMER website, [www.cofemer.gob.mx](http://www.cofemer.gob.mx)

**Table 2 - Variation in Municipal Registration Procedures**

	<b>Average</b>	<b>Min</b>	<b>Max</b>
<b>Before SARE</b>			
<b>Days</b>	30.1	2	60
<b>Procedures</b>	7.9	1	27
<b>Office Visits</b>	4.2	1	10
<b>After SARE</b>			
<b>Days</b>	1.4	1	3
<b>Procedures</b>	2.7	1	9
<b>Office Visits</b>	1	1	2

Source: These data come from the COFEMER website and are based on 32 municipalities from 17 different states.

## ***Reform Changes***

COFEMER set two administrative goals for the reform. First, firms should be able to take care of federal and municipal procedures all in the same place. Second, firms should be able to open their business within a maximum period of 48 hours. This required streamlining the overall process and implementing a one-stop-shop solution.

### ***Reform at the Federal Level***

The reform process began with a federal reform in 2002. This reform stipulated that firms should only be required to complete only one or two steps before being allowed to start operations, depending on their legal form. Firms that will operate as persons with entrepreneurial activity only have to obtain a taxpayer number (RFC) for their company. This step can be done via internet with the SAT. Firms that will operate as corporations also have to incorporate the business. They submit an application form personally or



through a notary public, who then completes the three steps for incorporating a company that are listed in Table 1 (obtaining an authorization for the company name from the Ministry of Foreign Affairs, notarizing the company deeds, and registering the deeds at the Public Registry of Commerce). Obtaining authorization from the Ministry of Foreign Affairs can be done electronically. Moreover, the notary public typically also requests the taxpayer number from the SAT electronically, so that firms don't need to take care of this step separately. The new law stipulates that the SAT and the Ministry of Foreign Affairs have to grant the taxpayer number and authorization for company name the within less than one business day.

The federal reform thus required firms to complete only the steps that are shaded in gray in Table 1 (plus any municipal procedures) before starting operations legally. The other federal procedures listed in Table 1 were not eliminated. Instead, firms are now allowed to complete these procedures after having started operations. Firms now have 10 days from the day they obtain a taxpayer number, before registering with the Ministry of Labor and Social Provision. (Depending on the firm's activities, the firm may also need to follow Commission for Security and Hygiene procedures.) The Secretary of Environment and Natural Resources needs to be notified of dangerous residues within 1 to 3 months after obtaining the taxpayer number, depending on the amount of residue. Employees need to be registered with Social Security 5 days after hiring them.

Overall, the reform did not reduce the number of federal procedures; it just delayed some procedures until after operation had started. However, clearly laying out the order of procedures and establishing response times for the government increased transparency of the process and probably also shortened the time required for completing federal procedures, particularly for obtaining a taxpayer number and for obtaining an authorization for the company name.

### ***Reform at the Municipal Level***

After the federal reform, COFEMER worked with municipal governments individually, providing guidance on implementing reforms locally and creating a single government office that could take care of both federal and municipal registration procedures. Table 2 shows that the reform significantly cut down on municipal procedures, days, and office visits for registering a business. The average number of days declined from 30.1 to only 1.4 and the average number of procedures from 7.9 to 2.7. The data suggest that the one-stop-show solution was implemented successfully, so that firms now only have to visit a single office instead of 4. Moreover, the maximum numbers for all three measures have come down, reflecting the fact that the reform led to more homogeneity among procedures across municipalities. An example of a procedure that was eliminated through SARE in one municipality is that pre-SARE the land use permit had to be approved by the town council, which delayed the registration process unnecessarily.

### ***Effectiveness of the Reform***

When examining the post-reform registration procedures in more detail, it appears that SARE resulted in a transparent and speedy registration process mostly for firms that will operate as persons with economic activity. For firms that will operate as corporations, the picture looks different. These firms are still subject to a bottleneck that has not been removed by the reform: the need for a notary public. As laid out in Table 1, the notary

publics can take care of the three federal steps required for incorporating a business. Although the established government response time is set at 24 hours for authorizing the company name, as late as 2007 it used to take 2 or 3 weeks to complete all three steps. The World Bank's Doing Business 2009 report shows a significant improvement, to an average of two days. However, the registration process is moderately costly for firms that operate as corporations, averaging \$200.

The Doing Business in Mexico 2009 report records the registration process in detail for 31 different Mexican states. It assumes that the business to register will operate as a corporation, which is why it does not directly inform us about the efficiency of the registration process for persons with entrepreneurial activity. However, the municipal step of obtaining an operating license, which is common to persons with entrepreneurial activity and corporations in low risk business areas, is typically reported to take 3 days or less in the municipalities that had implemented SARE by the time of the report. These numbers are consistent with the ones in Table 2, and show that Mexican municipalities have caught up to the "best practice" APEC members in terms of speediness in business registration (see Table 3). Registration at the municipal level now takes about as long as in Australia (2 days) and Canada (3 days). Table 3 shows that, with 2.7 procedures post reform, municipalities with SARE require about as many procedures as Australia, Canada, and New Zealand. However, to make the numbers for Mexico directly comparable with the numbers in Table 3, we need to add the federal procedures for a firm that will operate as a corporation to the 2.7 local procedures (the Doing Business report assumes that the business to be registered will operate as a corporation). This brings the number up to at least 8.7, not considering the need for registering employees and reporting harmful residues. As reflected in Table 3, this leaves Mexico in the intermediate range of business registration procedures among APEC member economies.

### ***Political Economy of Reform Process***

COFEMER was fully committed to implementing the reform as a means for stimulating economic activity and improving the business environment for micro, small, and medium enterprises. As mentioned in the introduction, COFEMER was particularly concerned about the fact that Mexico's business registration process was slow compared to other economies and even compared to the world average. However, COFEMER's motivation for reform alone was not enough – implementing the reform in Mexico's federal system required close cooperation with state and municipal governments. This need for coordination was possibly the most challenging step in the process of implementing SARE. In order to promote regulatory improvement in states and municipalities and to be able to provide technical assistance to sub-national governments, COFEMER first signed coordination agreements with all 31 states and the Federal District in which the entities agree to implement regulatory improvement programs.

**Table 3 - Business Registration in APEC Member Economies (2009)**

	<b>Procedures</b>	<b>Days</b>
<b>New Zealand</b>	1	1
<b>Canada</b>	1	5
<b>Australia</b>	2	2
<b>Singapore</b>	4	4
<b>Hong Kong, China</b>	5	11
<b>United States</b>	6	6
<b>Japan</b>	8	23
<b>Papua New Guinea</b>	8	56
<b>Russian Federation</b>	8	29
<b>Thailand</b>	8	33
<b>Malaysia</b>	9	13
<b>Chile</b>	9	27
<b>Mexico</b>	9	28
<b>Korea, Rep.</b>	10	17
<b>Peru</b>	10	65
<b>Vietnam</b>	11	50
<b>Indonesia</b>	12	76
<b>China</b>	14	40
<b>Philippines</b>	15	52
<b>Brunei Darussalam</b>	18	116
<i>Source: Doing Business 2009</i>		

### ***Geographic Reach of the Reform***

After having signed agreements with state government, COFEMER approached municipalities directly to sign memorandums of understanding with them regarding the implementation of SARE. However, Mexico has 2,445 municipalities, making it impossible for COFEMER to coordinate and work with all municipalities at once. Discussions with COFEMER have shown that they addressed this issue by defining a set of priority municipalities where they aimed to implement the reform first. Included in this set were the municipalities that concentrate most of population and economic activity in Mexico, which would allow the reform to reach a large fraction of the population and have the greatest impact.

COFEMER identified the priority municipalities based on a study by Cabrero, Ziccardi, and Orihuela (2003). This study developed an index of competitiveness for 60 of Mexico's major urban centers, encompassing about 225 municipalities. By June 2008, 137 municipalities had adopted SARE, only 71 of which were on the original list of priority municipalities. The implementation of SARE progressed only slowly since COFEMER had relatively limited resources for the rather big task of spreading SARE to municipalities. COFEMER had only a handful of people who were working on contacting municipalities, visiting the local governments, signing agreements with them, and implementing SARE locally. Overall, COFEMER found the local authorities to be cooperative and eager to implement the reform. However, the implementation process was quite complex, since it often required the coordination of various local agencies.

The fact that 65 municipalities that were not on the original list of priority municipalities adopted SARE is due to two factors. First, in a few but rare cases, municipalities contacted COFEMER and asked them to implement SARE. Second, the agreements that COFEMER signed with state governments sometimes stipulated a list of municipalities within the particular state where SARE would be implemented, and this list did not always correspond with the original 225 municipalities. For example, in the state of Tamaulipas, there were 7 municipalities on the original list of priority municipalities. The agreement between COFEMER and the state government also stipulated that SARE would be implemented in 7 municipalities, but 2 of these 7 were different from the original list.

Although only 136 out of a total of 2,445 municipalities had SARE by June 2008, COFEMER was successful in targeting municipalities that concentrated a large share of economic activity and population. According to the 2004 Economic Census and the 2005 Population Count, the 136 municipalities with SARE cover 54 percent of GDP and 38 percent of the Mexican population.

**Table 4 - Implementation of SARE over Time**

	2002	2003	2004	2005	2006	2007	2008
Municipalities with SARE	2	8	28	47	25	26	1

*Source: COFEMER*

### ***Eligible Industries***

With respect to the political economy of the reform, another important feature is that it applies only to firms operating in industries that don't pose any public risks<sup>12</sup>. Firms in industries that could pose public risks often require special licenses and screening, and it would not have been possible to apply the same simplified registration procedures to these firms. However, the reform still benefited a large share of firms and industries. According to the Mexican industry classification system CMAP (1999), there are a total of 1254 different industries in Mexico, 685 of which pose no public risk. These no public risk industries encompass about 80% of all firms operating, typically micro, small or medium size enterprises.

### ***Impact of the Reform***

As a measure of SARE's success, COFEMER asks municipalities to report the number of firms that register after the implementation of the reform, as well as the number of employees and the amount of investment in these firms. By July 2008, a total of 137,593 firms had registered under the SARE system, generating a total of 398,744 jobs and about US\$1.7 billion in investment.<sup>13</sup>

One concern with these numbers is that they do not necessarily reflect the true impact of SARE since some of the firms would presumably have also registered in the absence of the reform. There are currently two studies that try to address this problem by conducting an econometric impact evaluation of the reform. Both studies exploit the fact that SARE was

<sup>12</sup> These are mostly industries in the service and commerce sectors. Industries that are considered to pose a public risk are mostly in manufacturing, such as chemicals production. Other activities that fall into the public risk category are mining, transportation, and financial services.

<sup>13</sup> Source: COFEMER

phased in over time in different municipalities to compare firm creation and other outcomes of interest in municipalities that have already implemented the reform with municipalities that have not implemented the reform yet. In addition, they also compare the effects of the reform on firms in eligible and ineligible industries<sup>14</sup>.

Kaplan, Piedra, and Seira (2007) use data from the Mexican social security administration to measure the impact of the reform on firm creation and employment. They find that new firm start-ups increased by about 5 percent in eligible industries. Moreover, their results show that this effect is temporary and concentrated in the first ten months after implementation. This estimate corresponds to 4,029 firms having been created due to SARE. The average size of these new firms was 6.3 employees. Pre-reform, the social security data recorded about 53 new firms per municipality every month. The reform increased this number by about 5 percent, leading to 3 more firms per municipality being created every month (for 1,343 municipality months in the study). It is important to point out that the social security data used in this paper only captures firms with employees since an entrepreneur who is self-employed and does not have any employees will not register with social security. Moreover, some other entrepreneurs who open and register a business may employ a small number of workers without registering with social security. The estimate of 4,029 new firms may thus not capture the full effect of SARE since it does not include firms without employees or with employees that are not registered with social security. The administrative data from COFEMER suggest that the average size of firms registered after the reform is rather small (2.9). It is thus plausible that a number of the new firms did not have any employees, implying that it would be desirable to also consider the impact of SARE on a broader measure of firm creation.

Bruhn (2008) estimates the effects of SARE by relying on a broader data source, the Mexican Labor Market Survey (ENE). Unlike the social security data, this survey captures all types of firms, including informal firms, since it is a household survey that asks individuals whether they currently own a firm<sup>15</sup>. Bruhn finds that the number of firms increased by about 5 percent due to SARE. However, since this percentage increase is over a larger base (including the self-employed and firms that don't register their employees with social security) than the 4 percent increase estimated by Kaplan, Piedra, and Seira. Bruhn's estimate thus corresponds to a total of 30,658 firms, which is 7.6 times larger than estimated with the social security data. This estimate is based on 34 municipalities, implying that SARE led to the creation of 902 firms per municipality on average. An important question is whether this estimate can be extrapolated to other municipalities and whether implementing SARE in all Mexican 2,445 municipalities would then lead to the creation of  $2,445 \times 902 = 2.2$  million firms. This is unlike since, as discussed above, COFEMER first targeted municipalities that concentrated the largest fraction of economic activity. Spreading SARE to municipalities with lower economic activity would most likely lead to a lower impact on firm creating in those municipalities.

Another important feature of the ENE data is that it follows a panel structure, re-interviewing the same household up to five times. This allows Bruhn to examine into which occupation category the newly registered firm owners fell before the reform. The results show that businesses that were operating in the informal sector before the reform

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<sup>14</sup> Details on the methodology used in each paper are available in the respective working papers that appeared in the World Bank's Policy Research Working Paper series.

<sup>15</sup> A possible short-coming of the ENE compared to the social security data is that it may be less accurate since it is self-reported and not administrative data.

are not more likely to register after the reform. Instead, individuals who were previously working as wage earners set up new firms due to the reform. Bruhn further finds that overall employment in eligible industries increased by 2.8 percent after the reform. Part of this increase is due to the fact that wage earners switched out of ineligible industries and into eligible industries. Finally, Bruhn estimates the effect of the reform on income. There is no robust effect on overall income (this may be due to the fact that the data cover only 3 quarter after the reform on average, thus measuring short-term effects). However, the income of incumbent registered business owners declines by 3.2 percent, suggesting that the reform increased competition. Consistent with a competition effect, Bruhn also finds a decrease in the price level by about 0.6 percent in municipalities with SARE.

Ultimately, Bruhn, as well as Kaplan, Piedra, and Seira, investigate in which municipalities the reform had the greatest effects. Bruhn shows that municipalities that experienced a greater reduction in registration procedures saw greater effects on firm creation and employment. Kaplan, Piedra, and Seira find that the reform had a smaller effect on firm creation in municipalities where additional procedures (such as hiring a notary public) were more costly, as measured by the “Doing Business in Mexico” report. Similarly, the effect of the reform was smaller in municipalities where obtaining a zoning permit involves more corruption.<sup>16</sup> These last two findings indicate that although a business registration reform by itself can foster economic development, it can be even more effective when other related procedures and requirements are also reformed.

### ***Overall Lessons of the Reform***

- The reform has shown that it is possible to successfully simplify the registration processes, even in a complex institutional environment with many actors (or sub-national governments) involved.
- A major obstacle for spreading the reform was the need for coordination between different levels of government. Moreover, the large number of municipalities which all have independent jurisdiction over registration procedures made it necessary to identify priority municipalities for implementing the reform.
- The econometric impact evaluations provide evidence for the positive effects of the reform on business creation, employment, and competition. However, they also show a need for reform in other areas.
- In order to further simplify the registration process for firms that will operate as corporations, it appears necessary to reduce the amount of time taken and the fees charged by public notaries. The impact evaluation suggests that this step would lead to even more business creation.
- Firms are still subject to many other regulations that make doing business difficult, such as labor laws and tax requirements. For example, in the 2009 Doing Business Report, Mexico ranked 141 for employing workers and 149 for paying taxes (out of 181 economies). The presence of these obstacles is a possible reason why the impact evaluation does not find informal businesses registering after the reform.

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<sup>16</sup> This measure is taken from a Transparency International survey.

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## **Peru's Secured Transactions Reform: Bringing More Credit to the Private Sector?\***

### ***Introduction***

Finance is essential to economic growth and financial deepening—the provision of a broader range of financial services—is a frequent goal of national economic development. Increasing the access of different economic actors to credit is a key dimension of financial deepening. Often, the share of credit relative to an economy's total output is used to signal the probability that a larger number of productive activities will receive credit. That is, in the absence of firm, household or financial institution level surveys, this ratio is used as a proxy measure for access to credit. Furthermore, better laws for secured transactions may translate into higher levels of credit to GDP.<sup>1</sup>

In Peru, the Government was concerned about the paucity of domestic bank lending to the private sector. As early as 2001, the Minister of Economy and Finance pointed out that, although 90 percent of domestic bank lending went to businesses, this amounted to just 26 percent of GDP, compared to 70 percent in Chile and 150 percent in the US and Canada (See Appendix I).<sup>2</sup> At that time, creating, registering and enforcing security interests in Peru presented many difficulties. For many businesses, moveable properties represented as much as two-thirds of invested capital, yet they could not be used as collateral, thus limiting the access of those firms to credit. A series of steps was initiated to examine and address the problem of secured transactions, with a new law passed in June 2006.<sup>3</sup>

While the 2006 law was a positive step forward, some weaknesses remain that hamper the effectiveness of the new system. As a result, the new law is yet to have a significant effect on credit access, and stakeholders have not undertaken to use the new system on a large scale. As this experience demonstrates, while a legal reform is necessary and important, it is not always sufficient as a catalyst for change. Continuous reform and follow-up, dissemination and diffusion, in addition to a shift in stakeholders' attitudes are also important in order for a new law to have a practical, positive and significant impact.

### ***The motivation for reform: 20 types of security interests, 17 registries***

Prior to the reform, Peru's laws on secured transactions were burdensome at all levels, from the creation of a security interest to its execution. For example, parties needed to specifically describe in their agreement the limited number of moveable assets they were allowed to use as collateral. This requirement limited the use of key classes of business

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or of the government of Peru.

<sup>1</sup> See Fleisig, et. al. (2006) and Vig (2006) for two views on this subject

<sup>2</sup> Ministry of Economy and Finance (2001)

<sup>3</sup> A 2001 study concluded that differences in effective creditor right protections largely accounted for the smaller size of credit markets in Latin America compared to economies such as Canada and the United States. It also suggested that Peru's ratio of credit to GDP could almost double, from approximately 28 percent to 55 percent, if laws regarding creditor protection were enhanced, compared to a limited 7 percent increase in OECD economies (Galindo, 2001). The results come from a regression estimate that controls for growth, the size of the economy, and additional macroeconomic imbalances, such as inflation and fiscal deficits.



assets—such as inventory or accounts receivables—as collateral. Peru also had over 20 different types of secured interests, making creating a security agreement even more confusing and complicated for lenders and borrowers<sup>4</sup>. As pointed out, identifying permissible items involved high transactions costs.<sup>5</sup>

With regard to the registration of security interests, Peru used to have 17 different registries for different kinds of assets each one having its own regulations and requirements.<sup>6</sup> This system created a lot of confusion and uncertainty as, potentially, some assets could fall under the purview of more than one of the registries. In addition, having to consult a number of registries translated into increased transactions costs.

Finally, when the debtor defaulted, the procedure for the creditor to enforce on the collateral was slow and onerous. “Oftentimes, the execution of the security interest would take a time longer than the economic life of most moveable goods, to the level that the depreciation of the asset would reduce the value to zero at the time of collection.”<sup>7</sup> According to the Minister of Economics and Finance, in 2001 the judicial execution of a security interest in Peru took between 18 and 24 months. “If the creditor could recuperate his money in a period of three months from the date of non-compliance, the applicable interest rate could fall by up to three percentage points.”<sup>8</sup>

### *The reform process*

In August 2000, on the basis of a consultant report completed in 1996, the Government initiated a process to address this problem frontally.<sup>9</sup> They organized a series of workshop to examine proposals for reform. These meetings included all major private-sector stakeholder groups: Colegio de Abogados de Lima, Camara Nal. Forestal, Asociacion Empresarios Agrarios, Cámaras de Comercio, Asociación de Exportadores, Bolsa de Valores, Asociacion de Bancos, and others. Business groups provided very positive responses, identifying how moveable property guarantees could benefit their particular

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<sup>4</sup> 1.Regular Pledge (Civil Code); 2.Commercial Pledge (Commercial Code); 3.Stock Pledge (General Societal Laws and Stock Market Laws); 4.Pledge on interest in outstanding credit (Civil Code and Securities Code); 5.Agricultural Pledge (Law No. 2420 of 1916); 6.Industrial Pledge (General Industrial Law of 1982); 7.Mining Pledge and Mortgage (General Mining Law); 8.Warrants (General Law of Warehouse Inventory); 9.Real Property Mortgage (Civil Code); 10.Vessel Mortgage (Maritime Mortgage Law); 11.Aircraft Mortgage (Civil Aeronautic Law); 12.Fishing Vessel Mortgage; 13.Rural property mortgage; 14.Antichresis (Civil Code); 15.Trust in security (General Finance Laws); 16.Financial Lease; 17.Sale with no transference of title (Civil Code); 18.Right to withhold (Civil Code); 19.Floating pledge (General Finance Laws); 20.Engines and aircraft pledge (Civil Aeronautic Law); 21.Stock Security (General Societal Law); 22.Pledge in debtor’s intangible rights (INDECOPI: National Institute for the Defense of Competition and Intellectual Property); 23.Pledge in a credit to a third party (Credit Instruments).

<sup>5</sup> For example, “fish meal can be pledged as collateral because it can meet Peru’s legal requirements for specific identification through the identification number stenciled onto each pallet. But fruit concentrate, stored in containers of no standard size and with no identification, cannot meet those requirements and so cannot serve as collateral.” Fleisig, et. al. (2006)

<sup>6</sup> 1.Agricultural Pledge Registry; 2.Motor Pledge Registry; 3.Industrial Pledge Registry; 4.Mining Rights Registry; 5.Registry of Assets represented by book-entries; 6.Fiscal Registry of Installment Sales; 7.Registry of Urban Property; 8.Special Registry of Rural Property; 9.Naval Vessel Registry; 10.Aircraft Registry; 11.Motor Vehicle Registry; 12.Real Estate Registry; 13.Registry of Global and Floating Pledges; 14.Trademarks Registry; 15.Patent Registry; 16.Copyright Registry; 17.Fishing Vessel Registry.

<sup>7</sup> Freyre (2006)

<sup>8</sup> Ministry of Economy and Finance (2001)

<sup>9</sup> Appendix I provides an overview of the reform process in Peru.

businesses. At this early stage, the involvement of the Ministry of Economy and Finance (MEF) was very limited.

Subsequent to these workshops, in December, 2000, the consultant report was finalized and published by a local university. The turning point in attitudes towards the reform occurred in January, 2001, when the Lima Bar Association endorsed its main recommendations, emerging as a major force for reform inside the economy. Having a local champion for reform was a significant step in the process of change. Subsequently, in June, the MEF formed a Commission to review the issue. In July, the MEF Cabinet of Advisors released a “white paper”. This document restated the principal criticisms formulated against the current system and proposed changes in the law as well as the creation of a unified registry. Pursuant to this paper, the MEF set up a Commission to draft a *Proyecto Ley de Garantía Mobiliaria* (Bill on Guarantees based on Moveable Property).<sup>10</sup> The Commission on Economy and Financial Intelligence, the consultants who were hired to critique the first draft of the law, as well as the National Forum on Competitiveness (*Foro Nacional de Competitividad*)—which held nine seminars in February, 2003—modified the text of the law. Eventually, the Bill was presented to the Congress on December 19, 2003.

Meanwhile, in November, 2003, the Inter-American Development Bank (IADB), as part of a Competitiveness Reform Program, turned the reform of collateral law into a condition of its new loan to Peru. After negotiations and clarifications regarding the role of the notaries and priority rules, the law was promulgated on February 10, 2006, published on March 1, 2006, and entered into force on May 30, 2006.<sup>11</sup> This was achieved after almost five years of discussions at various levels. This is partly understandable by the fact that different economic and political systems demand varying policy responses. For example, the Government refused to give absolute priority to secured creditors (ahead of wages), as it believed that this would have negative repercussions on workers. What was important to the authorities was that all relevant concerns, including the role of notaries, existing practices, and social protections associated with the rights of workers were balanced against the rights of creditors to find a solution that would suit the Peruvian situation.

More generally, the slow pace of secured transactions reform could be attributed to the absence of a strong political base of support for them.<sup>12</sup> Because the benefits of these types of reforms are unlikely to be felt immediately, it is usually very difficult to attract policymakers to pursue them. It takes a while for the stakeholders—including lenders and borrowers—to become accustomed to the new system and learn how to use it. Banks and other financial institutions need time to develop products that would meet the demands of

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<sup>10</sup> Bill Number 9388/2003

<sup>11</sup> The concessions made during the negotiations were mainly aimed at the notaries, who wished to maintain their relevance under the new system. The new law maintained some responsibilities for the notaries during the perfection and execution process of a security interest. According to prominent legal experts, the position of the notaries was that excessive freedom in creating a security could debilitate execution in case of non-compliance. They argued that in an economy with judicial insecurity and a shaky culture of compliance, such a liberalization, which in economic terms signified only a nominal reduction in transaction costs, could lead to the instability of the system. On the other hand, the consultants argued that enforcement by notaries would not be as efficient as self-help repossession, the fees charged by notaries were not competitive, and their services were not readily available in all areas. Moreover, the involvement of notaries would limit the type of property that could be used as collateral, as the increased time required for notarial enforcement could sharply reduce the value of highly depreciable collateral valueless (for example, in agriculture).

<sup>12</sup> Shahid-Saless (2007)

the new system when, for example, the law makes it permissible to use additional types of assets (such as accounts receivable) as collateral. In addition, trusting and using new mechanisms—such as out-of court enforcement—are usually a cautious process, as most lenders would be averse to being the first to test whether, in the face of difficulties and default, the system will deliver what it promises. Finally, in order to avoid potential cases of abuse by creditors, less sophisticated users will require additional training to understand their rights and obligations and the consequences of their actions, such as defaults. This need is more pronounced when the law permits parties to agree to out-of-court enforcement procedures, an alternative that is rarely opted out of by creditors in a security agreement.

The final cost of the reform in Peru is not yet known. One estimate is based on comparing the two options that were put forward: to create an entirely new registry, or to unify electronically the multiplicity of registries that existed at that time. According to the estimates, the first solution would have cost US\$5 million, while the second could have reached approximately US\$2.9 million. The reformers selected the second option.<sup>13</sup>

### ***Content of the reform: more flexible rules on collateral***

The Bill on Guarantees Based on Moveable Property (Law 28677) redesigned Peru's rules on collateral. Almost any type of moveable asset, tangible or intangible, present or future, can now secure a loan. The more than 20 different pledges that existed were aligned under a single system: guarantee based on moveable property. The new law abandoned the requirement to describe assets specifically. Pledges on moveable property are now recorded in two registries: one for moveable property that consolidates the 17 old registries, and a new registry for contracts. Finally, the law allows parties to agree to sell the asset without court intervention if the debtor defaults. Appendix III contains a table of the most important changes to the law.

While significant weaknesses remain, the new law reflects international best practices in a number of areas. *First*, the new law allows all classes of debt, including present and future to be secured. This is important, as it will mean that under a single security agreement, a debtor could grant a security interest over its assets in order to secure all present and future obligations with the creditor. This eliminates the need to create a new security agreement every time the creditor wishes to grant a secured credit to the same debtor, thereby reducing the costs associated with access to credit. *Second*, the new law allows for the general description of assets, therefore all major categories of assets, including accounts receivable and inventory, can now be used as collateral. Not requiring a specific description of assets allows for changing pools of assets to be used as collateral. In the case of inventory, for example, this will mean that with the circulation of specific items of inventory in and out of the business, it will not be necessary to update the security agreement and the description of the assets contained in it. *Third*, the new law unified the system of registration. While the registry faces many challenges, the new law created the legal infrastructure for a modern registry, where security interests over many types of movable property can now be registered in a single, linked economy-wide registry. This is important as it reduces the costs associated with registration. In order to avoid ambiguity, assets no longer need to be registered in multiple registries. A computerized linked system

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<sup>13</sup> Interview with Ronald Cardenas Krenz, the Director of the Legal Department at the Universidad Femenina del Sagrado Corazon, and the former Superintendent of SUNARP. November 17, 2006.

of registration means that, by visiting a local registry, a creditor in one part of the economy will be able to verify whether a particular asset by a debtor has been used as collateral in another region of the economy. *Finally*, the law allows for an out-of-court enforcement mechanism referred to as Pacto Comisorio, which will mean that parties can agree in their security agreement that, upon default of the debtor, the collateral will be transferred to the creditor for an extra-judicial sale. The ability to use this enforcement mechanism reduces reliance on the court system, which is often lengthy and costly, and it could provide more confidence to creditors for enforcing their security interest. This could translate into lower interest rates.

Although the reform was a positive step forward, it suffered from weaknesses at the drafting stage. The Chamber of Commerce of Peru had been the new law's most vocal critic after its implementation, arguing that the law should have been suspended until the registry was fully operational. Its complaint focused on the absence of a national telecommunication linkage among local registries, which undermined compliance with the law and the judicial security of the transactions. Scholars and few members of Parliament have also asked whether allowing out-of-court enforcement and thus allowing debtors to renounce a trial is constitutional in a civil law system.<sup>14</sup>

Other criticisms came from experts who believed that certain components were essential to increasing the law's effectiveness, but were not incorporated in the final text. Among these, the inability to divide collateral finely in order to maximize the use of assets in obtaining credit from several borrowers was seen as effectively raising the cost to the borrower of seeking other lenders. Also, the new law did not void clauses that required payment of the entire loan if a second priority security interest is created, which was seen as defeating most of the benefits of broadening access to credit. Lack of clarity was another area of criticism. For example, the law does not specify whether, once a floating loan is paid back, the registration on that loan will terminate or not. This is critical, as having to re-register a loan every time the loan is paid off will mean that the creditor may lose its priority in the re-registration process on the same collateral. Repeating the registration process on the same asset would add to transaction costs and could be superfluous.

Finally, the law stated that, should the parties not agree on the terms of the contract, upon non-compliance, the creditor, through a notary, can send a notice of non-compliance to the debtor. Should the debtor fail to perform, three days later the creditor can proceed with an extra-judicial sale through a third party. As many critics, including the Lima Chamber of Commerce have pointed out, the three day deadline for payment is tight and in many cases impossible to comply with, creating situations for possible abuse by creditors, particularly towards unsophisticated debtors or those honest debtors that, in good faith, are unable to pay their debt.

Other problems arose as a result of the implementation of the new law. For example, recognizing the importance of notaries in Peru's legal system, the new law maintained their role. However, the new system did not make their services more affordable and widely available across the economy, making it difficult, and in some cases costly, to register security interests.

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<sup>14</sup> For a detailed analysis of the criticisms raised against the new law, see Appendix IV.

### ***Implementation issues***

The main problem with implementing the new law stems from the registration system. The law gave the National Superintendent of Public Registries 60 days to develop the regulatory, logistical, and technological infrastructure to merge all local registries on moveables, and centralize. Not surprisingly, the deadline was not met, and even six months later, the new system was not yet in place.

The unified registration system suffers from many of the former system's shortcomings. Security agreements cannot be registered directly, and still require the involvement of notaries. While the involvement of notaries does not necessarily pose a problem, as explained above, the fact that their fees are high in some jurisdictions and their services are not readily available across the economy pose significant challenges. In addition, much time can pass between when the security agreement is submitted to the registry and when it appears online. As a result, information about a collateral agreement does not immediately become available to the public. During that lag, a debtor could secure several loans from different creditors with the same asset.

Another issue is the high registration costs of the new system. Registering a leasing contract for 20 automobiles costs \$6,000. Before the reform, it was not necessary to register this type of contract. High costs may handicap the new system's ability to increase the amount of private credit in Peru.

### ***Impact of the reform***<sup>15</sup>

Approximately two and a half years after passage of the law, stakeholders believe the new system is not being used significantly by banks and other creditors. While some positive steps have been taken, the reform has not proven to be as dynamic as expected. The most important positive change is that it has contributed to structural advancement. Many notaries are now connected to the registry electronically and are able to send their information online. SUNARP (the collateral registry in Peru) has also been undergoing modernization and there have also been new offices opened for the purposes of registration of security interests in the economy. However, the process of change is generally considered to have been slow.

The limited impact of the reform could be attributed to a number of factors. *First*, the substantive weaknesses in the legislation which have been highlighted above are yet to be addressed. In addition, issues associated with the inefficiency of notaries and SUNARP's lack of resources have created institutional obstacles that have limited the impact of the new law. The Ministry of Economy and Finance, which initiated and moved the reform forward is yet to set up a body responsible for any follow-up reform work.

Moreover, due to a construction boom in Peru, the system's attention for the past two years has been focused on immovable property. As such, movable property and its use as collateral had been taking the back seat. In addition, for the past two years, it has been generally easy to have access to unsecured credit in Peru. However, given the recent construction slow down and the fact that debtors are finding themselves with multiple

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<sup>15</sup> A brief overview of post-reform activities can be found in Appendix V.

unsecured debt obligations, it is expected that attention will turn, once again, to moveable property as a form of valuable collateral.

A major obstacle in implementing the law has been that the key actors—lenders, borrowers, and lawyers—lack sufficient knowledge of and hands-on training on the new system. Post-reform training for users has been limited to only a few *ad hoc* seminars. Insufficient knowledge can have serious consequences, especially for less educated entrepreneurs and businesses in rural areas. According to stakeholders, the majority of businesses are unaware of the new law on moveable property. On the other hand, banks, while being aware of the new system, are still reluctant to grant credit based on moveable property. Not even the out-of-court enforcement procedure promised under the new law has attracted bankers to use the system. Instead, as an enforcement mechanism, banks rely on selling their bad debt portfolios to third-parties that are in the business of purchasing such debts. On the other side, while out-of-court enforcement facilitates the execution of security interests and encourages lending, debtors may not fully understand that they are relinquishing the right to have a court adjudicate a dispute over default.

### ***Lessons from the reform***

Peru moved ambitiously to unify its registration system, simplify the enforcement of collateral agreements, and expand the pool of assets usable as collateral. The reform was directed at tackling an important concern of businesses in the economy—the limited access to credit by the private sector, which was linked to difficulties in securing transactions. Other economies can learn from the positive aspects of Peru’s reform, while keeping in mind the elements that have weakened the effectiveness of the new law.

Specifically, the following elements seem to be very important when reforming secured transactions laws:

- Recognize the importance of the support and involvement of local stakeholders as an important and necessary impetus for a successful reform.
- Synchronize the start of the new registry’s activity with the law coming into force. This will guarantee that the technical and administrative regulations to implement the new system are in place.
- Set registration costs at reasonable rates, because excessive costs discourage financing.
- Develop, before implementing the law, a strategy for dissemination and training, aimed not only at the financial and legal industry but also at non-institutional users of the system—for example, small businesses and borrowers in rural areas.
- Ensure a follow-up mechanism that would identify the weaknesses of the system on a continuous basis, in order to make the necessary changes and implement the necessary reforms.

## Appendix I

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## APPENDIX II - TIMELINE OF THE REFORM PROCESS

<b>May, 1996</b>	The study by the Centre for Economic Analysis of the Law, written by Heywood W. Fleisig, Nuria de la Peña, titled "Peru: How Problems in the Framework for Secured Transactions Limit Access to Credit" was published.
<b>August, 1999</b>	IADB included the condition to reform the secured transactions law as a condition in its Financial Sector Reform Programme II for a Policy-Based Loan.
<b>August, 2000</b>	Workshops with the participation of various stakeholder groups were held. At this stage, the Ministry of Economy and Finance showed minimal interest.
<b>December, 2000</b>	The consultants (Centre for the Economic Analysis of the Law) distributed their final report titled "Trabas Legales al Credito en el Peru: Garantias Mobiliarias", which was ultimately published by a local university.
<b>January, 2001</b>	Colegio de Abogados de Lima endorsed the consultants' report's main recommendations for legal reform.
<b>June, 2001</b>	The Ministry of Economy and Finance set-up a Commission to review the issue.
<b>July, 2001</b>	The Ministry of Economy and Finance released a "White Paper" titled "Facilitando el Acceso al Credito mediante un Sistema Eficaz de Garantias Reales", restating all the major criticisms of the current system, and proposing legal reforms and the creation of a unified registry.
<b>November, 2003</b>	The IADB included a policy condition of Moveable Property Guarantees in a new Competitiveness Reform Programme as a Policy Based Loan. The aim of this programme was to have, by mid-2005, a moveable property law in effect, a property registry operation, and all regulations necessary for its functioning approved.
<b>December, 2003</b>	After the Ministry of Economy and Finance set-up a Commission to draft a Proyecto Ley de Garantia Mobiliaria (which was modified after receiving comments from the Commission of the Economy and Financial Intelligence of the Congress (Comision de Economia e Inteligencia Financiera del Congreso), the consultants who were hired to critique the first draft of law, and the Foro Nacional de Competitividad, which held nine Mesas de Trabajo in February, 2003), on December 19, 2003, the executive power presented to the Congress the final draft of the Proyecto.
<b>May, 2006</b>	After being promulgated on February 10, 2006, and published on March 1, 2006, the law entered into force on May 30, 2006.

**APPENDIX III – Highlight of the Changes in the Law as a Result of the Reform<sup>1</sup>**

CHANGE	DESCRIPTION
<b>Any legal entity can create security interests</b>	<ul style="list-style-type: none"> <li>• Prior to the reform, several laws in Peru limited the use of security agreements. For example, the trust (which allowed for the debtor to transfer ownership of the collateral to a trustee who could sell the collateral without court procedures). Prior to the reforms, only banks were allowed to serve as trustees. The reforms have allowed any natural or legal person, domestic or foreign to have access to the same system.</li> </ul>
<b>Pool of assets that can be used as security</b>	<ul style="list-style-type: none"> <li>• Many assets that were considered immovable were now considered movable, and all movable assets were brought under the umbrella this new law, titled "Law of Movable Guarantees". The new law eliminated almost all the special security interests that existed prior to the reform. The special security interests that continue to remain under the new system include security on patents and trademarks, and rights of the author, which continue to be registered under the special registry titled "Indecopi".</li> <li>• The assets <b>excluded</b> from being used as security include: remunerations, pension funds, warrants, and deposit certificates.</li> <li>• Important assets, including accounts receivables, changing pools of assets, future assets and inventory can now be used as security.</li> <li>• The movable property can guarantee all classes of debts, present and future, of the same debtor.</li> </ul>
<b>System of registry unified</b>	<ul style="list-style-type: none"> <li>• 15 registries were eliminated, including Agricultural Pledge Registry; Industrial Pledge Registry; Mining Rights Registry; Naval Vessel Registry; Registry of Global and Floating Pledges; etc.</li> <li>• The registries were merged into two unified registries; one for movable properties, and another for contracts.</li> <li>• The registries are to be unified, and inter-connected nationally by May 30, 2007.</li> </ul>
<b>Pacto comisorio</b>	<ul style="list-style-type: none"> <li>• The parties can agree on the terms of the contract in the case of non-compliance for the property to pass to the creditor for an extra-judicial sale, without the requirement of utilizing a notary, a third-party, or the court for such transfer.</li> </ul>
<b>Third-party sale</b>	<ul style="list-style-type: none"> <li>• Should the parties not agree on the terms of the contract, upon non-compliance, the creditor, through a notary, has to send a notice of non-compliance to the debtor. Three days later, should the debtor fail to perform, the creditor can proceed with an extra-judicial sale through a third-party.</li> </ul>

<sup>1</sup> Sandro Castellares Añazco, Legal Advisor, Chamber of Commerce of Peru, Interview with *Doing Business* on November 20, 2006

## Appendix IV – Criticisms on the New Law

THE LAW	CRITICISMS
<b>The law requires the submission of specific and irrevocable power to a third-party in order to transfer the property upon non-compliance<sup>1</sup>.</b>	What happens in the event that the third-party passes away or is dissolved?
<b>The law subordinated all the previous laws that controlled assets covered under the new law as movable property to the jurisdiction of the new law<sup>2</sup>.</b>	What happens with interests that were created prior to the reform on immovable properties that, under the new law, are considered movable?
<b>The law states that upon delivery of the letter of the notary to the debtor for non-compliance, the debtor has three days to pay, failing which, the process of extra-judicial sale will commence<sup>3</sup>.</b>	The three-day deadline for the payment is a very small, creating the situation for possible abuse.
<b>SUNARP<sup>4</sup></b>	The 60-day deadline for SUNARP to develop the regulatory norms for the organization and functioning of the registry is very tight to deal with a complicated issue such as this.
<b>Unconstitutionality of the law<sup>5</sup></b>	The new law, allowing for an extra-judicial execution, violates Article 139 of the 1993 Political Constitution of Peru. The Constitution of Peru does not allow for private jurisdiction, which the law at hand permits.

<sup>1</sup> Interview by the *Doing Business* with Sandro Castellares Añazco, Chamber of Commerce of Lima, Legal Advisor, Legal Department, November 14, 2006.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid.*

<sup>4</sup> *Ibid.*

<sup>5</sup> To date, no cases on the unconstitutionality of the new law have been presented before the courts in Peru. The argument of unconstitutionality has been raised, among others, by Nelly Fernández del Castillo, Raul Camacho Gálvez, *Estudios Sobre la Nueva Ley de Garantía Mobiliaria – Ley 28677*, Arco Legal Editores, Lima Peru, September, 2006.

### Appendix V – Snapshot of Post-Reform Developments

<b>Activity</b>	<b>Status</b>
Post-reform workshops and dissemination activities	Since the passage of the new law, other than few ad hoc seminars, no persistent series of seminar have been organized that would facilitate the dissemination of the new system, and the training of the stakeholders and users. This has significantly hampered the effectiveness of the new law.
Improvements to the registry (SUNARP)	Two of the most important advances since the passage of the law have been the opening of new offices by SUNARP for the purposes of registration, and the electronic connectivity of an increasing number of notaries in the economy directly to SUNARP and are able to carry out registrations through this electronic system. However, still many notaries (particularly in the rural areas) are still not connected electronically to SUNARP. The services of notaries are not available readily across the economies at affordable rates.
Amendments to the law	Since the passage of the law, no significant amendments have been made, and the most important shortcomings of the new law explained in the paper persist. However, there is currently a study being undertaken by the Inter-American Development Bank which aims to identify the weaknesses of the law as what will, hopefully, be a first step to further reforms. However, as it appears, no governmental body has, as of yet, claimed ownership and a clear priority and desire to reform this law.

## Credit Reporting Systems A Case Study of the Philippines\*

### *Introduction*

The current financial crisis, which started with the debacle in sub-prime credits in the US and other developed financial markets, is bound to change the way in which financial markets collect, process and use information on actual and potential debtors. Similar problems affect emerging financial markets, although on a smaller scale, given the more limited reach of formal finance in such markets. Even so, having imported models of credit reporting from the advanced financial markets, there is bound to be strong interest in re-examining the approaches used in emerging markets today.

Emerging markets often face numerous constraints that undermine the ability to collect and use financial information in effective ways, including weaker judicial and regulatory frameworks, administrative capacities and ICT systems. The development of credit information systems is seldom linear in such settings, reflecting an amalgam of imported technical principles and domestic adaptations as well as a series of opportunistic steps and political compromises in the actual implementation of reforms. This case study of the development of credit reporting systems in the Republic of the Philippines since 1981 describes some of the issues, trade offs and future challenges faced by reforms in this area.

Two features of the reform efforts stand out. *First*, many of them came in the wake of financial crises, rather than as part of a clear evolutionary plan for the development of the financial sector. It is interesting to note some of the choices made in such situations. For example, the first credit information agency, established in 1982, was in response to a money market crisis in 1981. However, it lacked many critical pieces of information infrastructure and, during a time when concerns about the abuse of authority were strong, this undermined its effectiveness. *Second*, the financial sector authorities needed to address the same set of issues encountered in the design of credit reporting systems in other developing economies. These are: public *versus* private ownership; going beyond the collection of negative credit histories to archiving positive information that could feed into a broader range of economic transactions; voluntary *versus* mandatory participation by financial institutions; the range of financial sub-markets and institutions to be covered; and procedures to verify records and protect consumer rights.

### *Brief history of the credit reporting system*

We can distinguish three main phases in the evolution of centralized credit reporting systems in the Philippines, each roughly a decade apart.

The proximate origin of the *first* system was the commercial paper crisis of the preceding year, which led to a round of failures of corporate and financial institutions. The government initiated several reforms to better assess the financial conditions of borrowing

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or of the government of the Philippines.

corporations. One of these was the creation of a credit information exchange organized under the Department of Loans and Credit of the central bank. The system allowed financial institutions to exchange credit data such as bank borrowings and commercial paper issuances. The reforms eventually led to the establishment of the Credit Information Bureau, Inc. (now the CIBI Foundation Inc.) in April 1982. CIB absorbed the functions of the central bank's system.

As the formal financial market expanded, the need for reliable credit information expanded in tandem. This marked the beginning of the second phase of development of the Philippines' credit reporting system. In 1990, the Bankers Association of the Philippines (BAP) established the BAP Credit Bureau, Inc., to centralize and share information on borrowers that was available at member commercial banks. The Bureau managed the Loandex Information System and the Negative Information File System and collated data from member banks' Credit Equity and Exposure Reports to the Central Bank. The BAP CB ultimately automated and rationalized manual methods of credit information exchange among member banks, cutting down processing time for loan applications significantly.

More recently, and representing the third phase of development of a credit reporting systems, the central bank has pushed for expanding credit to the "bankable" and the "entrepreneurial poor". The earlier systems had focused on existing borrowers with adverse records or on established borrowers in the larger urban areas, excluding these new classes of borrowers. The central bank sought a legal mandate for the creation of a centralized credit bureau to source more comprehensive credit information and thus develop a wider and more reliable database of both positive and negative information on borrowers. The Credit Information System Act, creating the Credit Information Corporation (CIC), came into force in October 2008, and will form the basis of the new credit reporting system.

Throughout this evolutionary process, the Philippines authorities recognized that the assessment by lenders of the repayment capacity of a borrower is the primary determinant of access to credit. For repeat borrowers, lenders gather information on their history of repayment, and usually develop an internal rating of the creditworthiness of the borrower. The costs of collecting such information and the resulting risk rating that emerges from such an exercise are vital factors in determining the lending rate and additional charges or requirements imposed by the lender on the borrower. Information processing, however, can prove to be a lengthy and costly process. As the formal financial sector expanded, centralized reporting and information sharing systems were clearly more efficient and cost effective than fragmented databases managed by individual institutions, as they allowed for faster, standardized credit evaluation on a comprehensive basis. This had the potential to strengthen credit risk management by lenders while expanding their base of potential borrowers. For borrowers, such systems allow for the increased availability of credit, with more types of credit made accessible at reasonable cost and with faster processing times.<sup>1</sup>

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<sup>1</sup> World Bank studies show that modern credit bureaus have evolved rapidly since the 1950s. In the 1990s, the number of credit bureaus increased in developed and emerging markets, with a strong correlation seen between the presence of credit bureaus and the general development of the economy. Among 78 private credit bureaus surveyed by the World Bank in 55 economies, banks, financial institutions or credit card providers owned 22 bureaus, seven by industry associations or chambers of commerce owned seven, governments were part owners of three bureaus, with the rest as independent credit bureaus. Doing Business Database on Private Credit Bureaus, 2006.

## ***Key institutional developments and choices***

### ***Phase One***

The Credit Information Bureau, Incorporated (now the CIBI Foundation, Incorporated), was the first major institutional development in the evolution of the credit reporting system in the Philippines. During the crisis of the Philippines money market (commercial paper) in the early 80s, when several corporate borrowers failed, the Government decided to assist financial institutions to better identify borrowers in distress and to be in a position to assess the need for instituting financing programs for priority industries. Toward this end, then President Ferdinand Marcos issued Letter of Instructions (LOI) No. 1107 on February 16, 1981, directing various government agencies to initiate institutional tasks.

As the Government viewed the issue as more than simply a financial market innovation, coordination among several agencies was required in order to meet broader developmental objectives. The Securities and Exchange Commission (SEC) started to monitor the financial condition of companies issuing commercial paper and provided guidelines to reduce or cancel the authority to issue such paper by non-creditworthy companies, that is, going beyond the mandate of a traditional rating agency. The Government tasked the Professional Regulation Commission with ensuring that certified public accountants utilized higher auditing standards for issuers of commercial paper. Finally, in order to determine the need for instituting a financing program to assist priority industries with the rationalization of their finances, the Central Bank, SEC, and the Development Bank of the Philippines began to assess in a more systematic manner the financial conditions of major borrowers in the money market.

In addition to developing the information base for a limited segment of the financial market and providing the means for better official assessments of distress financing needs, the authorities were concerned also with broader financial market risk management. To prevent excessive concentration of credit in particular instruments, the government tasked the Central Bank to initiate a credit information exchange among banks and other financial institutions involving data on bank borrowings, commercial paper issuances, and other forms of borrowing, managed by the central bank's Department of Loans and Credit. The LOI also directed the Central Bank, in coordination with investment houses and other financial institutions, to examine the need and feasibility of creating a credit bureau in the economy. The Credit Information Bureau, Inc. came into existence on April 14, 1982 as a non-stock, non-profit organization.<sup>2</sup> Members of included the Central Bank, SEC, and the Financial Executives Institute of the Philippines. The main business of the Bureau was the collation, development, and analysis of business information on individuals and corporations. The Bureau absorbed the operations and functions of the Credit Information Exchange System of the central bank.

However, the Bureau had trouble in securing credit information from government agencies and private institutions because of doubts regarding its legal ability to make credit information available. To provide further support for the Bureau and a firm legal basis for its operation, the Government *made it a national policy to promote the development and maintenance of rational and efficient credit processes by providing structured mechanisms for the organized supply of information to credit-related parties.* This was achieved through Presidential Decree 1941

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<sup>2</sup> Source: [www.cibi.net.ph](http://www.cibi.net.ph); referred to hereto as the Bureau

(“Recognizing and Supporting the Credit Information Bureau, Inc.”), issued on June 27, 1984. Among the measures taken, the Central Bank was empowered to provide information to the Bureau on any institution under its supervision, banks and other financial institutions could provide information to the Bureau, and the latter had to ensure that it would share the information only with accredited subscribers with legitimate interests.

The Bureau provided several services. The main ones included corporate business reports (e.g., management, history, operations, credit track record, banking relationships, financial condition including public records, and related current company developments) and consumer reports (e.g., information on individuals such as identity, background, reputation, business affiliations, financial standing, negative records such as court cases or cancelled credit cards). The Bureau also provided financial indicator reports that cover qualitative/quantitative analysis of the financial data of companies to determine their ability to repay obligations, and a property information service.<sup>3</sup> However, most analysts and market participants concluded that the shared information was fragmentary and usually slow to yield reliable real-time information. Financial institutions continued to use individual in-house information collection methods. In addition, due to a high degree of connected lending in the financial system, the demand for the kinds of financial information available through the Bureau originated chiefly from official entities tasked with financial sector stability, rather than from private market participants.

### ***Phase Two***

With the expansion of formal finance, especially commercial banking, and facing pressures from both rising competition and increasing financial market complexity, in the 1990s the commercial banks sought a centralized system for credit information available from banks and a more immediately available and reliable database. The Bankers Association of the Philippines (BAP) established the BAP Credit Bureau, Inc., on March 16, 1990 to facilitate the timely and effective exchange of credit information among the BAP member banks. The BAP CB developed the Loandex Information Exchange System that automated and rationalized manual methods of credit information exchange among BAP member banks on individual and corporate borrowers. In 1992, the BAP CB launched the Negative File Information System (NFIS) that maintained data on bank clients with adverse loan accounts, closed current accounts, cancelled credit cards, and court case files. The BAP CB also endeavored to streamline the voluminous reportorial requirements of the central bank related to the credit exposures of banks. The BAP CB initially began with the centralization and storage of Credit Exposure Reports (CREDEX) submitted by the members on a quarterly basis.

The BAP continued to expand the coverage of the information exchange system as well as to track the evolving needs of financial institutions. It examined the feasibility of establishing a consumer credit information system that would provide a fully functional on-line database for the entire banking and financial sector, as well as for the business community. In the second half of the 1990s, as in other developing economies of the region, the BAP looked for technology providers or strategic partnerships with internationally renowned credit information agencies. Upon review, however, the at least one such system was considered to be too advanced and expensive relative to the needs of

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<sup>3</sup> The CIBI was incorporated as a separate entity in 1997, with commercial operations starting on April 1, 1999. CIBI is majority-owned by a private entity, MOTAN Corporation.



the market and the search process was, therefore, discontinued. Instead, it proceeded with the automation of the NFIS to exchange information between the BAP CB and the member banks in a more expeditious and cost-effective manner. The Bureau also sought to expand its service and information sources and thus established alliances with other organizations, such as the Chamber of Thrift Banks, the Philippines Finance Association, the Bank Administration of the Philippines (BAIPhil), and the Rural Bankers Association of the Philippines.

The concerted efforts by BAP and the official agencies yielded positive results, despite a relatively weak supportive system of laws, regulations, and banking culture when compared to some of the other economies of the region. With the centralized information database and automated systems developed by the BAP CB, the processing of loan applications became faster providing the banks with a better information base for credit risk management. Over time, the services of the BAP CB were integrated, and today constitute an important source of information for banks and finance companies. Some of the outcomes are discussed below (see Tables 1, 2 and 3 for details).

### ***Loandex Information Exchange System***

The LIS remains the system accessed exclusively by the members of the BAP, but on a voluntary basis. As of September 2008, 32 of the 38 commercial banks subscribe to the LIS. Information in an LIS report of a borrower's credit includes the amount borrowed per facility, outstanding balance, security/collateral provided, date the facility was granted and expiration date, and the creditor's experience. A member bank submits a query on a borrower to the LIS that is routed to all participants for their immediate response. After 5 working days, the BAP CB's system provides the collated responses to the inquiring bank. In August 2008, BAP launched a real-time version of the system through which reports inquired over the previous 91 to 180 days period were also available online. Participation in this system is subject to guidelines that ensure the confidentiality, safety and reliability of information exchanged, with corresponding penalty provisions for violations. The number of inquiries in the system has increased at an annual average rate of 7% from 2005 to 2008.

### ***Negative File Info System***

Participants to the NFIS are able to retrieve data on bank clients with adverse records within 2-3 hours from receipt of inquiries. Records included in the system are:

<b>Records</b>	<b>Description</b>	<b>Periodicity of Submission to BAPCB</b>
<b>Adverse Loan Accounts</b>	Loan accounts of subscriber banks classified as either items in litigation, foreclosed (under real & other properties owned and acquired), or written-off	Semi-annual
<b>Current Accounts Closed due to Improper Handling (formerly the Bouncing Checks Watchlist)</b>	Data on mishandled current accounts closed by subscriber banks	Monthly

<b>Records</b>	<b>Description</b>	<b>Periodicity of Submission to BAPCB</b>
<b>Cancelled Credit Cards</b>	Mishandled cards cancelled by credit card centers	Monthly
<b>Court Case Listings</b>	List of credit-related complaints filed in the courts	

Since 2000, the BAP CB has implemented a regional NFIS through which bank branches are able to access the NFIS without going through their head offices. From 63 subscribing institutions in 2000, the NFIS currently has 97 subscribers because of the membership of a larger number of finance companies, rural banks and thrift banks. The number of inquiries increased on average by about 20% per year from 2005 to 2007. In terms of number of records, BAP CB maintains 3 million records as of October 2008, up from only 61,182 records in 1999.

### ***Real Property Database System***

Two institutions—BAP CB, together with the BAIPhil—launched the RPDS in 2002. The RPDS is an electronic compilation of the fair market values of real estate properties held by banks and financial institutions as loan collaterals and foreclosed assets, among others, provided to the BAP CB on a semi-annual basis. Additional information on the property is also included, such as flooding, absence of a right of way, existence of squatters, etc. In 2006, the RPDS was made available via the internet to subscribers. A number of thrift banks are now included among the participants in the RPDS. From only 9,677 records in December 2002, as of October 2008 the RPDS has 86,983 records. Despite such impressive growth, the database is still fragmented and incomplete, suffering the same underreporting and misreporting problems faced by the tax authorities in tracing the ownership of real property.

### ***Titles Caution List Database***

The TCLD is a collection of spurious, non-existent, or otherwise questionable land titles. This database complements the RPDS. As of October 2008, BAP CB had 1,242 records in the TCLD, up from 593 in December 2002.

In addition to the above, BAP CB has also developed other services, including the collation and analysis of credit information on individuals and corporations, and the publication of industry and market studies, surveys in support of credit analysis, securities ratings and other output. These reports supplement the vast array of information from other sources available to market participants, including from numerous private analysts that have emerged in recent years due to high market demand for specialized services.

### ***Phase Three***

Over the past decade, a number of factors have led to reforms of the credit reporting system in the Philippines. Despite earlier progress in developing systems for exchanging information, concerns about limited coverage (of both financial institutions and debtors), the security and use of information collected, and the absence of adequate consumer protection surfaced repeatedly. At the same time, the Government embarked on a

financial sector reform program oriented towards increasing the volume of financial savings, reducing the risks of financial institutional instability, and expanding the reach of formal finance to cover hitherto underserved groups, especially micro- and small enterprises and firms in smaller markets. Actions taken during this decade have culminated in the October 2008 passage of the Credit Information System Act and the establishment of the new Credit Information Corporation, a majority of whose shares the Government owns. During the process of finalizing the legislation and the shape of the institution, proponents faced a number of the common issues identified with establishing credit reporting systems in developing economies, including those of ownership, scope of participation, efficiency, and the integrity of information contained in the system.

The central bank's promotion of sustainable microfinance had a major influence on the evolution of the CIC and related legislation. Micro, small and medium enterprises account for about 99.6 percent of the economy's total industries and employ about 70% of the workforce. Furthermore, about 4.1 million families belonging to the lowest income strata are engaged in microenterprise activities.<sup>4</sup> In the absence of access to formal financial services from markets that benefit from economies of scale, these sectors rely on expensive sources of credit, such as moneylenders, which sometimes hampers their potential for rapid growth. Moreover, almost all of the credit at traditional commercial banks and finance companies required borrowers to put up significant amounts of collateral, mainly in the form of real property, which constrained the ability to borrow of smaller sized and startup enterprises.

To address this problem, the central bank recognized the need to make the credit information system in the economy more comprehensive. As borrowers provided information on a voluntary basis, information from the CIBI was limited in scope. Information from the BAP CB was limited to data from the participating banks—mainly the commercial banks and a number of thrift and rural banks, and other financial institutions. These banks cater mainly to employees in urban areas who tend to have standard records on which banks could base credit decisions (e.g., payroll records). Voluntariness had another drawback, as the participating financial institutions tended to hoard information on good borrowers for fear of losing clients to their competition. Furthermore, the central bank recognized that as the number of lending institutions participating in microfinance increased and multiple borrowings expanded, a comprehensive credit reporting system would be crucial in reducing the risks of credit pollution and in promoting credit discipline among borrowers.

With such a goal in mind, the BSP, in coordination with the National Credit Council, commissioned a study on the establishment of a central credit information bureau. The basis for the assessment was that an improved and expanded system would lead to reducing the importance of collateral-based lending in total lending, improve the access of responsible borrowers to credit, lower the cost of borrowing by addressing informational lacunae, and promote credit discipline. The Government incorporated subsequent initiatives to seek legislative support for the establishment of the CIC within its broader reform agenda to develop the economy's financial industry. The components of this agenda included improvements in central banking, securities, and insurance regulation, pension reforms, and the resolution of corporate financial distress.

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<sup>4</sup> "Stimulating the Growth of Microfinance in the Philippines", Speech given by central bank governor Amando M. Tetangco, Jr. on September 19, 2005 at the NCR Stakeholders' Forum on Microfinance"

The first bill seeking the establishment of the CIC was filed in 2004 as Senate Bill No.(SBN) 1843, entitled “The Credit Information Bureau Act.” After two public hearings conducted by the Committee on Banks, Financial Institutions and Currencies, the bill was substituted by SBN 1936 (“The Credit Information System Act”) reported out to the Plenary on February 2005. SBN 1936 was approved in June 2006. In the Lower House, House Bill No. 5948 substituted other related bills (HBN 3819 and 4356) on November 2006. HBN 5948 was approved and was certified urgent by the President of the Philippines on December 2006.

However, due to technicalities, the legislature did not enact the proposed CIC bill, despite the discussion in the Bicameral Conference Committee. It was re-submitted to the Senate (SBN 62) and House of Representatives (HB Nos. 118, 1731, 2443 and 3312) in 2007. The Committee on Banks, Financial Institutions and Currencies conducted its public hearing on October 2007 and reported out SBN 62 immediately with refinements (substituted by SBN 1881 under Committee Report No. 17) while the House of Representatives instantaneously approved and transmitted to the Senate the substituted version (HBN 4260 under Committee Report No. 621). The Bicameral Conference of both Houses of Congress was held on September 2008, and both Houses adopted the consolidated bill on the same date. On October 31, 2008, the consolidated version of the bill was signed into law by the Philippines President as Republic Act (RA) 9510.

An important feature of this process was the nature and intensity of the public dialogue that preceded the establishment of the CIC. Most parties supported the attempt to set up a comprehensive credit reporting system in the Philippines, recognizing that, in addition to improving credit market efficiency and growth, the CIC would have spillover effects from a healthier financial sector to the stock market of the economy. At the same time, however, several interest groups raised critical issues. For example, during the deliberation of related bills on the establishment of the CIC, the Philippine Credit Reporting Alliance (Philcera) raised the issue of potential unfair competition between the CIC and existing privately-owned credit bureaus.<sup>5</sup> A prominent senator supported their concerns, and during the interpellation of SBN 1936 stated forcefully that the CIC was likely to create unfair competition and would eventually have a monopoly of the credit information business. This was likely as the intention was to make participation mandatory, so CIC would have access to significantly greater amounts of information than would any other financial firm. Moreover, as a government entity, it could cover its costs through Budget subventions, while private bureaus would not receive this benefit.

Proponents provided assurances that several design elements would limit CIC’s market dominance. They argued that the proposed system was not intended to erect barriers to entry in the credit information business, so in theory the CIC should not be a monopoly.<sup>6</sup> Despite this (admittedly weak) response in the face of the two concerns mentioned in the previous paragraph, proponents of the CIC were required to “sell” their ideas forcefully during the debates. They argued, for example, that CIC would not provide credit rating

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<sup>5</sup> Members of the Philcera include the CIBI Information, Inc., Asian Credit Consultants and Business Services, Equifacts Information, Inc., First Asia Corporate Business Connection, and Excellent Credit Information, Inc. The products and services of these companies include credit and mortgage reports, credit investigation services, property appraisal and evaluation, financial statements or credit analysis, fraud prevention and risk management, collection services, check fraud and verification, and tenant and employment screening services.

<sup>6</sup> Interpellation by Senator Osmeña on June 6, 2006 (Senate Journal, Session No. 89)

services like the existing bureaus; instead, it would provide a comprehensive information base that enhanced the credit rating services of the other agencies. Further, the rates charged by the CIC were regulated to be fair, reasonable and affordable, without the intention of pushing existing bureaus out of business. Under existing Philippines laws and regulations, a monopoly can exist as long as it is regulated and that its services are in the public interest. The proponents of the new system made a strong case that the CIC fit within these laws, as the intention was to provide the financial system with a comprehensive and credible history of borrowers.

In the end, to address these concerns and ensure passage of the legislation while maintaining the effectiveness of the proposed credit reporting system, the final version of the law included the following provisions:

- The CIC shall produce only basic credit data limited in form and content only to objective and factual information, and thus exclude any subjective information or opinion; and
- Fees that the CIC will collect would be regulated, taking into consideration the policy of promoting fair competition.

The features of the new CIC are worth noting, as they reflect a basic design favored by many developing economies. Unlike the existing credit bureaus in the Philippines, the CIC is government-owned, with 60 percent of the corporation's common shares held by the National Government. The government will dispose 20 percent of its shares after five years. Qualified investors, who will hold the remaining common shares, are likely to include bank, quasi-bank, and other credit-related associations, and associations of consumers. In the original design, the central bank was to be the majority owner of the corporation, similar to the credit bureau of Sri Lanka. Ultimately, however, the central bank felt it necessary to promote a government-owned bureau in order to provide greater assurance to borrowers that CIC would handle the information it collected in a secure manner. During the deliberations of the bills, however, several parties raised the issue of conflict of interest and its implications for misuse of the data. The argument presented was that the central bank, as the majority owner of the CIC and, at the same time, regulator of credit institutions, would potentially face such a conflict. Since the Corporation Code governed the CIC, it was thus proposed (and adopted) for the Securities and Exchange Commission, instead, to be the regulator of the new bureau.<sup>7</sup>

Also under the new law, participation to the CIC is compulsory. Aside from banks, users include quasi-banks, their subsidiaries and affiliates, life insurance companies, credit companies and other institutions that provide credit. Additionally, the CIC is authorized to access the database of government offices, judicial and administrative tribunals, prosecutorial agencies and related offices, and government-administered pension plans. The new system would also prescribe permissible uses for the credit information obtained from the CIC. Also unique to the CIC, negative credit information of borrowers would be deemed obsolete after 3 years, which addresses a key concern in the design on credit reporting systems, especially those created during a period of pro-activity with regard to using finance for economic development.

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<sup>7</sup> Interpellation held on December 18, 2007 (Senate Journal, Session No. 45)

The CIC also aims to provide a balance between the need for comprehensive credit information and consumer protection. Through educational programs the CIC will endeavor not only to make borrowers aware of the value of credit to their activities, but also of the credit granting process and of their rights (such as access to information for a fee, the right to dispute inaccurate information, and the right to be informed of reasons for any refusals of credit). With such information, users are able to become aware of their individual credit profile and better determine which credit product suits their needs.

Table 1 - No. of Subscribers and Inquiries

	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Dec 05	Dec 06	Dec 07	Oct 08
<b>No. of Subscribers</b>									
LIS									
Regular LIS (KBs) <sup>1</sup>	53	49	42	39	34	34	34	34	32
Online LIS									12
NFIS	63	62	59	64	67	80	96	99	97
KBs	34	32	30	30	30	30	30	30	30
Card Cos.	11	11	11	12	14	14	14	14	14
Financing Cos.	8	8	9	10	11	17	19	19	21
TBs	7	8	8	11	11	17	18	20	20
GFIIs	3	3	1	1	1	2	2	2	2
RBs							13	14	10
RPDS							11	11	12
KBs							9	9	9
TBs							2	2	2
RBs							0	0	1
<b>No. of Inquiries (For the Year)</b>									
LIS									
Regular LIS (KBs)	219,966	205,728	218,377	227,488	239,327	250,988	274,018	294,800	252,636
Online LIS									185
NFIS	1,477,748	1,308,190	1,197,018	1,781,992	2,986,676	4,047,577	4,531,985	5,098,945	4,524,801
RPDS							2,656	3,848	3,228
<b>No. of Inquiries (Average per Day)</b>									
LIS									
Regular LIS (KBs)	883	850	884	917	965	1,020	1,105	1,184	1,351
Online LIS									4
NFIS	5,935	5,233	4,866	7,071	10,407	13,767	15,208	17,285	20,021
RPDS							9	13	14

Note: GFIIs – Government Financial Institutions

Source: B-APCB

<sup>1</sup> The total number of commercial banks (KBs) in the Philippines declined due to mergers & acquisitions. There are currently 38 KBs..

Table 2 - No. of Records

	Dec 02	Dec 03	Dec 04	Dec 05	Dec 06	Dec 07	Oct 08
<b>NFIS</b>	1,047,126	1,176,965	1,889,922	2,164,578	2,504,079	2,878,043	3,236,139*
<b>ALA</b>	49,377	49,625	175,469	200,859	255,640	297,590	418,838
<b>CIH</b>	56,846	60,504	181,539	193,429	201,428	213,452	223,989
<b>Individuals</b>	53,433	56,777	169,244	180,088	187,607	198,865	208,754
	3,413	3,727	12,295	13,341	13,821	14,587	15,235
<b>Corporations</b>							
<b>CCC</b>	365,904	457,236	866,100	1,053,764	1,285,324	1,553,022	1,779,333
<b>CCL</b>	574,999	609,600	666,814	716,526	761,687	813,979	813,979
<b>RPDS</b>	9,677	27,651	42,921	54,969	65,422	78,472	86,983
<b>TLCD</b>	593	946	1,160	1,233	1,241	1,241	1,242

\*NFIS records is comprised of about 98% individuals and 2% corporations

Source: B-APCB

Table 3 - Fee Structure

In Philippine Pesos (VAT inclusive)	Inquiry Fees		Annual Subscription Fees	
	KBs	Non-Member Banks	KBs	Non-Member Banks
<b>LIS</b>	63.64			
<b>NFIS</b>	5.60 <sup>2</sup>	11.20	none	3,360.00
<b>RPDS</b>	22.40	33.60		6,720.00

Source: B-APCB

<sup>2</sup> Also for card companies & subsidiaries of KBs



Table 4 - Features of the Existing &amp; Future Credit Reporting Systems in the Philippines

	<b>CIBI</b>	<b>BAPCB</b>	<b>CIC (as per RA 9510)</b>
<b>Motivation</b>	<ul style="list-style-type: none"> <li>To systematically assess the financial conditions of borrowers &amp; identify the non-credit worthy companies</li> <li>To determine the financial requirements of various industries</li> </ul>	<ul style="list-style-type: none"> <li>To service the growing demand of banks for faster availability &amp; more reliable credit information</li> </ul>	<ul style="list-style-type: none"> <li>To increase availability of uncollateralized credit at lower cost for good borrowers &amp; the entrepreneurial poor</li> <li>Ensure consumer protection</li> </ul>
<b>Primary Services</b>	<ul style="list-style-type: none"> <li>Collate, analyze &amp; provide credit and business information on individuals &amp; corporations</li> </ul>	<ul style="list-style-type: none"> <li>Facilitate an automated exchange of credit information among commercial banks, &amp; other banks and financial institutions</li> <li>Provide &amp; publish studies, securities ratings and others in support of credit analysis</li> </ul>	<ul style="list-style-type: none"> <li>To establish a comprehensive, fair &amp; reliable system for information gathering of basic credit data with existence of fair competition within the industry</li> </ul>
<b>Obligations as a Reporting Institution</b>	<ul style="list-style-type: none"> <li>Does not guarantee accuracy, completeness or timeliness of reports<sup>1</sup></li> </ul>	<ul style="list-style-type: none"> <li>Penalties are imposed on users for delayed &amp;/or erroneous submissions</li> </ul>	<ul style="list-style-type: none"> <li>Sanctions are imposed for non-submission of reports, delayed &amp; erroneous reporting</li> </ul>
<b>Participation of Information Providers</b>	<ul style="list-style-type: none"> <li>Voluntary</li> </ul>	<ul style="list-style-type: none"> <li>By subscription: <ul style="list-style-type: none"> <li>LIS – commercial banks</li> <li>NFIS – commercial banks, thrift banks, &amp; rural banks</li> <li>RPDS – commercial banks, thrift banks &amp; BAIPhil members</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Compulsory participation of banks, quasi-banks, their subsidiaries &amp; affiliates, life insurance companies, credit companies, &amp; others that provide credit facilities</li> <li>With authority to access government offices, judicial &amp; administrative tribunals, prosecutorial agencies &amp; related offices, government-administered pension plans</li> </ul>
<b>Obsolescence of Data</b>		<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>3 years</li> </ul>

<sup>1</sup> Source: [www.cibi.net.ph](http://www.cibi.net.ph)

	<b>CIBI</b>	<b>BAPCB</b>	<b>CIC (as per RA 9510)</b>
<b>Ownership</b>	<ul style="list-style-type: none"> <li>Privatized</li> </ul>	<ul style="list-style-type: none"> <li>Commercial banks</li> </ul>	<ul style="list-style-type: none"> <li>National Government shall own 60% of common shares, 20% of which shall be disposed of after 5 years</li> <li>40% of common shares shall be owned by industry associations of banks, quasi-banks, other credit-related entities &amp; associations of consumers</li> </ul>
<b>Obligations of Users of Reports</b>			
<b>Permissible Purposes</b>			<ul style="list-style-type: none"> <li>Prescribed</li> </ul>
<b>Consumer Rights</b>	<ul style="list-style-type: none"> <li>No access rights</li> </ul>	<ul style="list-style-type: none"> <li>No access rights</li> </ul>	<ul style="list-style-type: none"> <li>With access rights</li> <li>Borrower has right to know cause of refusals of credit</li> <li>Educational campaign</li> </ul>

## ***Conclusion***

Although the “credit information index” for the Republic of the Philippines, at 3.0, is below the Asia/Pacific regional average of 3.8, reforms over the past quarter century have resulted in improvements in the quantity of information provided to the main financial institutions.<sup>1</sup> Nevertheless, it is estimated that only about 6 percent of the population is covered by credit bureaus, compared to about 25 percent for the region. There is substantial potential in the economy to use its IT prowess to strengthen the information exchange infrastructure as well as to accelerate the conversion from an essentially paper-based system to provide a retrospective database that is long enough to be useful to users of this information. Given the prospective difficulties of many firms and financial institutions in the period ahead—a reflection of an adverse domestic and global economic conditions—there may be a need to re-examine the appropriate data retention periods, which is currently three years. In many cases, the performance of borrowers can deteriorate rapidly in an economy-wide crisis, despite them having maintained clean slates in the past, so decisions regarding the future credit ratings of such borrowers will require extreme sensitivity, rather than the mechanical application of regulations. In these circumstances, it will be instructive to see how the central bank—the majority owner of the newly-created CIC—will act. An opt-out period during the transition to normal economic conditions is one such practical possibility, but there is no global experience to draw upon, and strong political endorsement is likely to be needed.

The importance of the existence of credit reporting systems is not undermined in the Philippines. The establishment of the first system, the Credit Information Bureau Inc., in the 80s was an important step in providing lending institutions a credit information base on which to better evaluate the borrowing capacity of individuals and corporations. The banking industry however sought for a better system in which to centralize credit reports and information using the value of automation and advanced technology. With this, the BAP CB was incorporated to service their increased need for a better information system to improve credit risk management.

With the Philippine central bank's thrust to feed on the growth potential of micro, small and medium enterprises in the economy, the need for a more comprehensive credit information base was determined. The CIBI's voluntary system of obtaining credit information is prone to make the bureau's database incomplete, forcing credit providers to deal with high credit risk. The BAP CB's information database, though compulsory for participating financial institutions, remains limited to commercial banks, rural and thrift banks, and few financial institutions, leaving out other potential borrowing sectors in the credit market.

After 4 years of hard work, efforts of the BSP, National Credit Council and supportive legislators, have led to the finalization of the law creating the future Credit Information Corporation in the Philippines. The CIC is expected to have a more comprehensive source of information. Unlike the voluntary system of CIBI, provision of credit information shall now be mandated from lending institutions, covering more types of lenders than the participating financial institutions in the BAP CB. Additionally, the bureau shall now be authorized to access credit information from various government offices to expand the information base of the bureau.

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<sup>1</sup> The World Bank Group's Doing Business Report calculates this index

Taking after the improvements made in the credit reporting system in the US, the CIC shall now also provide for participation from the borrowing public and consumer rights. Institutions involved in the reporting system shall now be obliged to ensure accuracy of information provided and used, allow only permissible use of credit information accessed, delete information deemed obsolete after 3 years, and provide access and information rights to consumers. The CIC shall promote consumer awareness of the credit granting process and encourage credit discipline.

With this improvement in the credit reporting system, it is hoped that the credit base of lending institutions shall expand but with better tools for credit risk management and equal rights and protections to the borrowing public.

The Philippine financial industry and its borrowing market now look forward to the establishment of the Credit Information Corporation and the implementation of Republic Act 9510. It is indeed a vital and big step in improving the potentials of the lending system in the economy and its contribution to the entrepreneurial efforts of individuals and corporations.

## **Tax Administration Reform in Thailand\***

Since the public administration reforms initiated several years after the Asian Financial Crisis, the issues of effectiveness, efficiency and value for money have been emphasized in all government agencies in Thailand. The Public Administration Act (Amendment Act (No. 5) 2002), stipulated that public administration and State operations would be performed according to the principles of good governance with effectiveness and efficiency, they would be aimed at benefiting the Thai people, and based on value for money and streamlined work processes. The public sector is required to deliver better and more responsive services, and both its administrative and operational aspects would be subject to the continuous evaluation of performance.

Early in the reform process, it was recognized that increasing the efficiency of Thailand's tax system would deliver demonstrated benefits to both the private and public sectors. It would address one of the most frequent complaints of the private sector regarding red tape. Almost a decade ago, it would have been difficult to believe that the Revenue Department (RD) would become a lead reforming agency a frontrunner in using ICT in public administration, while providing high quality services to the public.<sup>1</sup> Since then, the RD has won several domestic and international awards on ICT development and public service, which has made it the role model for e-government development in Thailand. During the same period, being a public administration reform pilot for introducing performance based management, the RD has proven that it can succeed not only in collecting revenue according to plan, but also in delivering better services, as measured by concrete key performance indicators. This case study analyzes reforms in tax administration at the Revenue Department of Thailand from 2000 to 2008, and highlights lessons from the reforms.

### ***Motivation for the tax administration reform***

The major reforms of tax administration in the RD began after the economic crisis of 1996-97. There was a great need for government revenue to meet the rising demand for public expenditure to boost economic recovery, sustain fiscal stability, raise the confidence of foreign investors, and service a higher burden of external loans that were borrowed to help shore-up the financial sector and promote social recovery. Tax revenue (mainly from the Revenue, Excise, and Customs departments) used to be as high as 17 percent of total output (GDP) before 1997, but after the crisis it fell to less than 15 percent. The pressure for increased revenues was felt by the RD, as it was the main tax revenue collector (it collected 65 percent of tax revenues in 1997). The problem facing the RD then was not only how it could increase revenue collection but also how it could collect revenue in the midst of several tax reform measures aimed at reducing the tax burden on businesses and individuals to boost domestic consumption and help economic recovery. The RD needed to reform

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or of the government of Thailand.

<sup>1</sup> The Revenue Department collects more than three-fourths of total tax revenue. It administers the income tax, value added tax, specific business tax and stamp duty. The other two tax collection offices in Thailand are the Customs Department and the Excise Department, under the Ministry of Finance. The social security contribution is administered by the Social Security Office, under the Ministry of Labor.

tax administration urgently in order permit more taxes to be collected from existing tax sources, even if rates remained the same or went lower.

Another key motivation for the changes in the RD was the public sector reform program of the Thai government, which started in 2003. The RD was one of a handful of government agencies that piloted results-based management and citizen-centric reforms. Accordingly, the RD adopted new vision and mission statements, supplemented by medium term strategic plans with key performance indicators to measure its success. The Director General (DG) of the RD is required to sign an annual public service agreement and enter into a formal commitment with the Finance Minister. Every unit within the RD commits to the targets; public service agreements are often signed online by every level, such as agreements between the DG and chiefs of regional offices, and between the latter and the heads of provincial tax offices.

A third major influence on the reform package was the rise of information and communications technology (ICT) in both the Thai and global economies. ICT was widely used in business and was increasingly a part of daily life. With the advances in ICT, the availability of web-based technology, and cheaper computers, the RD saw an opportunity to catch up with its taxpayers. At the same time, leading tax authorities around the world had introduced ICT in tax administration. The RD had been benchmarking itself against them, so it was highly motivated to improve tax administration by following the global trends. The ICT development efforts were given a boost when e-Government was introduced in Thailand in 2002.

### ***Content of the tax administration reforms***

#### ***Embedded within the broader reform program of the Government***

The most recent tax administration reforms in Thailand should be seen within the broader context of government-wide reforms in public administration. In the past, the performance of the RD was measured by tax collections alone. However, since the public administration reform, the issues of effectiveness, efficiency and value for money have been introduced to all government agencies in Thailand. The Public Administration Act (Amendment Act (no. 5) 2002), stipulates that the public administration and government business should be performed according to the principles of good governance with effectiveness and efficiency, aimed at benefiting the Thai people, and based on value for money and streamlined work processes. The public sector is required to deliver better and responsive services. Public administration and government work is subjected now to continuous performance evaluation. According to the Act, the RD was required to implement a results-based management system by setting its strategies and work plan according to key performance indicators. Moreover, the strategic and work/project plans have to be reviewed systematically. This system represents a major change from the traditional bureaucratic system since there is concrete and continuous performance evaluation. It also creates healthy competition among public organizations for the coveted position of “best overall performance”. One of the awards won by the RD is the “best service to citizen award” from the Office of the Public Sector Development Commission.

There has also been a change in administration at the provincial level. Previously, provincial tax offices were partly under the authority of provincial governors and the Ministry of the Interior. As a result of the restructuring, the tax offices throughout the

economy report only to the Revenue Department, Ministry of Finance. This change has eased the work of the RD and has enabled the provincial offices to perform according to a common headquarters policy. This has helped standardize RD operations across the economy and reduce interference in revenue collection from various provincial government officials.

### ***Extensive use of ICT***

The RD has improved its efficiency through utilizing ICT extensively in tax administration. ICT-enabled tax administration was complex to introduce, but the Thai agencies were able to move rapidly because of careful and systematic planning. Today, tax administration is more efficient and tax services are of higher quality. RD staff now work on a real time online pooled database of taxpayers, which helps speed transactions. Work processes have been revised, redesigned and streamlined in order to reduce taxpayer costs and times in dealing with the RD. More than 60 taxpayer service functions have been restructured, which has led to a significant reduction in time spent on tax registration, tax refunds, and tax documentation requests. For example, the time taken for VAT registration has been reduced from one day to 15 minutes, and requests for a copy of a tax clearance certificate from 3 days to 16 minutes.

During 2001-2007, a key driver of improved tax administration was the development of ICT in revenue collection and revenue management. Taxpayers can now use the internet to download tax returns and electronically compute the amount of tax they owe, file tax returns and make payments through a greater number of ICT and non-ICT based channels. They can use the RD call center for answers to their tax queries. Likewise, RD officials in 956 offices nationwide can now work in real time with online applications using an intranet system. The intranet system is a platform for RD officials to communicate and work online, using a pooled database for accessing taxpayer files, up-to-date laws and regulations, as well as external databases for tax collection purposes. It also allows senior managers to monitor revenue collection, or to give suggestions online on the pre-filing examination by tax officials, known as the “supervision system”, which is increasingly used by the RD to replace the higher cost and longer post-audit system.

### ***Changes in organizational structure***

To enlarge the tax base to raise revenues, the key reforms were in the area of expanding withholding taxes to cover almost every type of income and setting up the Large Taxpayer Office (LTO) for greater control over this major revenue stream. As a result of its new functions and responsibilities, the RD restructured its organization by setting up four new divisions, including LTO, the Electronic Processing Administration office, Investigations and Non-compliant Business Tracking unit, and VAT Refunds for Tourist office. In addition, the RD also revised the regional structure of the organization and headquarters in order to reallocate staff from the minor to the major tax sources.

The Bureau of Large Business Tax Administration, commonly known as LTO (Large Taxpayer Office), was established in June,1999 to have more control over major tax sources and to raise productivity by having a unit that could perform core tax functions on a one-stop basis and provide comprehensive tax services tailored to the needs of the large taxpayers. LTO is responsible for administering tax collection and supervising tax delinquencies and tax audits of the large taxpayers, as well as tax refunds, providing tax

rulings, processing tax appeals, and enforcing penalties and fines. Initially, LTO employed 300 staff and was responsible for tax collections that accounted for about 55 per cent of total RD tax revenue. However, due to more complex tax submissions of large taxpayers and an increase in the number of large taxpayers ( from 2,200 firms in 1999 to 2,400 in 2007), the number of staff has increased to 700 (3 percent of the total RD employees). LTO review the situation continuously to ensure that it is limited to working with the largest taxpayers. It has raised the annual business revenue threshold for cases considered from Baht500 million in 1999, to Baht1 billion and Baht2 billion in 2001 and 2007, respectively.

The Government utilized organization changes such as the above, together with the creation of other specialized agencies and changes in work processes, to closely monitor tax sources and to bring underground businesses into the tax net. Changes in work process played a key role. In 2002, the RD began focusing systematically on non-compliant taxpayers to raise the level of compliance and equity in the tax system. It set up the Investigations and Non-Compliance Business Tracking Office (NCBO) for planning, setting up strategies and regulations for the investigation of non-compliant businesses as well as bringing them into the tax net. The office is also responsible for analyzing new tax bases and investigating complaints on tax evasion. During 2003-2006, approximately 850,000 new taxpayers were registered in the tax system. Non-compliant taxpayers are under a special watch conducted by the responsible supervisory teams in provincial offices.

Replacing the post-audit assessments of tax returns and payments with a pre-filing examination was a major change in work process. In the post-audit system, typically staff would work on assessment cases dating from incorrect payments from three years before, and it would take them up to two years to complete investigations and receive the amount owed to the RD. Often, taxpayer situations would have changed during this period, and the amount of penalties and accumulated fines could be well above the market interest rate. Not only was the system inefficient, it also increased taxpayer burdens. By contrast, now the RD actively manages relationships with taxpayers. The monitoring and tracking engines in the supervision system have enabled the RD to work with up-to-date information. The public can contact the tax authorities relatively easily. In 2006, the RD introduced the TCL system that functions as an on-line gateway connecting 4,780 outlets nationwide where tax payment information is entered into the system. Data from TCL system can be compiled, evaluated, and analyzed as well as used as data inputs for other application systems, including the Government Financial Management Information System (GFMIS).<sup>2</sup> One obvious benefit of TCL system is that it dramatically reduces the time needed to make a daily collection report, down, on average, from one month to one day. In 2007 the RD also started to share information with Bangkok Metropolitan area authorities, so staff can access geographical data providing the most up-to-date business addresses and locations of taxpayers.

Apart from on-line real time work system such as e-supervision system, the RD uses intranet for internal communications, operations and management. For example, the tax code, tax rulings and procedures, e-circulation as well as e-forms are available online. Together with the change in work process, the RD also uses ICT in changing the supporting administration functions. The ongoing project is known as e-office. E-office

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<sup>2</sup> The GFMIS is a real time financial management system for the public sector which was fully implemented in March 2005. The GFMIS includes systems for budget planning and appropriation, budget monitoring, execution and electronic payment, national accounting (revenue and expenditure), capital procurement, auditing, organizational management, and personnel administration and benefits.



attempts to create applications for all supporting administration functions in stead of doing manually, labor intensively as well as reduce the time unnecessarily taken in supporting functions. So far the applications include online leave requests, motor pool online reservation system, online meeting rooms reservations, and online registration of office correspondence documents.

In 2008, the RD set up a unit responsible for planning and delivering RD business strategies for small and medium enterprises. It is still too early to evaluate the unit. However, as SME account for 80 percent of taxpayers by number, this is an important direction in which to move.

### ***Key actions***

Some key nodes at which actions were taken are discussed in greater detail below.

### ***ICT***

In 2007, the RD had a budget of about Baht3 billion (0.18% of the Government budget) to collect tax revenue of around 14% of GDP. It employed more than 22,000 people in 956 offices around Thailand, and processed about 23 million tax returns annually. More than three hundred rulings are issued each year to help resolve complex tax problems. More than one third of the tax returns (approximately 7.6 million) are now filed online, and the RD call center receives roughly 2,000 telephone calls per day. Measured by the number of website visits, which rose from 2 to 16 million between 2003 and 2007, the RD website is currently one of the top government websites.

By the year 2000, the RD already had databases for each type of tax.<sup>3</sup> Initially, the data were developed separately, stored independently and were unlinked. During 2001, the RD started the process of developing a pooled database accessible by the staff. The use of web technology in tax administration started with a pilot project on the issuance of taxpayer identification number. In 2007, optical character recognition technology was implemented, to be used with personal income tax and corporate income tax returns. It eliminates data entry functions for these two types of tax returns and ensures the correctness of data.

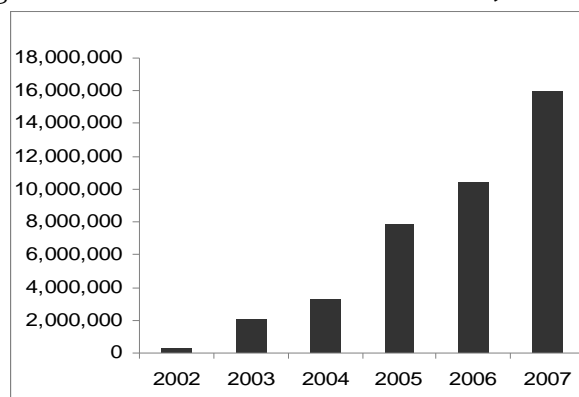
The RD website was launched in 1999 as a source of tax information and services. All tax laws, regulations and rulings as well as double tax agreements between Thailand and economy trading partners are available on the website. Taxpayers and tax professionals can check tax calendars and the availability of tax seminars, and to register online for seminars. Moreover, all tax forms, filing guides, and applications can be downloaded electronically and used for filing returns or applying for tax registration. This helps reduce the administrative costs of the RD in printing out tax forms and lowers compliance costs for taxpayer who would otherwise have to physically collect forms from tax offices. Since the RD website was launched, the number of website visits has gradually increased reaching more than 16 million in 2007 (Figure 1). In addition, since 2007, access to the website for people with disabilities—such as visual, hearing or mobility impairments—is possible. This corresponds to the 2007 Thailand Constitution which requires that all citizens have equal rights to access public services and information. With the voice browser and screen reader

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<sup>3</sup> Only for major taxes: personal income tax, corporate income tax, value added tax and specific business tax.

technologies enabled, people with disabilities can have access to almost the entire range of information and services available on the RD website.

**Figure 1 - Number of RD website visits, 2002-2007**



*Source: Revenue Department*

The development of electronic filing was implemented in 2001 starting with 3 types of VAT and CIT tax returns. In the following year, the RD expanded it to cover all 15 types of PIT, CIT, VAT, and SBT tax returns. The Bureau of Electronic Processing Administration was set up to improve the quality of services and to ensure that the RD can meet increasing demands for electronic services. The RD implemented various strategies to increase the use of electronic filing, one of which was the “tax agent” scheme. Since 2004, qualified accountants (both firms and individual accountants) can register as “tax agents” with the RD and file tax returns and make a payment through the internet on behalf of taxpayers. The number of such filings reached 7.6 million in 2007, which accounts for almost one third of the total tax return filings of the RD. To further reduce the burden of paperwork for taxpayers, since 2002 the RD has allowed them to keep their tax records in electronic form. The RD also developed a data exchange system with the Ministry of Interior and the Ministry of Commerce to reduce redundancies in the documentation, and since 2006 it allows individual taxpayers to use their personal identification number (PIN) instead of having to obtain a tax identification number (TIN), which supports the national e-government plan to promote the use of a single personal identification number.

In addition to filing and paying tax at the Revenue Office or through online tax lodgment (e-filing and e-payment), taxpayer can also file tax return and pay tax through various channels including Krung Thai Bank, the post office, Land Department, Excise Department and Customs Department. During the income tax season, Tax Mobile Units (TMU) are set up at markets and department stores to make it more convenient for taxpayers. Taxpayers who file electronically also have a wide array of payment channels: post office, counter service, tele-banking, internet banking, ATM, mobile banking, and the like. In 2007, around 10 percent of taxes (Baht109 billion) were made through the electronic payment system.

The RD web service that was initiated in 2005 has spearheaded the utilization of ICT by other users nationwide. It encourages the application of a full e-business model, in which stakeholders can electronically conduct all business transactions by providing different types of online information. In the private sector, businesses can integrate their system through web service applications to be able to verify on-line the individual tax identification

numbers of their employees and to use the online automatic personal income tax calculation to compute individual tax obligations. To avoid the use of fake VAT invoices, entrepreneurs can also check whether the issuing entities are bonafide registered persons. In the public sector, aggregate and disaggregated tax collection information is available for analysis by the core economic agencies. Other information available relates to joint ventures, foreign companies and companies granted investment promotion privileges by the Board of Investment. Also available on the RD website since 2007 is the “tax map”, which is based on a Geographic Information System. The map enables RD analysts, policymakers and other users to visualize income tax sources, disaggregated to the region, province, district, and sub-district level. For example, RD officials can use the tax map to identify areas where the tax base is expanding, and to see regional or district revenue trends over time.

The RD call center was launched in 2005.<sup>4</sup> Taxpayers can make queries ranging from general information about the RD to more specific tax law and regulations as well as status of tax refund. Taxpayer can also make complaints through call center or select other automatic answering functions such as electronic download form. At the early stage, more than 50 regular staffs from different functions of the RD have been recruited to take turn in the call center lines which receiving approximately 2,000 calls a day. Currently, the RD call center system also integrates with the RD knowledge management system where the operator can access to RD knowledge and be able to provide standardized answer and information to customers. The RD also expanded services line to meet increasing demand from 55 lines to 120 lines. In addition, the new interactive call center was launched on October 2, 2007 which allows a call operator to accept comments or suggestions using web chat with taxpayers.

### ***Public Private Dialogue***

To create a partnership with the business sector, since the year 2000 the RD has regularly set up meetings with business representatives. The objective of these meetings is to build trust, but also to listen receive feedback on RD services and suggestions on how the RD and tax system can support businesses. However, a formal structure and periodicity for the meetings was not set until 2007, when the RD consulting committee on public sector development was established. The objective of this committee is to ensure regular and organized private sector participation in the monitoring of public administration. The committee consists of representatives from the Board of Trade, Federation of Thai Industries, associations of Thai banks, and senior officials in the RD. The quarterly committee meeting is intended to surface the concerns of the business sector and there are some examples of its influence. A key area of private sector complaints was delayed VAT refunds, to which the RD responded by developing in 2007 the VAT refund monitoring system with an automatic alert if the refund was delayed beyond a specified performance deadline.

### ***Tax refunds***

Each year, the RD refunds about 15 percent of the tax it collects, and has to deal with more than ten thousand tax refund requests. Delayed tax refunds reduce the cash flow of

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<sup>4</sup> The RD call center categorize queries into nine groups including (i) tax law and regulations inquiry; (ii) request for tax registration; (iii) tax refund inquiries; (iv) electronic filing; (v) electronic form download; (vi) telephone number for other services; (vii) complaints; and (viii) inquiry in English.

businesses and impede the ability of firms to compete in the world market. The RD has cut down red tape and helped certain classes of exporters to get their tax refunds in a timely manner—down from 3 months to 15-45 days for “good” exporters, and 30-60 days for others. Claimants can also get their refunds transferred directly into their bank accounts. In addition, the RD has recently introduced VAT refund control and monitoring system which will automatically alert an officer about the delayed in VAT refund case.

To speed personal income tax (PIT) refunds, the RD started in 2001 with a revision of disbursement procedures and the criteria for approving refunds. The streamlining of work processes helped 96.7 percent of tax refund claimants (1.2 million) to receive payments within 2 months. In the following years, the RD further reduced taxpayer burdens by mailing tax refund cheques, rather than requiring taxpayers to pick them up from the tax office. In 2003, the RD developed an IT system that automatically processed tax refund requests filed on the internet and allowed claimants to print their own tax refund cheques after the system had completed an examination of the veracity of the claims. As a result, the time taken for a claimant to receive the refund fell from 1 month in 2003 to 15 days in 2005. In addition, taxpayer can also check the status of PIT refunds from the RD website. The system tells the taxpayer whether their filings have been completed, or if RD officials need additional documents for audit before approvals are given. Also, taxpayer can be informed through Short Message Service (SMS) on a mobile phone when the tax refund cheque is sent to taxpayer, or when the revenue officials need more supporting documents.

In the past three years, VAT refunds have grown rapidly. The average growth of VAT refunds (22 percent per year) was double the growth of VAT collections (11 percent). Therefore, the share of VAT refunds in VAT revenue collection has increased from 56 (1999-2004) to 70 percent (2005-2007). While the high VAT refund corresponded to high export growth, it was potentially a sign of higher levels of fraud, such as using fake tax invoices, over-invoicing export sales, or under-reporting domestic sales. Generally, pre-audits before VAT refunds are needed to minimize tax fraud. However, limited staff and extensive pre-audit processes can also cause a long delay in refunds, with all the attendant costs to firms. Therefore, the RD has improved the process by streamlining work rules and documentation, and creating registers of good and registered exporters who are exempted from pre-audits.

In 2001, the RD classified VAT claimants into three groups; Good Exporter, Registered Exporter and other VAT refund claimants. Good Exporters are those with good tax and financial records and export sales of more than 70 percent of total sales. They receive VAT refunds within 15-45 days (15 days for filing VAT returns via internet, and 45 days for filing at a revenue office). Registered Exporters are those with good tax and financial records and export sales of more than 50 percent of total sales, shall receive VAT refunds within 30-60 days (30 days for filing returns via internet, and 60 days for filing at a revenue office). For other VAT refund claimants, the refund process is longer, but cannot be more than 3 months. Although the system started in 2001, only 17 percent of exporters are qualified as Good or Registered.

With regard to streamlining work processes, the RD set up a Baht5 billion reserve fund (approximately 40 percent of monthly VAT refunds) to make advance refund payments to claimants. This helped shorten disbursement periods. In addition, the RD also set up criteria for VAT refund claimants who were not to be subjected to pre-audits. Claims of less than Baht 35,000 or those accompanied by a bank guarantee were automatically

exempted, but with the proviso that a post audit would be required. In addition, in July 2007, two new systems have been implemented to increase efficiency. The first is the VAT refund control and monitoring system mentioned earlier. The other updates the Good and Registered Exporter databases with real-time data to enable continued fast track processing.

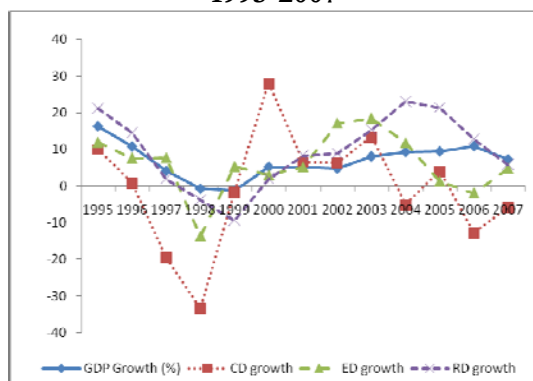
### *Tax measures to promote economy competitiveness and growth*

Although not simply tax administration reforms, certain tax policy changes had an important effect the way and speed with which the RD delivered its services to the public, especially firms. Responding to the need to promote Thailand's economic recovery, the RD has implemented various tax policy reforms to promote growth, competitiveness and equity. The key areas are (i) expanding the use of withholding taxes to gain more revenue and bringing those outside the tax net into the system (ii) abolishing VAT on small businesses (VAT registrants with revenue between Baht 60,000 to 1,200,000 used to pay VAT at 1.5 percent of total receipts) and raising the threshold for a VAT registrant from Baht 1,200,000 to 1,800,000 (iii) reducing the income tax rate for corporate income tax for SMEs and listed companies to 15-25 percent (iv) gradually increasing the PIT tax waiver from 0 to Baht 50,000 (1999); Baht 80,000 (2003); and Baht 100,000 baht (2004) (see list of tax measures implemented by the RD during 1998-2007 in Annex 1).

### *Impact of the reform*

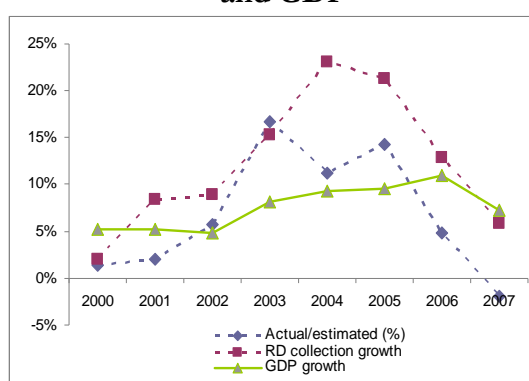
The main impacts of reforms were on revenue collection and on the time spent by taxpayers to comply with RD regulations. The set of indicators that are used to evaluate the impacts of reform on revenue collection are the growth of tax collection compared to the tax base (that is, GDP); actual relative to estimated tax collections; and revenue relative to the cost of collection. The set of indicators used to evaluate the impacts of reform on the time spent by taxpayers to comply with RD regulations are drawn from survey data collected by the RD since 2003. Each year, the RD selects the types of services for which it will streamline work processes. The survey conducted in that year assesses the average time spent by the taxpayer to receive that particular service, relative to 2003, the first year of the survey.

**Figure 2: Growth of GDP and revenue collection by the RD, ED and CD, 1995-2007**



Source: FPO, NESDB

**Figure 3: Actual revenue collection by the RD compared to estimated figure and GDP**

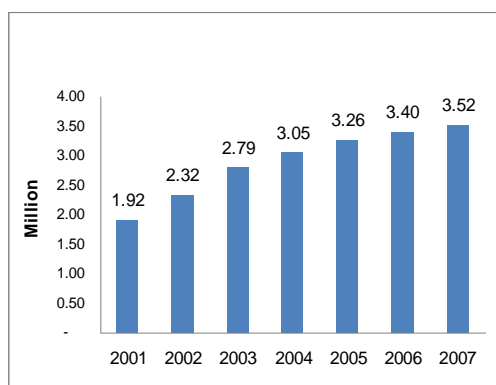


Source: RD, NESDB

There has clearly been an increase in RD efficiency and productivity in tax collection. After the implementation of several reforms during 2001-2005, including the pooled database, new supervision system, and expansion of the withholding tax system, the RD's tax collections started rising at twice the rate of growth of GDP.<sup>5</sup> It was even higher than the growth rate of revenues at the Excise and Customs Departments, by 0.5 and 3 times, respectively (see Figures 2 and 3). From 2001 to 2007, the number of CIT filings doubled and revenue increased more than 1.5 times (see Figures 4 and 5). Although, the high growth of tax collections could be attributed to the recovery of the Thai economy, it should be noted that it outpaced the growth of GDP and collections by the other tax collection agencies. Tax collections per RD employee increased from Baht23 million in 2001, to Baht51 million in 2007 (see Figure 6). Revenues relative to operational costs increased from Baht462 million in 2001, to Baht621 million in 2007.<sup>6</sup> During 2003-2006, the RD also reported that the number of taxpayers had increased by more than 850,000.

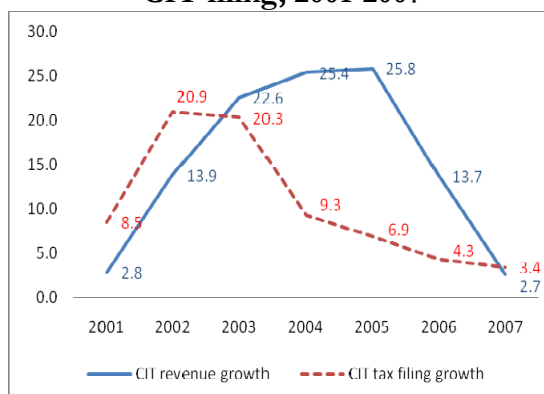
The development of ICT has helped the RD to deal with a rising demand b taxpayers for electronic services for taxpayers. Each year, the RD has to deal with more than 23 million tax returns. After implementation of electronic filing services in 2001, the number of tax filings through the internet increased by almost 2 million per year during the first three years (see Figure 7). In 2007, more than one third of tax returns were filed online.

**Figure 4 - CIT filing, 2001-2007**



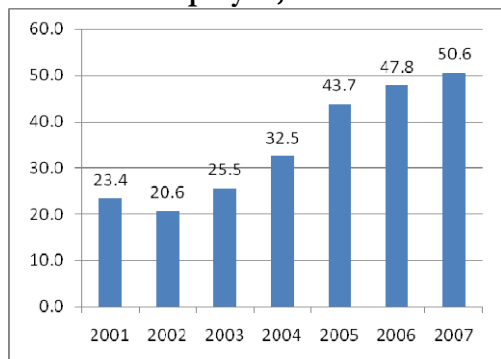
Source: FPO, RD

**Figure 5 - Growth of CIT revenue and CIT filing, 2001-2007**



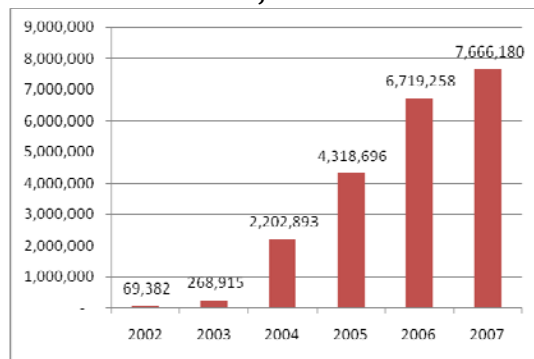
Source: FPO, RD

**Figure 6 - Tax revenue per number of RD employee, 2001-2007**



Source: Revenue Department

**Figure 7 - Number of tax filing through internet, 2003-2007**



Source: Revenue Department

<sup>5</sup> The growth of revenue collections during 2006-2007 are excluded because of special factors—appreciation of the Baht and changes in financial accounting methods—IAS 39) in those years.

<sup>6</sup> Operational costs exclude capital expenditure, for example, computer and ICT investments.

In an attempt to reduce time and cost burdens for taxpayers, the RD has upgraded its service standards for more than 60 key services delivery to taxpayers. Streamlining work processes and utilizing ICT in tax administration have helped reduce time spent on tax registration, tax refunds, and requests for copies of tax documents. Table 1 below shows the actual time taken for service delivery, with the data drawn from the RD surveys (see Table 1).

While the impacts of RD tax administration reform mentioned above have proven to increase efficiency in revenue collection and shortened time and financial costs for taxpayers, the World Bank's Paying Tax indicator in its Doing Business report for Thailand, which is available since 2005, shows that Thailand's overall rank in this area has declined from 83 to 89. As these rankings are relative to those of other economies, they suggest that despite forceful tax administration reforms in Thailand, other economies are judged to have made greater progress. This is seen, for example, in the unchanged rankings for Thailand's tax rate (37.7), time (264), and payments (35) rankings. (Table 2). Moreover, most reforms in the RD that had direct impacts on time and payments (e-filing, e-payment, etc) started in 2002, preceding the inclusion of Thailand in the Doing Business database. Also, the RD reforms after 2005 had focused on internal ICT reform (for example, TCL on-line taxpayer database, e-office service), the RD call center, tax registration, and tax refunds (especially the VAT refund which had been identified by the private sector as a major problem). Therefore, most reforms that had a powerful impact and were carried out early in the reform program are not captured in the data, especially tax refunds and tax registrations which are the main obstacles in starting and doing business for small and medium sized firms. In addition, electronic filing and electronic payments, which are measured by the number of payments in the Doing Business study, instead of in terms of time taken, do not reflect fully the amount of progress made.<sup>7</sup> For Thailand, taxpayers have greatly benefited from the reduction in time (waiting/recognition, transport, decision, payment and other time costs) as a result of the reforms. A judgment based on the Doing Business indicators alone can be faulty, unless the above considerations are kept in mind.

On the other side, another problem with the indicators is that they are based on the judgments of tax consultants, instead of actual SME taxpayers. A tax consultant will tend to underestimate the actual time spent on paying taxes, because of greater familiarity with the processes and rules than the SME, who have limited tax knowledge and a limited ability to update themselves on tax laws and regulations. Although, the indicator that measures the time taken by tax consultant may have a purpose in terms of standardization and comparability across economies, it excludes the significant time and cost burdens of SME in training and updating themselves on new tax laws and regulation. These are high in all transitional situations or in rapidly growing economies, when modernization and expansion of tax laws take place, or even when a tax regime is characterized by numerous tax exemptions.

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<sup>7</sup> The Doing Business 2008 data note states that the number of payments takes into account electronic filing, where full electronic filing is allowed and it is used by the majority of medium-size firms. The tax is counted as paid once a year, even if the payment is more frequent. (page 78).

**Table 1 - Improved Service Delivery Standards of the Revenue Department**

	Actual time taken (Average)				
	2003	2004	2005	2006	2007
<b>Registration/changes in registration/cancellation of registration</b>					
Value added tax registration	1 day	15 min			
Specific business tax registration	1 day	15 min			
Request for income tax ID/reporting of changes	1 day	10 min			
Notify change/cancellation of VAT registration	1 day	15 min			
Change/cancellation in SBT registration	1 day	15 min			
VAT Refund for Tourist Shop					
-Request for approval	30 days	5 days			
-Request for change of approved shops	30 days	3 days			
Process for canceling VAT registrant status	120 days	23 days			
Request for Tax Auditor status	30 days	13 days			
Application for ROH status	60 min		15 min		
Request for renewal of tax auditor certificate	30 days				14 days
<b>Tax related documents</b>					
Request for tax clearance certificate	3 days	16 min			
Request for copy of tax returns					
-Personal income withholding tax	5 days	1 days			
-Corporate income withholding tax	15 days	1 days			
-Personal income tax	5 days	10 min			
-Corporate income tax	5 days	14 min			
Request for certificate for tax purpose (English)	15 days		7 days		
Request for tax invoice substitutes	na			16 min	
Request for a copy of tax refund notice	na			1 days	
Request for PIT refund cheque replacing old ones	na			12 days	
<b>Tax refund</b>					
VAT refund					
(i) Good exporter					
-filing through internet	30 days	na			
-filing at local office	60 days	30 days			
(ii) Registered exporter					
-filing through internet	45 days	22 days			
-filing at local office	90 days	37 days			
VAT refund for others	69 days				16 days
Request for direct bank transfer (VAT refund)	30 days	13 days			
Request for a 'registered exporter' status	98 days				53 days
Request for a 'Good exporter' status	98 days				47 days
Request for income tax refund (if clear evidence)	43 days				20 days
<b>On-line services</b>					
Notification of changes in types of tax returns filing via internet	30 min		Upon submission		
Notification of changes in e-mail address or request for a password	30 min		Same		



	Actual time taken (Average)				
	2003	2004	2005	2006	2007
Cancellation of filing via internet	30 min		Same		
<b>Others</b>					
Request for VAT refund for tourists claim form	30 days	3 days			
Request for joint VAT filing	45 days	6 days			
Request for changes of VAT joint filing	60 days	6 days			
Request for a substitute for VAT registration certificate	15 days	6 days			
Request for use of cash registration machine	60 days	30 days			
Notifying of training participation	30 min		Upon submission		
Notifying number and names of juristic partnerships, to be audited by certified accountant	30 min		Same		
Notifying operation in jewelry trade business	90 days		6 days		
Request to purchase stamps for sale	60 min		23 min		
Request for paying personal income tax in installments	na			15 min	
Notifying the building area used	na			22 min	
Notifying building construction completion	na			19 min	
Notifying the start date for use of buildings	na			19 min	
Notifying change of building area used	na			18 min	
Notifying record keeping in electronic format	na			22 min	
Notifying operation in gold trading business	na			24 min	
Agreement on stamp purchases for sale	na			18 min	
Request for changing rate or method of depreciation calculation	na			28 days	
Request for changing accounting period or changing the last day of accounting period	na			31 days	
Request to be a R&D researcher	na			45 days	
Request for tax burden reduction during appeal process	85 days			26 days	
Request for specific business tax joint filing	45 days				20 days
Request for an approval of petrol station to be a retail business operator	60 days				23 days
Request for software house ID	45 days				22 days
Request for changing accounting method	110 days				45 days
Request for changing place of keeping records	45 days				17 days
Request for changing valuation method of goods or stock	79 days				48 days
Request for zero penalty or reduction of penalty/interest	57 days				26 days
Request for time extension of appeal filing	79 days				55 days
Request for information					
- In case where information is available at the requested office	na			22 min	
- In case where information is available at other offices	Na			45 min	

Source: Revenue Department Performance Report, 2004-2007

**Table 2 - Paying Tax indicators from Doing Business Report**

<b>Year</b>	<b>Rank</b>	<b>Payments (number)</b>	<b>Time (hours)</b>	<b>Total tax rate (% profit)</b>
2005	..	35	264	37.7
2006	83	35	264	37.7
2007	89	35	264	37.7

*Source: Doing Business Report, World Bank*

### ***Lessons learned from the reform***

An organization can reform itself by building on what it already has. Reform does not necessarily mean abolishing the existing system in order to design a new one. In fact, the RD learned that its success would come from determination and creativity in developing its existing platform. One noteworthy example was an innovation in the supervisory system. Taxpayer files in the supervision system were based on existing, although disparate, databases, and were made available to staff through the existing intranet system. The idea was to utilize existing resources to their full potential. If the RD had waited for a perfect system, it would not have made as much progress as it did.

There were three success factors in the RD reforms: the IT system, the vision and determination of managers/leaders, and human development. The RD was able to secure a sufficient budget from the government to support IT reforms. The use of IT in tax administration has boosted the RD's efficiency. Staff members at every level, around the economy, are able to access data from everywhere. In order to equip staff with the ICT knowledge required to perform their functions, there are training and change strategies in place, especially for the conversion from a paper-based culture to an intra/internet based and service-oriented culture.

Setting a long term plan (3-5 years) and strong leadership for achieving objectives have led the RD to move forward with a clearer direction and in effective manner. The fact that staff members at each level understand their responsibilities clearly and helps the organization to develop systematically and coherently, which results in a successful reform program. Strong leadership is essential in successful reform. The leadership must have vision and set a clear strategy. The leadership must also be able to develop a strategy to overcome resistance to change. For the RD, a key element was the adoption of new technologies, so it invested in training and familiarization, and applied pressure through eliminating manual processing over a number of stages.

Human development is essential for the success of a reform program. Staff must have the ability to perform their functions effectively i.e. they must have tax law knowledge, be expert in business, be IT literate, and possess a customer oriented attitude. Staff development is one of the most important factors in sustaining the reform's success. Staff need, first, to be trained to do their current jobs better. However, training is also required for selected high potential staff to become future managers of the reform and change processes, and to be able to steer the organization in response to or in anticipation of changing environments and needs. A range of training options, from on-line and short face-to-face training to degree courses are required for human development.

Apart from the three success factors as mentioned above, there were other supportive factors, such as broadening withholding tax bases, public sector reform, and exchange of information between government and state enterprises. By expanding the types of income subject to withholding tax, the base increased as well as the ability to cross check. The public sector reform has pushed most government agencies to develop themselves, which also created a competitive environment for government agencies to provide quality services to their customers. The public sector reform also promoted collaboration among government units in moving towards e-government. An example of such collaboration is the exchange of information, which has reduced the burden of the taxpayers (e.g., using the national ID as a tax ID) and increased RD's efficiency as it was able to use complementary information in its tax collection (such as geographical information, electricity usage information).

There were a few major factors that were obstacles to the reform process.

*Politics:* If an economy's politicians do not pay taxes, or try to influence the system in order not to pay taxes, voluntary taxpayer compliance can be undermined seriously. Business and individual taxpayers are more willing to pay taxes if they see that the tax is applied to everyone fairly, and that taxes are used effectively to improve public services. In the case of Thailand, as in many economies, the Government failed to improve basic infrastructure and education. The results of the Thailand Investment Climate Survey (2005)—of 1,300 firms across eight manufacturing industries—show that regulatory burdens, skills shortages, and inadequate infrastructure are the top three obstacles for doing business. On top of that, there were tax evasion scandals involving high ranking elected officials and their families. In one case, a taxpayer facing a situation on share transfers that was similar to that faced by a high ranking official was given an adverse ruling by the RD. The taxpayer raised the issue in court, claiming that the RD had applied a different standard to the situation of the influential person's case. The resolution of this case is still pending, but six executives of the RD have been dismissed so far in relation to it. While this is not an isolated example, it illustrates the difficult environment in which the RD is forced to operate.

The reform of Thai tax structure has occurred mainly through a number of tax incentives and exemptions, which somewhat contradicts the global trend towards simplifying tax system. This is partially a response to populism, as few politicians understand the adverse effects of a complicated tax system. An increasing number of tax exemptions, tax deduction and tax privileges distort resource allocation, erode the tax base, make the system become less transparent, and have increased the tax burden on those without exemptions and privileges (see details of tax measures in Annex 1). The RD has been successful in increasing its efficiency and improving services through the application of ICT in tax administration and streamlining work processes. Therefore, there is more fiscal space for the Government to reduce tax rates, but also to increase tax exemptions and even increase public spending to follow populist policies. This, in turn, has spurred the RD to further improve its efficiency in order to raise enough revenue to compensate revenue losses, which is a perverse motivation for reform.

*Staff rewards:* Increasing work pressures without appropriate reward, whether in terms of salary, promotion, or welfare, are a major obstacle to motivating staff, hence to achieving effective reforms. It is also a factor in increasing the level of corruption. The 5,000 staff newly recruited after the crisis fell by nearly a half due to increased work pressures and low remuneration compared to the private sector or other tax collection agencies such as the

Customs Department and Excise Department (the two departments derive special bonuses from catching tax cheats).

*Different levels of IT development of government organizations:* The different rate of progress in introducing ITC to different government agencies has been an obstacle for sharing information. The RD developed IT by relying on its own staff, which had the advantage of allowing continuity. On the other hand, the disadvantage of using just in-house staff for IT development when rapid strides are being made is that skills and numbers may not be adequate. Therefore, it became essential to continuously support IT staff to keep pace with the fast changing environment.

*Globalization and cross border trade and investment:* Globalization and increasing cross border trade and investment increased opportunities for tax avoidance. As the rules of international trade and investment changed rapidly, it has proven difficult for the RD to keep pace and plug existing or emerging loopholes, a problem compounded by pressure from politicians seeking to avoid taxes on their cross border activities.

*Post-evaluation of the reform:* The RD is yet to conduct an *ex post* evaluation of the reforms to measure their real impact of either reform in tax administration or implementation of tax incentives. For example, expansion of withholding tax (WHT) to almost every types of income and implementation of supervision system was widely accepted in the RD as effective tools to raise revenue collection and to broaden tax base. However, the actual impact of WHT on business sector compliance cost has not been measured. Similarly, *ex post* evaluation of the supervision system is also needed. The supervision system requires RD officials to closely monitor taxpayers before they file tax returns. While this system helps increase revenue collection and ensures that taxpayers pay tax properly while reducing costs from *ex post* audits, which can lead to high penalties and accumulated fines, the supervision system can also be misused by corrupt officials and lead to a higher burden on taxpayers.

## Annex 1: Development of Tax Administration Reform, 1998-2007

a: Revenue Collection & Efficiency	
- Large Taxpayer Office	<ul style="list-style-type: none"> <li>Set up Large Taxpayer Office (LTO) in 1999 to provide one-stop-service (advise, filing &amp; payment, audit, collecting arrears, approving refund) to 2,143 taxpayers which have revenue exceeding 500 Million Baht.</li> </ul>
-Supervision System	<ul style="list-style-type: none"> <li>Revise criteria for large taxpayers in LTO by increasing taxpayer's revenue from 500 MB to 1000 MB, and adding stock exchange listed companies; regional operating head quarters (ROH); and SOE privatization company.</li> <li>Encourage use of <b>supervision system</b> (pre-tax filing advise and monitoring system) instead of post-audit system by setting up a team to monitor taxpayers individually and using on-line intranet system to record team's comments or opinions on taxpayer's performance.</li> </ul>
-Data Management	<ul style="list-style-type: none"> <li>Develop <b>Data Warehouse</b> which is the PTT, CIT and VAT taxpayer database.</li> <li>Set up the <b>Point Of Sale (POS)</b> which is the nationwide on-line tax receipt machine which allow the RD to monitor tax revenue collection from every office at the of the day.</li> </ul>
	<ul style="list-style-type: none"> <li>Revise criterias for large taxpayers in LTO by increasing taxpayer's revenue from 1000 MB to 2000 MB, and adding international banking facilities companies; merchant marine companies; and petroleum companies.</li> </ul>
	<ul style="list-style-type: none"> <li>Develop <b>Transaction Control Log (TCL)</b> system which is the on-line taxpayer database where the official can check history of tax records, tax arrears, tax assessment, and tax refund. An official can also add comments to each individual taxpayer file. In addition, the TCL also link with other revenue collection agencies (Excise Department, Land Department, etc) and Government Financial Management Information System (GFMS).</li> </ul>

<p><b>-e-office/Intranet</b></p>	<ul style="list-style-type: none"> <li>• Develop <b>2000-2002 IT Master Plan</b>.</li> <li>• Set up the RD intranet system at <a href="http://rdsrv.go.th">http://rdsrv.go.th</a> and lotus note email for the RD officials (<a href="mailto:webmail@pasi.rd.go.th">webmail@pasi.rd.go.th</a>).</li> <li>• Increase use of internal and external data for tax collection including data from government procurement, electricity consumption, export and import from custom department, and excise tax collection, etc.</li> </ul>	<ul style="list-style-type: none"> <li>• Develop <b>e-office</b> by starting from online office correspondence documents which can store document image and retrieve document file using search tools.</li> <li>• Link corporate data from Business On-Line (BOL) from Ministry of Commerce for tax collection.</li> </ul>	<ul style="list-style-type: none"> <li>• Expand <b>e-office</b> services including (i) online-leave request (ii) motorpool online reservation system (iii) non-compliance business survey system (iv) online tax appeal monitoring system.</li> <li>• Link data with Social Security Office for tax collection.</li> </ul>	
<p><b>b: Compliance</b></p>				
<p><b>-Tax registration</b></p>	<ul style="list-style-type: none"> <li>• Match tax identification number(TIN) with personal identification number(PIN) in order to link data between Ministry of Interior and RD which can reduce documents (house registration, ID card) required for tax registration.</li> <li>• Implement on-line tax identification number nationwide (PINHIP 2000) which allow taxpayer to register or correct personal information from any tax office.</li> </ul>	<ul style="list-style-type: none"> <li>• Allow individual taxpayer to use PIN instead of TIN for filing PIT return.</li> </ul>	<ul style="list-style-type: none"> <li>• Implement on-line tax registration for VAT and CIT taxpayer.</li> <li>• Link corporate data with Ministry of Commerce to reduce documents required for CIT registration.</li> </ul>	
<p><b>-Tax filing/payment</b></p>	<ul style="list-style-type: none"> <li>• Provide <b>Tax Mobile Unit(TMU)</b> in department store during PIT filing season.</li> <li>• Increase payment window by allowing taxpayer to pay tax at post office or at bank.</li> <li>• Produce PIT return with name and address of taxpayer</li> </ul>	<ul style="list-style-type: none"> <li>• Implement <b>electronic filing (e-filing)</b> by starting with 3 types of tax return in 2001 to 15 types of tax return in 2002.</li> <li>• Set up Bureau of Electronic Processing Information to responsible for e-filing.</li> <li>• Increase payment window by</li> </ul>	<ul style="list-style-type: none"> <li>• Allow taxpayer to file and pay tax at other revenue collection agencies including Excise Department, Customs Department and Land Department.</li> <li>• Expand tax mobile units in Sunday market, department store,</li> </ul>	

	information and mail to taxpayer. <ul style="list-style-type: none"> <li>Develop employee withholding tax calculation software in order to distribute to government and private sector.</li> </ul>	allowing taxpayer to pay tax through electronic banking, tele-banking, ATM, and mobile phone. <ul style="list-style-type: none"> <li>Allow taxpayer to file tax return and pay tax at Bank counter service (in addition to filing through internet and RD office)</li> </ul>	bank, etc.	
<b>-Electronic data</b>	<ul style="list-style-type: none"> <li>Allow company which have more than 100 employees to file tax returns on behalf of its employee using diskette instead of paper.</li> </ul>			
<b>-Internet Services</b>	<ul style="list-style-type: none"> <li>The Revenue Department webpage (<a href="http://www.rd.go.th">www.rd.go.th</a>) was set up in 1999. Information on website include name of VAT registration, laws and regulation, Double tax agreement, etc.</li> </ul>	<ul style="list-style-type: none"> <li>Allow taxpayer to file tax return online (<b>e-filing</b>)</li> <li>Provide tax form download on internet (<b>e-form</b>)</li> </ul>	<ul style="list-style-type: none"> <li>Allow taxpayer to check status of tax refund online.</li> <li>Develop <b>web-services</b> including (i) checking PIN or TIN (ii) revenue collection (iii) lists of Joint venture and foreign company (iv) lists of VAT refund for tourist shop (v) lists of VAT registrants (vi) lists of CIT taxpayer (vii) list of VAT-exempted jewelry business (viii) on-line PIT calculation service.</li> </ul>	<ul style="list-style-type: none"> <li>Develop accessibility website for deaf and blind people with voice browser and screen reader technologies.</li> <li>Provide tax map as disaggregate level as province, district, sub-district using GIS technology.</li> </ul>
<b>-Call Center</b>			<ul style="list-style-type: none"> <li>Set up <b>RD Call Center</b> (02-272-8000 and 02-272-9000) with automatic call distribution to 8 types of questions (i) tax laws (ii) VAT registration (iii) tax refund (iv) electronic filing (v) tax form download (vi) telephone number service (vii) complaints (viii) services for english speaker.</li> </ul>	<ul style="list-style-type: none"> <li>Increase call center service lines from 55 lines to 120 lines and expand service to interactive call center system allowing taxpayer and RD operators to communicate through telephone, fax, and internet chat with the online knowledge management system.</li> </ul>
<b>-Public-private dialogue</b>	<ul style="list-style-type: none"> <li>Develop electronic mail (<b>e-</b></li> </ul>			<ul style="list-style-type: none"> <li>Set up <b>“the RD</b></li> </ul>

		<p><b>taxinfo)</b> to send out new tax laws, regulations, rulings to business/individual taxpayers.</p> <ul style="list-style-type: none"> <li>Set up quarterly consultative meeting with representatives from Board of Trade, Chamber of Commerce, Bank's Association, Federation of Thai Industries.</li> </ul>			<p><b>consulting Committee</b> on public sector development to ensure private sector participation in monitoring and improving public administration.</p>
<b>c: Equity, growth, competitiveness</b>					
<b>-Tax refund</b>					
<b>-Personal Income tax</b>	<ul style="list-style-type: none"> <li>Develop image processing tax refund monitoring system in order to monitor status of PTT refund.</li> </ul>	<ul style="list-style-type: none"> <li>Streamline PTT refund process (After implementation, 96% of 1.2 million tax claimants received tax refund within 2 months).                             <ul style="list-style-type: none"> <li>Change payment of tax refund from cash payment at the revenue office to mailing cheque directly to tax claimants.</li> <li>Use automatic cheque printing and signing system (after implementation, tax claimants received tax refund within 1 months).</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Streamline work process and reduce number of days to ensure that tax claimants receive refund within 15 days.</li> </ul>	<ul style="list-style-type: none"> <li>Set up the on-line tax refund status system where tax claimants can check the status of their refund on-line.</li> <li>Send SMS to tax claimants to request for additional documents or to inform status of tax refund approval.</li> </ul>	
<b>-VAT</b>		<ul style="list-style-type: none"> <li>Set up the fast VAT refund for exporter by classifying exporter into three groups : Good exporter, Registered Exporter; and other exporter. Good exporter and Registered exporter shall get tax refund within 15-45 days and 30-60 days consecutively.</li> <li>Good exporter and registered exporter who file tax return through internet can get tax refund directly transfer to their bank account instead of cheque.</li> </ul>		<ul style="list-style-type: none"> <li>Set up the real time online centralize database for approving Good Exporter and Registered Exporter status online and keeping the data of up to date.</li> <li>Set up the VAT refund control and monitoring system which have automatic alerting system to remind RD officials of delayed case and checking status of refund process.</li> </ul>	



<p><b>-Tax policies reform</b></p>	<ul style="list-style-type: none"> <li>• Tax incentives for debt restructuring, merger and acquisition, and securitization activities.</li> <li>• Waive PIT for income not exceeding 50,000 baht.</li> <li>• Reduce VAT rate from 10% to 7%.</li> <li>• Exempt of 1.5% VAT on small business which have income not exceeding 1.2 million baht.</li> <li>• Tax incentives to promote real estate business (; reduce specific business tax rate on transfer of immovable properties from 3% to 0.1%)</li> </ul>	<ul style="list-style-type: none"> <li>• Increase types of income which are subjected to Withholding Tax.</li> <li>• Reduce CIT rate for Stock Exchange Listing companies.</li> <li>• Tax incentives for Small and Medium Enterprises (reduction of CIT rate and increase initial deduction for asset depreciation)</li> <li>• Waive PIT for income 50,000-80,000 baht.</li> <li>• Tax incentives to promote second house buyer.</li> </ul>	<ul style="list-style-type: none"> <li>• Waive PIT for income 80,000-100,000 baht</li> <li>• Allow PIT allowance for taking care of parents.</li> <li>• Exemption of 1.5% VAT on small business which have income not exceeding 1.8 million baht.</li> <li>• Tax incentives to promote use of energy saving machine and new machinery.</li> <li>• Tax incentives for Regional Operating Headquarter.</li> </ul>	<ul style="list-style-type: none"> <li>• Tax incentives for replacing old machines.</li> <li>• Increase PIT allowance for mortgage interest.</li> </ul>
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## **Land Titling Reforms in Vietnam\***

Formal transfers of property are the cornerstone of a market economy and support efficiency in the allocation of productive resources. Specifically, they can promote investment through inter-firm exchanges or sales of real property, and by giving entrepreneurs access to formal credit markets, with real property serving as collateral. Land title reforms, especially, are critical components of a program to improve the investment climate in an economy. Their significance in promoting business is even greater in economies involved in a transition from collective or government ownership to private ownership. Reforms in land transfer rights have had a powerful impact in economies such as China and Vietnam, even if they were limited to user rights, rather than full private ownership of land.

This paper presents a case study of Vietnam's land titling reforms and their impact on doing business. Vietnam is a developing economy in a transition from central planning and state ownership to market allocation and increasing private ownership. The Vietnamese land titling reform experience offers crucial lessons. Among the direct lessons from implementation is the need for a set of pre-conditions for success: well-developed vision of the basic content, direction and pace of reforms, buy-in from implementing agencies at all levels, and the systematic monitoring of outcomes, preferably by the public. Broader lessons include the need for changes in the public administration mind-set to foster a "service orientation" among officials, and the need to ensure adequate levels of compensation for public servants and the right incentives to facilitate implementation of a fair system.

### ***Political economy of the reform process***

Vietnam initiated economic reforms while it was a poor, food importing economy. In 1986, it launched a major economy-wide reform—*Doi Moi* (Renovation)—which was based on the model of a market economy under state management, but with economic space for domestic and foreign private capital. In the first ten years, Vietnam focused on reforming agriculture, with an emphasis on reducing dependence on subsistence agriculture and moving toward commercial production. A major policy component was the re-allocation of land held by agricultural cooperatives to households/individuals for permanent use, without payment of a land use fee. Just three years later, Vietnam became one of the biggest rice exporters in the world, overtaking Thailand, long considered the leading food exporter in the world. More important, starting from yields that were just 50 percent higher than neighboring Thailand's, Vietnam's productivity is now almost twice as high (Table 1). As in the case of China, much of this increase in production and productivity resulted from reform of the land allocation system and the changes in incentives that resulted from a greater private stake in land.

Following the success in agriculture, economic reform efforts focused on developing Vietnam's industry and service sectors. During the following ten years of *Doi Moi*, Vietnam decided to promote industrialization and modernization, concentrating on several policies

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\* The findings, interpretations, and conclusions expressed in the study do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent, or of the government of Vietnam.

to develop missing markets, introduce competition in all economic sectors, improve business conditions, attract foreign investment, and reform the public administration system. Since 2000, the focus has been on strengthening the competitiveness of the economy, by deepening and expanding reforms that improve the business environment. Vietnam views public and private non-farm enterprises as the engines of industrialization and modernization, and has a vision of itself as an industrialized economy by 2020.

**Table 1 - Rice production/productivity of Vietnam and Thailand (1991-2007)**

Year	1991	1994	1997	2000	2003	2007
<b>Rice Production (million tons)</b>						
Vietnam	19.6	23.5	27.6	32.5	34.6	35.9
Thailand	20.4	21.4	23.5	25.8	27.3	28.2
<b>Rice Productivity (100 kg/ha)</b>						
Vietnam	31.1	35.6	39.0	42.4	46.4	49.8
Thailand	23.2	24.7	25.4	25.9	26.9	27.6

*Source: General Statistics Office of Vietnam; United States Department of Agriculture*

**Table 2 - Structure of GDP by Ownership (2003 – 2006)**

	2003		2004		2005		2006	
	US\$ millions	%	US\$ millions	%	US\$ million	%	US\$ millions	%
<b>Total</b>	21,015		22,652		24,564		26,571	
<b>State sector</b>	8,635	41.1	9,304	41.1	9,990	40.7	10,625	40.0
<b>Non-State sector</b>	10,031	47.7	10,729	47.4	11,609	47.3	12,565	47.3
<b>Foreign investment</b>	2,349	11.2	2,619	11.6	2,966	12.1	3,381	12.7

*Source: General Statistics Office of Vietnam*

The economy's industrialization started with a policy of encouraging foreign investment, investment by Vietnamese people based overseas, and the domestic private sector. This is an appropriate strategy for economies that lack a sufficient base of domestic entrepreneurs, and is one that other East Asian economies adopted successfully. The contribution of the State economic sector to the economy has fallen sharply, chiefly by transforming State enterprises into joint stock companies. Meanwhile, the contribution of the non-State economic sector is now larger than that of the State sector (Table 2). The total number of non-State enterprises has increased strongly each year (Table 3). The Government eliminated formal, legislated monopolies, and non-State enterprises are now able to participate in all economic sectors.

Political economy considerations require that a relentless search for new drivers of economic growth that will accelerate the transition to a self-sustaining, market-based economy mark each phase of economic development in Vietnam. The impetus gained from opening markets to the non-State sector has been useful in propelling Vietnam rapidly towards middle-income status. However, the Government recognizes the need for new growth drivers to consolidate these gains. The leadership have decided to focus on strengthening the competitiveness of the economy, based mainly on creating a better

environment for business, facilitating the development of small and medium enterprises (SME), and strengthening the competence of domestic enterprises.

Special attention to the development of SME is a key component of the current policy package. Vietnam has more than 120,000 SME (more than 90 percent of total enterprises); 95 percent of non-State enterprises fall in this category, and they form a powerful interest group in the reform process. In 2001, the Government issued a specific decree on supporting SME development (Decree No. 90/2001/ND-CP, 2001), in which government support focuses on easy access to land for productive purposes, and to credit, export markets, to general market information.

**Table 3 - Number of Active Enterprises by Ownership (2003 – 2006)**

	2003	2004	2005	2006
<b>Total</b>	<u>72,012</u>	<u>91,756</u>	<u>112,950</u>	<u>131,318</u>
<b>State enterprises</b>	4845	4597	4086	3706
<b>Non-state enterprises</b>	<u>64,526</u>	<u>84,003</u>	<u>105,167</u>	<u>123,392</u>
<b>Private enterprises</b>	25,653	29,980	34,646	37,323
<b>Limited companies</b>	30,164	40,918	52,505	63,658
<b>Others</b>	8,709	13,105	18,016	22,411
<b>Foreign investment enterprises</b>	2,641	3,156	3,697	4,220

*Note: SME in Vietnam are enterprises having less than VND 10 billion of capital or less than 300 employees.*

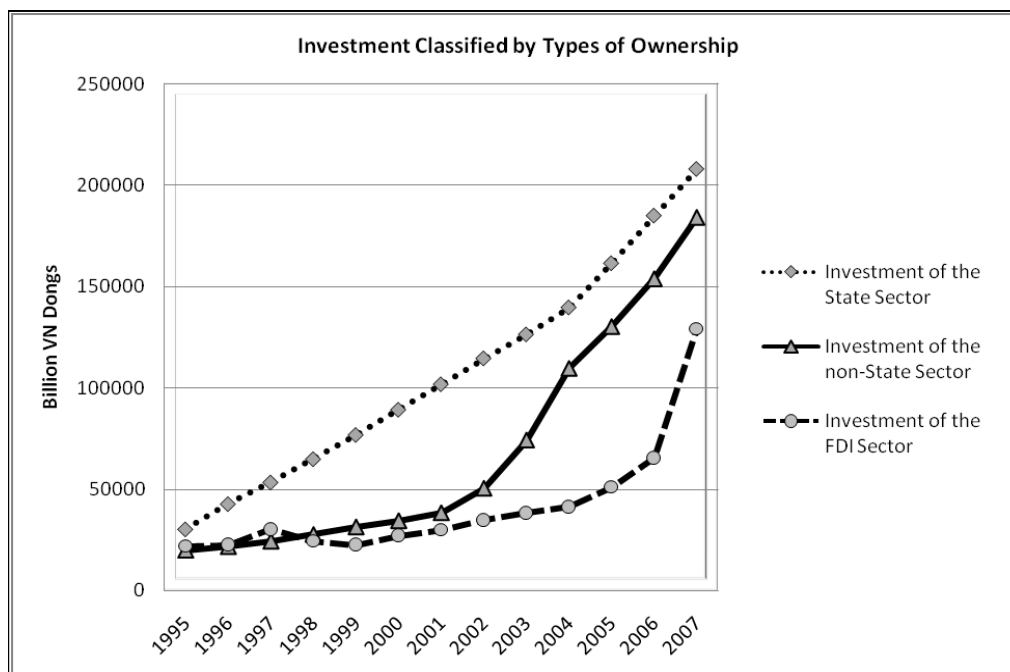
These policy directions reinforced the progress on making access to land easier for SME, and received a further boost recently by the pronouncements surrounding Vietnam's accession to the WTO (CPCC Resolution No. 08-NQ/TW). Policies on international economic integration have motivated high levels of exports from Vietnam, especially from SME; exports rose from US\$9.2 billion in 1987 to US\$17 billion in 2002 and over \$50 billion in 2008. Similarly, as shown in Figure 1, investment as a whole has been on an upsurge since economy-wide reforms took hold, State investment has grown at a steady rate while non-State investment has boomed. This is especially true since 2003, when the draft of 2003 Land Law was amended towards facilitating domestic investment. FDI has boomed since 2007, after Decree No. 84/2007/ND-CP provided relatively robust reforms of land policy for foreign investors. The link between land titling reforms and economic outcomes is visible even in the macro-data, a relationship that is rarely established as clearly in the experience of other economies. Although this is not conclusive evidence of the effect of the legislative changes, there is strong evidence from other sources of a causal link (Vo, 2008).

### ***Public administration reforms***

As described above, the imperative of rapid economic growth to meet the expectations of Vietnamese citizens for a better life was a prime mover of the reforms. Reform has become a major focus of the political system, and is continuously emphasized in the political resolutions of the Communist Party and National Assembly, and in the executive policies of the Government. Public administration reforms, which are visible to the citizenry, are needed to foster buy-in from households and opinion leaders, as well as from foreign investors. For that reason, the participation of people/enterprises in reform implementation and in monitoring the administrative machinery is very effective in maintaining the momentum of economic development measures.

Since 2000, the Government has organized a number of forums for dialogue with the business community, chiefly to learn about the difficulties and challenges facing them. The Vietnam Chamber of Commerce and Industry (VCCI) holds annual meetings with firms, in which the Prime Minister participates. The Ministry of Planning and Investment (MPI), working with the International Financial Corporation (IFC) of the World Bank Group, also holds an annual dialogue between several Ministries and enterprise associations in order to resolve promptly any generic problems raised by the enterprises. Land issues have always been a major part of the dialogue between the authorities and the domestic and foreign enterprises that participate in these meetings.

**Figure 1 - Investment Responses (1995-2007)**



Online dialogue via the internet has become an important channel connecting the State authorities with people/enterprises. The Prime Minister, several Ministries, and the PPC hold regular online dialogues with the public. The internet is used effectively to publicize administrative information, and thus it brings the State authorities and citizens closer to each other (Vo. D.H., 2007). In some recent interviews conducted with SME directors for preparing this case study, it was clear that most believe administrative and market information to be critical inputs for all enterprises. Therefore, the development of ICT and its wider application in the Government's administrative machinery is a core activity of the E-government program that is underway in Vietnam. A number of procedures for certificates/licenses/permits currently permit the use of online facilities.

Thus, Vietnam has viewed its reform of administrative procedures as an important component of the economic transformation aimed at facilitating enterprises, household and individuals in doing business, promoting transparency in markets, improving production efficiency, and boosting economic development. The major actions in this area include:

- In May 1994, the Government adopted a resolution on reforming the administrative procedures of government authorities in working with people and organizations, considered a breakthrough in administrative reform in Vietnam (Resolution No. 38-CP, 1994).
- In September 2001, the Prime Minister presented the Master Program on Public Administrative Reform (MPPAR) for the period of 2001-2010 (Decision No. 136/2001/QĐ-TTg, 2001). MPPAR defined several policies related to business environment reforms. These included administrative procedures that were simpler, clearer and standardized, the devolution of a number of procedures from state authorities to enterprises, social organizations and non-governmental organizations; introducing the concepts of one-stop mechanisms at all levels, specifying responsibilities for implementing assigned tasks and introducing inspection mechanisms to monitor dealings with people (with associated penalties), and requiring greater dialogue with civil society and enterprises.
- In 2007, the Communist Party Central Committee (CPCC) adopted a new resolution (Resolution No. 17-NQ/TW, 2007). It included a one-stop shop mechanism based on consolidating related administrative agencies and public service agencies. After that, the Government adopted an Action Plan to accelerate administrative reform (Resolution No. 53/2007/NQ-CP, 2007).

### ***The land titling reforms***

Land titling reforms fit within the broader administrative reform program of the Government. However, the reform of land administration lagged behind the State's guidelines on administrative procedure reform.

- The *first* Land Law (Land Law, 1987) described land titles very generally--land users were required to obtain a land tenure certificate (LTC) issued by the State after formal registration of land. The associated land administration system (LAS) was unchanged.
- The *second* Land Law (Land Law, 1993) focused chiefly on providing greater dynamism for agricultural production by recognizing the rights of households/individuals using land. However, the land rights of enterprises were not included (Vo D.H., Trung T.N. 2008). This Law elaborated a system for the entire economy based on a unified LTC and a few new regulations regarding land administrative procedures. Enterprises had only one way to access land—through land leased from the State—and they were given the right to transact properties attached on land, but not the land itself. Moreover, state enterprises received higher priority on land acquisition than private enterprises, and domestic enterprises received higher priority than foreign enterprises. At that time, there were three possibilities for land-related transactions: (i) Applications for land leasing by the State for investment projects, (ii) Applications for selling-buying properties attached to land, including land lease rights, and (iii) Applications for sub-leasing land in industrial zones to improve technical infrastructure.
- The *third* Land Law (Land Law, 2003) completed the process of reforming land policy (Vo D.H., Trung T.N., 2005). First, this Law instituted equitable rights and obligations on land between State and other domestic enterprises, and equitable economic benefits on land use between domestic and foreign investors. Second, mechanisms for land acquisition by the State were restricted. Instead, the Government promoted access to land through transfers, leases, and land contributions by users as

their capital contributions to investment projects. Third, all procedures were initiated simultaneously, including land allocation/leasing or recovery by the State, the issuance of titles, permits to modify land use purpose, transfers, leases, donations, inheritances, mortgages, and contribution as capital. Fourth, the Law centralized registration in Land Registration Offices (LRO), a type of public service agency.

The fact that all government agencies launched administrative reforms under a national policy facilitated land titling reforms. The one-stop mechanism is the most visible institutional manifestation of this, introduced all the way from the central to the communal level, and by every relevant agency of the Government. However, there is still need to reform administrative procedures within the many agencies. Many local authorities have set up one-stop shops that consist of clusters of officials authorized to deal with the procedures of all related agencies, but without the participation of the individuals/enterprises who request services.

The Ministry of Natural Resources and Environment (MoNRE) considers this mechanism appropriate for simple services. For complex services, however, there is need for a flow of documents through the many related specialized agencies. MoNRE and the Ministry of Finance (MoF) have, for example, issued an inter-ministerial circular on moving cadastral documents from land registration offices to tax authorities to determine the fees and payments involved in the process land administration process. Investors normally interact with several different administrative authorities (such as the Department of Planning and Investment (DPI) for investment registrations or investment approvals, Department of Construction (DoC) for construction design approvals, Department of Natural Resources and Environment (DoNRE) for the application of land allocation/leasing and environmental impact assessments, and the Department of Tax (DoT) for paying financial obligations. Enterprises needing to conduct real-property transactions must visit the Notary Office (NO), LRO for land not attached with dwellings or DoC for land attached with dwellings. There is, therefore, substantial complexity in the system. Coordination among the agencies as well as internal procedures within the agencies needed reform to achieve the desired levels of efficiency.

### ***Implementing land titling reform at local levels***

When the Land Law 1993 became effective, the Provincial People's Committees (PPC) were in charge of promulgating specific regulations on registration of land and attached properties as well as on construction permits. Implementation of the regulations varied greatly, depending on the characteristics of each province as well as its leaders. Most provinces designed their own documents, procedures, and corresponding fees/charges, but seldom stated the period for completing each procedure. Some of larger cities specified deadlines, but seldom adhered to them. In several provinces, un-specified "off the book" regulations caused difficulties. There were many relatively large expenses required by custom (but not legally stipulated), such as fees for local infrastructure development requested by People's Committees at the district and commune level where the projects were to be located. The cost of land transactions—both formal and informal—was high

Since 2001, the Government has pressed local authorities to reform administrative procedures in general, and land administrative procedures in particular. This did not prove to be as difficult as expected, as all provinces have found that promoting investment in the industrial sector can accelerate provincial growth. Because of inter-provincial competition,

they have often extended preferential treatment to attract investment. Most provinces in the focal economic regions promote “red-carpet” policies for investors. The simplification of procedures for land allocation/leasing has proven to be a very effective preferential instrument for attracting investment.

After the Land Law 2003 came into effect, legislation required concrete procedures for land allocation/leasing, and for the registration of land. In addition, PPC's were made responsible for promulgating specific regulations adapted to local conditions. However, MoNRE carried out an inspection of Land Law implementation in 2005. It found that only 14 of 64 provinces in the focal economic regions had issued specific regulations regarding the procedures for land allocation/leasing, changes in land use, and land recovery. Consequently, since 2007, the Government has accelerated the introduction of the one-stop shop mechanism. To date, almost all provinces and districts have a one-stop shop mechanism for land administration (LA). In provinces with large numbers of investment projects, DoNRE has applied quality control models for LA procedures, following the ISO 9001:2000 standards. In some active provinces, DoNRE has even applied “Bar Code” technology in dealing with LA procedures, which allows service requesters to know where and by whom their files are being processed.

The current LA system in Vietnam is based on a decentralized scheme, operating at four levels. MoNRE is only responsible for the development of land legislation, and the guidance and inspection of the implementation of land legislation. Provincial People's Committees have full authority on land issues related to organizations, district People's Committees have full authority on land issues relating to individuals and households, and commune People's Committees are in charge of monitoring current land use and the implementation of land legislation. Therefore, only province and district level officials can process land administration procedures. Unfortunately, many local authorities make mistakes in performing LA tasks due to capacity constraints, lack of awareness of their responsibilities to the general population, or intentional harassment. MoNRE applies two measures in attempts to fix these weaknesses: one is the annual inspection of the implementation of land legislation at local levels, and the other is organizing a dialogue with citizens and enterprises to obtain feedback on implementation. During 2004-2007, these two measures have proved to be useful in addressing mistakes made by local authorities, and in enhancing the efficiency of the local machinery.

Several institutional, social, and political difficulties associated with the implementation of land titling reforms are worth noting.

- *First*, due to historical complexities access rights to land have always been a complicated issue in developing and transitional economies. In particular, inadequate awareness on the role of managers in LA systems is a major problem in the latter. In the previous regime of collective ownership and centralized planning, the State's allocations of land was seen as a grant, while in the market economy land allocation with land use fees is seen as an arms-length market relationship. In the latter system, administrative authorities simply deliver land registration services according to legal regulations. However, large parts of the land administration bureaucracy continue to act according to the old ways. Delays in adopting this new view of administration leads to difficulties in moving most land registration procedures from an administrative agency framework to one that operates like a public service agency. In Vietnam, although land registration offices have been established in the new mode, many offices



continue to retain older responsibilities and land files, thereby making land reform procedures more complex than necessary.

- *Second*, as in many other economies, the administrative relationships between ministries are unclear, and ministries often compete for administrative power. For example, the Vietnamese tax authority maintained its own cadastral records before 2004, rather than relying on those issued under LA authority. Under present arrangements, an inter-ministerial agreement between MoNRE and MoF is used to address this problem. Similarly, there are two land registration systems: the first for land attached with dwellings under the authority of Ministry of Construction (MoC), and the second for land without attached dwellings under the authority of MoNRE. In November 2007, the Vietnam National Assembly adopted a resolution on setting up a unified real property registration system (Resolution 07/2007/QH12, 2007), but it is yet to be implemented.

- *Third*, in developing as well as transitional economies, with increased industrialization and urbanization, land prices usually tend to increase drastically. Rapidly increasing land prices usually induce corruption in LA procedures, thus impeding land allocation decisions. Perversely, the ability to transfer land titles easily may contribute to rapid price escalation and, if monetary and other conditions are loose, may assist in creating asset bubbles in property. Clearly, this is a phenomenon affecting not just Vietnam, as seen in the recent property speculation witnessed across East Asia, where economic growth and wealth creation has been rapid. The ability to transact land in the same way as other commodities is, thus, a double-edged sword, one that is essential for rapid economic development but also the basis for increasing complexity in economic management.

### ***What was the outcome of land titling reforms?***

This section discusses some of the results of the reforms to improve access to land that Vietnam introduced in its transition to a mainly market-based economy. The discussion is in three parts: an evaluation of pre- and post-2004 land registration procedures, the status and impact of current legislation and its implementation, and enterprise perceptions of the ease of doing business within the current land administration system.

#### ***Pre- and post-2004 procedures***

As mentioned above, after 2004 the new Land Law and Construction Law focused on the Central Government promulgating detailed administrative procedures and guidelines for implementation, the creation of public service agencies, review and subsequent elimination of redundant or inefficient procedures, and introduction of the one-stop mechanism for land transactions. The main obstacles in achieving the goals of the reform process came from two groups—officials involved in implementing the procedures, and leaders at the district and commune levels.

For this case study, surveys of changes between pre- and post-2004 procedures were conducted in five central cities - Ha Noi, Hai Phong, Da Nang, Ho Chi Minh, and Can Tho. The surveys covered administrative procedures for (i) land allocation/leasing from the State for implementation of investment projects, together with those for land recovery, compensation and site clearance; (ii) land transfers; and (iii) construction permits. The findings are summarized below:

*(i) Land allocation/leasing*

Before 2004, there were almost no regulations in the Land Law regarding procedures for land recovery and land allocation/leasing, which were issued by Provincial People's Committees (PPC). Each province had its own specific administrative procedures. However, motivated by the need for more rapid economic growth and economic competition with other provinces, some elements of standardization began appearing during 2001-2004, with differences mainly in the number of supporting documents required by each province and the time it took to meet all requirements. In general, the procedures were enough complex and investors needed several face-to-face contacts with several administrative authorities at provincial and district levels to obtain access to land. Enterprises faced great difficulties in get inter-ministerial agreements on land prices and terms.<sup>1</sup> In practice, investors usually had to go through additional informal procedures and make large informal payments to People's Committee at all levels (sometimes classified as voluntary contributions for local infrastructure development).

After 2004, although the procedures are better defined, they are complex, essentially reflecting complicated relationships among State actors, investors, and current users of land. Nevertheless, if land is available with the State (that is, no land recovery is required), the number of procedures has fallen to 9, it takes about 57 days to complete them, but the financial costs have increased.<sup>2</sup> In cases where there is a need for land recovery, the average number of procedures is 30 and it takes about 319 days to complete, but at the same cost as above. In practice, enterprises still have to pay large informal payments to local People's Committees.

*(ii) Land transfers:*

Before 2004, the legal framework for property (including land) transfers was defined in the Civil Code of 1995. The procedures were not very complex, but the transferor/transferee needed to have direct contacts with several administrative authorities at the provincial and district levels. The total number of procedures was 8, and they took 14 days to complete at a cost of VND 20,000 for the cadastral fee and 1 percent of value of the transferred property for the registration fee.<sup>3</sup> In practice, the procedures took longer to complete because of the nature of the administrative machinery.

There has been noticeable improvement in the procedures for transferring property. The number of procedures has fallen to 4, and it takes about 11 days to complete them. The current costs are estimated to be 0.7 percent of the value of the transferred property (0.15 percent for the transfer document appraisal fee, 0.5 percent as a registration fee, and about 0.05 percent for the notary and cadastral fee)<sup>4</sup>. These indicators compare very favorably

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<sup>1</sup> On average, the number of procedures was 16, it took 149-159 days to complete the formal procedures at a cost of VND 100,000 for LTC issuance fee and VND 500/1m<sup>2</sup> for cadastral mapping charges. Enterprises were required to pay land use/leasing fees for transfers of land from the State according to the price of the land, as defined by the PCC.

<sup>2</sup> VND 1,000/sq.mt. for land allocation/leasing document appraisal fee, VND 500/sq.mt. for cadastral survey fee, VND 10,000 for cadastral fee, VND 100,000 for LTC issuance fee. Firms also need to pay land use/leasing fees according to the market price of land, as payment for land transfers from the State.

<sup>3</sup> In addition, the transferor/transferee had to pay 2-4 percent of the value of the transferred property as a transfer tax.

<sup>4</sup> The transferor pays a 25 percent income tax on the income generated by the transferred property.

with the OECD average (4.7 procedures, 33.3 days, and a cost equivalent to 4.5 percent of the property value).<sup>5</sup>

*(iii) Construction permits*

Before 2004, PPC was also responsible for issuing the procedures for construction permit. In general, the procedures were complex. Investors needed to prepare numerous documents related to construction planning, location, and design, and needed to handle these directly with several administrative authorities. There was an average of 8 procedures, which took 72 days to complete, at a cost of VND 1-3 million for the construction planning certificate fee, VND 10,000 for the cadastral charge, and 2.5 percent of the notional construction costs. Investors also incurred the following costs: 0.5 percent for the investment project appraisal fee (but not exceed VND 45 million), 1 percent for the technical design appraisal fee (but not exceed VND 114 million), 1 percent for the notional budget appraisal fee (but not exceed VND 114 million). In practice, the procedures took much longer because of the complexities involved and the need for direct contact with officials.

After the National Assembly approved the Construction Law, the time taken to receive construction permits fell sharply. However, there is a curious situation between the legislative frameworks for land and for construction—in the land legislation, land allocation/leasing decisions occur after project promoters have approvals for the general design of construction projects, but in the construction legislation, the general design of construction projects can only be approved after receiving a decision on land allocation/leasing. After 2004, although the number of procedures remained at 8, the time taken fell to 47-52 days, at a cost of VND 10,000 for the cadastral fee, VND 100,000 for the construction permit fee, 1-2 percent of notional construction costs as a construction fee.

***Status and impact of current legislation***

Enterprises in Vietnam can obtain land in two ways: (i) land allocations/leases from the State when the authorities issue an administrative decision to recover land from existing users and reallocate it to enterprises upon payment of a land use/lease fee; and (ii) via land transfer, land lease or in-kind capital contributions by existing land users (market methods). Before 1998, domestic enterprises and foreign investors could only access land by the State but not through the market (Land Law, 1993). From 1998 to 2004, domestic enterprises and foreign investors could access land by the State, and the State delegated the right to domestic enterprises to access land from the market (Law on amendment and supplementation of some articles of the Land Law, 1998). From 2004 to 2007, domestic enterprises could access land from the market for all types of projects, but could only access land from the State for the construction of industrial zones, urban zones and big investment projects). Foreign investors (with 100 percent foreign capital) could only access land from the State (Land Law, 2003). After 2007, access to land of domestic enterprises has remained unchanged, whereas foreign investors have been able to access land by the State as well as the market (Decree No. 84/2007/ND-CP, 2007).

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<sup>5</sup> Doing Business 2008, World Bank Group, <http://www.doingbusiness.org/ExploreEconomies/?economyid=202>

It can be seen that the current land legislation of Vietnam provides several options for enterprises to access land, and administrative procedures regarding access to land have been specifically regulated with respect to the content of documents, responsibility of authorities, timeframe for approval, and fees/charges/taxes. However, there are still several difficulties in accessing land:

- Although large domestic enterprises and foreign investors have the right to access land from the Government, there are three major obstacles. The Government has not provided details on locations. Administrative procedures for land recovery are very complicated and time consuming, since land compensation is usually judged inadequate, leading to complaints and lengthy negotiations. Finally, informal contributions to local People's Committees are still required.
- SME usually have only one way to access land from existing land users (land transfers, land leases or in-kind capital contributions). Although the administrative procedures have eased, finding land at affordable prices has become difficult because of the property boom and rates of alienation of land that are well below the increases in demand for commercial uses .
- Foreign investors are unable to access land from individuals/households, which accounts for a differential effect on their balance sheets..
- SME involved in joint ventures with foreign enterprises have very limited access to land, that is, through projects transferred from other investors.

Obstacles of the nature described above are refinements to the current Land Law that need to be addressed to complete the reforms on access to land that will improve the business environment, especially for SME. In addition, contradictions among the land, construction and housing laws, which were described briefly in the preceding section, need to be addressed to foster efficient development of the market for real estate.

In addition to procedural obstacles, there are problems in implementation. The 2005 inspection by MoNRE focused on broad implementation of the Land Law 2003. But, for the 2006 evaluation, specific assessments were made of "pending plans" (plans that had been approved but not implemented), "pending land recovery" (when the land compensation process for site clearance was incomplete), and "pending projects" (investors had received land use approvals but had not started their projects). An analysis of the reports from these inspections (Report No. 165/CP-NN, 2005 and Report No. 32/BC-CP, 2006) showed, first, that there are still inconsistencies in the land legislation system because the authority for land administration is fragmented. Further, some components within different pieces of legislation (pertaining to construction, housing, real estate development, investment, civil code, taxes, and the like) needed to align with each other. A major implementation issue was that although land use planning undergirds the Government's allocation/leasing decisions, many localities are yet to develop high quality plans, or any plans at all. At end-2006, 1,649 planned zones, with a total area of 344,665 hectares, were classified as "pending planning". The implementation of land recovery, compensation and resettlement needs improvement, mostly due to unclear and incomplete administrative procedures and inadequate land compensation. At end-2006, there were 1,288 projects, with a total area of 31,650 hectares, classified as "pending land recovery". Finally, in many localities the procedures for earmarking the location of land for investment projects are complicated and opaque, the quality of investors is inadequate in terms of their ability to implement projects, and many capable investors were rejected. This accounted for the 1,206 projects, covering an area of 132,463 hectares, classified as "pending projects". The

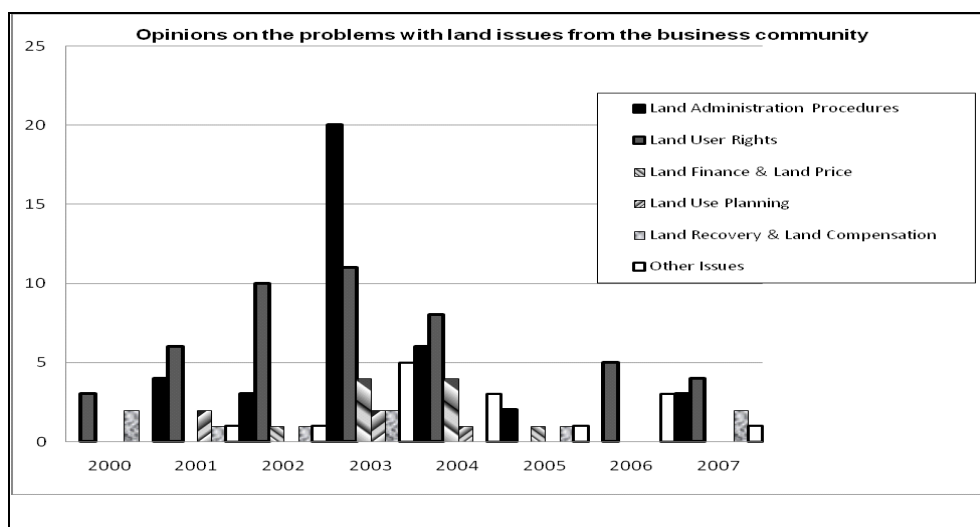
National Assembly of Vietnam had conducted its monitoring of land use planning at the end of 2005 and on issue of land title certificates at the end of 2007. Based on the findings above and these other investigations, it adopted a Resolution to develop a unified registration system for real properties in 2008, including land and properties attached to land (Resolution No. 07/2007/QH12, 2007).

The nature of land administration-related complaints, monitored by MoNRE and the Government Inspection Agency, provides an alternative view of implementation. Land complaints are always a hot issue that threaten the social sustainability of development processes everywhere, and limit access to land by enterprises. Due to the large number of cases classified as “pending land recovery”, many enterprises have no land for project implementation, despite having made substantial outlays for land compensation. At end-2006, 70 percent of the 17,000 land complaints focused on land recovery, land compensation and resettlement, *of which* 70 percent were on land price appraisals (Vo D.H., 2008). Clearly, the poor land valuation system that exists in Vietnam today has obstructed enterprise access to government land.

### *The perceptions of firms*

As mentioned earlier, MPI and IFC have been holding annual business forums to obtain the views of firms on land legislation, as well as applications of regulations at local levels. Figure 2 collects responses for the period 2000-2007 and shows the concentration of areas where firms expressed their concerns. Consultations on the draft Land Law 2003 yielded the highest level of responses, which focused on administrative procedures. Improper land user rights have also been a cause for concern among firms. During 2005, problems with land do not seem to have been a large concern, but they re-emerged in 2006 and 2007. The explanation seems to lie in the inability of the legal system in general, and land legislation in particular, to keep up with evolving development needs. The Land Law 2003, while useful, was suitable for a short period, until Vietnam became a member of the WTO in 2005. It entered into a series of bilateral and multilateral commitments for improving its business environment, because of which the existing land legislation began to constrain the economy’s international economic integration.

**Figure 2 - Firm-level Perceptions**



Since the adoption of the Land Law 2003, the opinions of SME on land issues have also been posted in the leading newspapers in Vietnam.<sup>6</sup> In addition, two conferences organized by MoNRE in Hanoi (30<sup>th</sup> September 2005) and Ho Chi Minh City (19<sup>th</sup> October 2005) provided additional views. Both sets of opinions fall into five categories: difficulties in access to land for business purposes, complicated land administrative procedures, excessively high market prices for land, uncoordinated land legislation and legal documents; and other opinions. These surveys showed that nearly half the firms found complicated administrative procedures to be a significant constraint, with land allocation/lease/transfer and difficulties in land recovery procedures accounting for the most difficulties. This was followed by concerns about high land prices, chiefly land lease prices and land compensation costs

### ***Conclusion***

The reform of public administration has been an indispensable part of the economic development of Vietnam, with the primary aim being to expand the private sector and enhance its contribution to economic development. Such reforms are also required for developing economies and transitional economies in their international economic integration. The practical implementation of reforms of land administration in Vietnam demonstrate that the proposed strategy and measures need to be stated clearly and definitely in the core national documents on policy, and all levels of leadership need to be educated on its ramifications. Redundant and outmoded laws and regulations need to be eliminated relentlessly. However, successful reforms depend not just on modernizing and strengthening legislation. The most critical success factor is the ability to change the mindset of administrators toward service delivery, and for this to be successful there is a need for tough anti-corruption measures as well as coordinated salary reforms. Close monitoring and continuous evaluation are needed, and tapping the opinions of the public offers an effective means of implementing robust schemes for M&E. Quantifiable indicators of performance and the use of modern IC technologies need to be integrated into the reforms. There have been large benefits from land administration reforms in Vietnam, with SME and foreign investors gaining the most.

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<sup>6</sup> They included Vietnam Net, VNExpress, Labour, Youth, The Communist Youth, Economic Times, Business Forum, and Saigon Liberation.

### ***Key legislation and references***

1. Decision No. 136/2001/QĐ-TTg dated 17<sup>th</sup> September 2001 of Prime Minister issuing the Master Program on Public Administrative Reform in the period of 2001-2010.
2. Decree No. 90/2001/ND-CP dated 23<sup>rd</sup> November 2001 on supporting SME's development.
3. Decree No. 84/2007/ND-CP dated 25<sup>th</sup> May 2007 of the Government stipulating additional rules on LTC issuance; land recovery; implementation of rights on land use; procedures for land compensation, support, resettlement while State recovers land; settlement of administrative complaints about land
4. Land Law 1987, adopted by the VIII National Assembly in the second session on December 29<sup>th</sup>, 1987
5. Land Law 1993, adopted by the IX National Assembly in the third session on 14<sup>th</sup> July 1993.
6. Law No. 10/1998/QH10 dated 2<sup>nd</sup> December 1998 on Amendment and Supplement of Land Law
7. Law No. 13/2003/QH11 dated 26<sup>th</sup> November 2003 - Land Law
8. Political Document of the Mid-Term Session of VII Vietnam Communist Party Congress (20-25 January 1994).
9. Resolution No 38-CP dated 04<sup>th</sup> May 1994 of the Government on reforming administrative procedures of government authorities in working with people and organizations.
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