

Subnational Reform in Business Regulatory Framework

Experiences and Challenges in Select Indian States

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ACRONYMS

AP	Andhra Pradesh
AAFIR	Appellate Authority for Industrial and Financial Reconstruction
BIFR	Bureau of Industrial and Financial Reconstruction
CAF	Common Application Form
CII	Confederation of Indian Industries
CLB	Company Law Board
DIC	District Industries Centre
EOUs	Export Oriented Units
FDI	Foreign Direct Investment
GNI	Gross National Income
GoI	Government of India
GO	Government Order
IDA	Industrial Disputes Act
KIFB	Karnataka Industries Facilitation Bill
MOEF	Ministry of Environment and Forests
NCLT	National Company Law Tribunal
OSS	One-Stop Shop
PAC	Public Affairs Centre
RBI	Reserve Bank of India
SEZs	Special Economic Zones
SICA	Sick Industry Companies Act
SIDBI	Small Industries Development Bank of India
SPCB	State Pollution Control Board
SMEs	Small and Medium Enterprises
SWAs	Single Window Agencies
SSI	Small Scale Industry
WB	World Bank
WTO	World Trade Organization

IMPROVING THE INVESTMENT CLIMATE FOR HIGHER AND SUSTAINED GROWTH EXPERIENCES IN BUSINESS DEREGULATION IN SELECT INDIAN STATES

Abstract: *Research has demonstrated the importance of good investment climate and governance for sustained and higher economic growth, which in turn contributes to poverty reduction. The quantity and quality of investment flowing into India or any other country depends upon the returns that investors expect and the uncertainties around those returns. These expectations are guided by three broad and interrelated components that shape these expectations – macroeconomic framework, regulatory environment and quality of infrastructure. This paper reviews the progress made by India’s five leading states in improving the micro-level regulatory policies concerning entry, exit and operation to facilitate private sector led growth. It is too early to assess the impact on investment climate of the business deregulation measures initiated in some Indian states; however, there are interesting lessons that India can share across the states. The paper concludes that improving governance and streamlining complex regulations over business entry, exit and operations are institutional in nature and thus complex and time-consuming. However, this remains a critical part of the larger effort to improve the investment climate, and one that requires focused policy attention and implementation.*

1. **Objective.** Research has demonstrated the importance of good investment climate and governance for sustained and higher economic growth, which in turn contributes to poverty reduction.¹ India’s regulations of entry, exit, and operations are complex and non-transparent. There have been various investor surveys that ranked the number one constraint to investment and growth as excessive bureaucratic interference in business operations (for example, PAC, 1999). This paper reviews recent reform experience of selected Indian states in improving governance and streamlining complex regulations over business entry, exit and operations in industry and services, and to draw lessons relevant to the Bank’s strategy in helping advance reforms in these critical areas of investment climate.

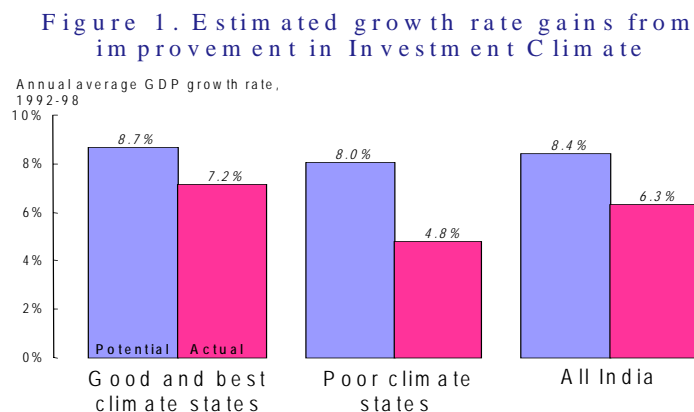
2. **Structure of this paper.** Section I summarizes key issues concerning business regulation and empirical findings on the linkages between investment climate and growth. Section II analyses the broad regulatory framework related to starting, operating and closing a business in India. Section III focuses on the quality of governance and institutions; more particularly concentrate on the administrative and regulatory structures which enable or disable private sector investment in five Indian states – Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. These states have been chosen due to the following factors: (i) leadership in industrialization and enterprise in India with these five states accounting for almost 50% of total industrial output; (ii) better business environment among Indian states as demonstrated by the first investment climate survey of the World Bank and the Confederation of Indian Industries (CII) (2002) (referred to as the WB-CII survey), although significant improvement is required; (iii) consistently the top five recipients of new investments – both domestic and foreign – in India²; and (iv) relatively better physical and social infrastructure. In this context, the paper will describe key regulatory issues in these states and summarize recent reform efforts related to streamlining of business regulations in entry, exit and operation and the importance of public and private sector partnership. Section IV summarizes lessons learnt.

¹ World Bank and Confederation of Indian Industries, 2002.

² Excluding Delhi, where most foreign investors often register their main office in India but set up manufacturing bases in the other states.

I. INVESTMENT CLIMATE AND GROWTH

3. Research and empirical evidence have demonstrated a strong link between investment climate and growth. Based on the research done by the World Bank and the Confederation of Indian Industries (2002 and 2003b), if each Indian state could attain the best practice in India in terms of regulation and infrastructure, the economy should grow about 2 percentage points faster. The gains would be particularly large in the poor climate states (an extra 3.2 percentage points of growth), reflecting the fact that the move from their current state to the best practice in India would be a large improvement. But even in the better climate states there is significant room for improving the investment climate in particular areas: moving to the best Indian practice would add 1.5 percentage points to the growth rate for these states (Figure 1). If India could achieve Chinese or Thai levels in distinct investment climate areas its growth acceleration would be even more dramatic. While the specific estimates have some uncertainty around them, the general point is quite robust: removing bottlenecks that prevent efficient infrastructure services and private initiative more generally would lead to faster growth and poverty reduction in India.



4. What is meant by the “investment climate”? The quantity and quality of investment flowing into India or any other country depends upon the returns that investors expect and the uncertainties around those returns. It is useful to think of three broad and interrelated components that shape these expectations (World Bank-CII report, 2002).

- *First*, there are a set of macro or country-level issues concerning economic and political stability and national policy towards foreign trade and investment. By these, we generally refer to macroeconomic, fiscal, monetary, and exchange rate policies as well as political stability.
- *Second*, there is the issue of efficacy of a country’s regulatory framework. As far as firms are concerned, these relate to the issues of entry or starting a business, labor relations and flexibility in labor use, efficiency and transparency of financing and taxation, and efficiency of regulations concerning the environment, safety, health, and other legitimate public interests. The question is not whether to regulate or not, but whether such regulations are designed in incentive compatible ways, avoid adverse selection and moral hazard, serve the public interest, are implemented expeditiously without harassment and corruption, and facilitate efficient outcomes. While such variables are hard to measure, our surveys clearly suggest that regulatory efficacy varies widely across countries and, as far as India is concerned, across states.
- *Third*, and no less important, is the quality and quantity of available physical and financial infrastructure, such as power, transport, telecommunications, and banking and finance. When one surveys entrepreneurs about their problems and bottlenecks, they will often cite

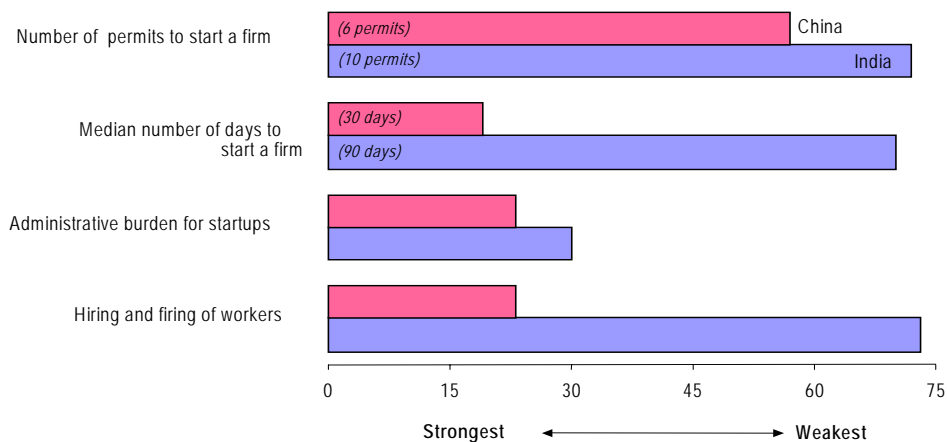
infrastructure issues such as power reliability, transport time and cost, and access and efficiency of finance as key determinants of competitiveness and profitability.

5. The primary concern of this paper is one critical element of the investment climate—the regulation of entry, exit and operation of businesses.

6. It has been demonstrated that easy business entry and exit improve productivity gains. A research on entry/exit and productivity change in Chile (Liu, 1993) concludes that the forces of competition discriminate against less efficient producers. Average technical efficiency levels are higher among the surviving and new entrants than among exiting plants. The gap in productivity between surviving and exiting plants and between exiting and entering plants has widened over time; while the gap between surviving and entering plants has narrowed. Moreover, entering plants have improved their productivity. Although the economy-wide recession in Chile in 1982-1983 affected the productivity of each cohort to different degrees, there were increases in productivity after recession, reflecting both the replacement of inefficient producers by efficient ones and the improvement of productivity by entrants. This suggests that microeconomic policies that removed all distortions are effective in discriminating between inefficient and efficient producers.

Figure 2: Entry and exit in India and China

Ranking out of 75 countries surveyed in the Global Competitiveness Report 2001



7. As summarized by the World Bank report (2002), for firms to be able to innovate and to take advantage of new opportunities, it is important that entry and exit procedures are complemented by the smooth workings of factor markets. The movement of labor and capital from less productive activities to more productive ones is central to realizing the benefits of greater competition and openness. For India, significant challenges remain in these areas. As demonstrated by Figure 2 above, comparing with China, India firms take longer time to acquire approval for setting up a new business. Further, the excessive regulation of industrial relations is often singled out as one of the reasons why India is not doing as well as it should in terms of the growth of its exports. The restrictions on the hiring and firing of workers is identified as one of the greatest challenges of doing business in India according to the Global Competitiveness Report – India ranks 73rd out of 75 countries (China ranks 23rd). In the CII-WB survey, the typical firm reported that it had 17% more workers than it desired and that the labor laws and regulations were the main reason why it could not adjust to the preferred level. These regulations are a key reason why firms are reluctant to take on new employees. Besley and Burgess (2002) also identified labor regulations as a key factor in the pattern on manufacturing development in India and have been a constraint on growth and poverty alleviation.

8. Based on the investment climate rankings of Indian states (WB-CII, 2002 and 2003), an ICRIER study (2004)³ estimated multilateral total factor productivity (TFP) indices for the total registered manufacturing sector in all the major states for the period 1980-2000. It concluded that investment climate clearly matters for TFP. For instance, the percentage of the management's time spent with government officials of regulatory and administrative issues is negatively associated with TFP. Further, mandays lost in industrial disputes has a negative association with TFP. On the other hand, the variables representing the availability of power for industrial use and disbursement of credit in various state industries are found to exert a positive influence on TFP. In essence, a market friendly investment climate is essential for achieving higher level of TFP. This conclusion is robust and unaffected by the choice of investment climate indicator.

9. Another telling indicator of how competitive the markets are in a country is to look at the productivity dispersion of firms within an industry that operate there. Firm level studies in several countries indicate that lower productivity dispersion is associated with increased openness and greater competition with foreign firms. The investment climate assessment of the manufacturing sector undertaken by the World Bank concludes that there is considerable productivity dispersion in India (World Bank, 2002) due to slow exit of inefficient firms and entry barriers to dynamic new firms.

II. REGULATION OF BUSINESS ENTRY, EXIT AND OPERATIONS IN INDIA

10. Since India's independence in 1947 and before the reforms in the 1990s, India had adopted a command and control approach to development. Apart from regulating external trade and exchange rates, the government nationalized various productive activities. Further, a highly complex regime was set up to regulate industrial activities through licensing control, reservation of many productive activities to the public sector, and control of labor markets, prices, and wages. Liberalization in the 1990s has significantly opened up the Indian economy and gradually relaxed the government control over licensing, marketing, and prices.

11. However, government regulations of business entry, exit and operations remain complex, and India lags behind countries such as China (Table 1, Figure 3). While it is relatively easier to legislatively decontrol the reservation of many sectors previously only for public investment, and over prices and wages, complex regulations over the actual entry/exit/operation require deeper institutional reforms and a radical shift in government's mindset and approach towards industry.

12. The federal structure of India stipulates that certain aspects of business regulations are within the exclusive purview of the central government (for example exit policy and bankruptcy procedures), some are within the purview of both the center and the states (for example entry and labor regulations), while others are largely within the domain of the states (for example inspections and compliance with regulations). Understanding the respective roles of the central and state governments in business regulation are important to have a deeper appreciation of the issues and reforms required.

A. Entry Regulation

13. Entry regulations consist of two basic elements: (i) areas which are reserved to the public sector or certain categories of industries (e.g., size or sector); and (ii) how easy it is for the private sector to set up a new business in permitted areas taking into account necessary safeguards for environment and social

³ Investment Climate and Total Factor Productivity in Manufacturing: Analysis of Indian States, ICRIER, April 2004

concerns. In India, the first element is within the purview of the central government. The second element has increasingly become a state's issue, though for important and large FDI projects, the central government continues to play an important role.

14. On the first element, India has made significant progress since the early 1990s in gradually opening up areas to domestic and/or foreign investment which have been previously exclusively reserved for the public sector or certain categories of the private sector and FDI limits have been relaxed in most of the sectors⁴. As of 2003, there are only two sectors (atomic energy and railways) reserved for the public sector and six industries related to public health and safety as well as national defense requiring mandatory licenses.⁵ While foreign investment is still not permitted in select sectors (including agriculture, print media), the number of sectors in which foreign investments are allowed automatically (by registering with the Reserve Bank of India) has increased. Barring items reserved for exclusive production by SSIs (see paragraph below), all other manufacturing sectors have been opened up to private investments, domestic or foreign. Further, more service and infrastructure sectors have been opening up.

15. A key regulation of business entry by the central government is the Small-Scale Industry (SSI) reservation, which stipulates that total investment per firm cannot exceed Rs.10 million (about \$210,000) for over 600 product groups covering a wide range of industries, such as garment and toys⁶. It has been well documented that reservation has led to capacity fragmentation, and sub-optimal production scales in many sectors, reducing the competitiveness of Indian exports (World Bank, 2000). This along with the labor market rigidity has been a major export constraint for India, and allowed China, for example to out compete India in these sectors. With the gradual reduction in import tariffs in India—from about 55% on average in 1990-91 to about 20% in 2003-04⁷, import competition has made SSI de-reservation an imperative. Since the Abid Hussain Committee Report (1997), de-reservation has come under political debate. However the reform has been slow and sometimes back tracking. As of April 2003, there were still 675 items reserved for exclusive production in the small-scale sector. It is time to eliminate SSI reservation policy to unleash India's businesses, encouraging them to grow and compete in world markets (World Bank, 2003a).

16. On the second element, i.e., how easy it is for a private firm to get permit to set up his/her business in permitted area, progress has been made, but slow and insufficient. India has higher requirements for the number of permits and significantly longer median number of days to start a firm than almost all countries included in the Global Competitiveness Report's database. The Doing Business Database of the World Bank reinforces this by comparing entry regulations in India vis-à-vis other competing investment destinations (Table 1). Compared to the ease of entry of new businesses in Singapore or Ireland and other east-Asian economies, India takes the longest to register new businesses and at considerable cost.

⁴ For more details, refer to the comprehensive manual on FDI in India (Policy and Procedures) released by the Department for Industrial Policy and Promotion, Government of India in August 2003. (Available online at <http://www.dipp.nic.in/manual/>)

⁵ Distillation and brewing of alcoholic drinks; Cigars and cigarettes of tobacco and manufactured tobacco substitutes, Electronic aerospace and defense equipment (all types); Industrial explosives including detonating fuses, safety fuses, gun powder, nitrocellulose and matches; Hazardous chemicals; and Drugs and pharmaceuticals (as per Drug Policy issued in September 1994 and subsequently amended in February 1999).

⁶ In 1999, the Cabinet decided to lower the investment ceiling for small-scale industries from Rs.30 million to Rs.10 million.

⁷ Report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act 2003, Ministry of Finance, Government of India, July 2004.

Table 1: Comparing Entry Regulations in Select Countries

	No. of Procedures	Duration (days)	Cost (% GNI per capita)	Min. capital (% of GNI per capita)
Malaysia	7	56	26.6	0
Singapore	7	8	6.1	0
Taiwan, China	8	43	6.3	221.9
Pakistan	10	53	44.4	0
Brazil	16	86	12.0	0
Ireland	3	16	10.4	0
Mexico	7	51	20.6	106.3
Thailand	8	45	6.7	0
India	10	88	51.1	458.9
China	12	55	13.2	4,330.30

Source: Doing Business Database, World Bank

17. Official clearances for business entry are required at both the federal and the state level. Table 2 below lists types of approvals required from the central government. The federal approvals—registration and certificate of starting a business—have become increasingly automatic for “green” industries. The lengthy clearances at the federal level mainly concern large projects with environment implications or those in the mining industry or in infrastructure such as power. For example, a typical foreign power project needs to obtain about 42 government clearances and approvals (GoI, 2002).

Table 2: Stages a Typical Project Has to Go Through for Central Government Approvals in India

S.no	Type of Clearance	Authority	Act under which required
1	Registration as a Company	Registrar of Companies	The Companies Act, 1956
2	Clearance from Coastal Regulation Zone	MOEF	The Environment (Protection) Act, 1986
3	Environment Clearance	MOEF	The Environment (Protection) Act, 1986
4	Forest Clearance for diversion of forest land	State Forest Department/MOEF	The Forest (Conservation) Act, 1980
5	Explosive License	Controller of Explosives	The Explosives Act, 1884
6	Certificate of commencement of business	Registrar of Companies	The Companies Act, 1956
7	Rehabilitation and Resettlement Plan	State Government/MOEF	
8	Permission for Import of goods	Director General Foreign Trade	Exim Policy
9	Pollution Clearance	State Pollution Control Board (SPCB)/ Central Pollution Control Board (CPCB)	The Water (Prevention and Control of Pollution) Act 1974 & The Air (Prevention and Control of Pollution) Act, 1981

Source: GoI, 2002

18. Approvals by the state government continue to be a protracted process in most Indian states. Table 3 below describes a typical process an investor would need to go through for setting up a new business.

Table 3: Stages a Typical Project Has to Go Through for State Government Approvals in India

S.no	Type of Clearance	Authority	Act under which required
1	Allotment of Land		
a.	Allotment of land/shed in industrial areas	Concerned Industrial Development Authority	
b.	Allotment of Government Land	District Collector/revenue Department	State Land Revenue Act
c.	Acquisition of Land	District Collector / State Government	The Land Acquisition Act 1894
2	Change in land use		
a.	Conversion of Land use to Non agriculture purposes	District Collector/ Revenue Department	State Land Revenue Act
b.	Change in land use in urban areas	Town Planning Department	State Urban Improvement/Municipal Act
3	Approval of building plan		
a.	Approval of building plans in Industrial areas	Concerned Industrial development Authority	
b.	Approval of building plans in other areas	Local Authorities #	Municipal Byelaws
4	'No Objection' from Fire Department	Fire Services Department #	
5	Release of power connection	State Electricity Board or its successor entities	
6	Consent for setting up captive power plant	State Electricity Board or its successor entities	The Electricity (Supply) Act, 1948
7	Release of water connection		
a.	Release of water connection in Industrial Areas	Industrial Development Authority	
b.	Release of water connection in other areas	State Water Supply Department	
8	Site Clearance Certificate – required in case of identified highly polluting industries	State Government	The Factories Act, 1948
9	Boiler Certification	Chief Inspector of Boilers	The Indian Boilers Act, 1923
10	Registration as a Factory	Chief Inspector of Factories	The Factories Act, 1948
11	Sales Tax Registration	Sales Tax Department	State Sales Tax Act
12	Registration under the Trade Union Act, 1926	Labor Department of State Government	The Trade Unions Act, 1926
13	Registration under the Provident Funds Act, 1925	Labor Department of State Government	The Provident Funds Act, 1925
14	Registration under Shops and Establishments Act, 1988	Labor Department of State Government	The Shops and Establishments Act, 1988
15	Registration under Industrial Disputes Act, 1947	Labor Department of State Government	The Industrial Disputes Act, 1947
16	Registration under Minimum Wages Act	Labor Department of State Government	The Minimum Wages Act, 1948
17	Registration under the State Employees Insurance Act 1948	Labor Department of State Government	The State Employees Insurance Act, 1948

Source: GoI, 2002

19. The Department of Industrial Policy and Promotion, Government of India, in May 2001 commissioned a study to identify the reasons for slow progress in implementation of investment project which revealed that about 20% of the respondents considered governmental clearances to be a problem. While large projects, especially power projects, requiring GoI's environmental clearance take long to get clearances, many problems were related to delays in clearances/approval at the state government and local government level. Land acquisition was a particularly difficult clearance to get for medium and large sized projects.

20. Each state government regulates business entry differently, with different institutional set up, different legislation and different clearance process. In the state of Karnataka, for example, an investor needs to submit three application forms regulated by the central government, 16 application forms

regulated by the state government, and three application forms regulated by state utilities for setting up power, water and telecom connections. The government approval procedures behind these application forms are complex and often duplicate the same clearance function across a number of agencies. For example, three different agencies approve a building plan in Karnataka—the Chief Inspectorate of Factories and Boilers, the local government authority and the Karnataka Industrial Areas Development Board. Further, there are concepts such as initial in-principle clearances that are provided promptly and much more delayed actual clearances which result in project implementation delays and cost escalation. In the state of Tamil Nadu, prior to reform, 10 application forms were required for pre-project clearances, with a sequential process of obtaining official approvals for investment project over Rs.25 crore from about one dozen departments and agencies.

B. Exit Regulation

21. Exit regulations concern both the bankruptcy procedures that govern the disposal and restructuring of assets as well as labor laws governing the retrenchment of labor force. The first issue is exclusively at the purview of the central government, while the second is largely within the purview of the central government with the States implementing the federal framework with limited freedom.

Table 4: Comparing Bankruptcy Indicators in Select Countries

	Actual Time (in years)	Actual Cost (% of estate)	Efficient Outcome Achieved	Goals-of-Insolvency Index⁸
Brazil	10.0	8	0	24
India	11.3	8	0	21
Pakistan	2.8	4	0	63
Ireland	0.4	8	1	88
Malaysia	2.2	18	0	52
México	2.0	18	1	61
Singapore	0.7	1	1	99
Taiwan, China	0.8	4	1	68

Source: Doing Business Database, The World Bank

22. Exit and bankruptcy regulations and procedures in India are outdated and ineffective. These have led to inefficiencies in the system, making industrial restructuring almost impossible. Under the Companies Act, the tasks of restructuring, amalgamating and winding up companies are performed by the high courts and district courts, while the revival/rehabilitation of sick companies was assigned to a quasi-judicial body called the Bureau of Industrial and Financial Reconstruction (BIFR) under the Sick Industries Companies (Special Provisions) Act, 1985. Any sick firm registered under the Company Act must go through the BIFR process, which is protracted and complex. Recent estimates show that it is entirely common for liquidation proceedings to take more than 2 years, and over 60% of liquidation cases before the High Courts have been in process for more than 10 years. BIFR has also shown to be a protracted and cumbersome process. Not surprisingly, when looking at the share of firms that go bankrupt, India has a much lower share (0.04%) than other emerging markets, such as Thailand (World Bank-CII, 2002). This fact is also reflected in the bankruptcy indicators developed in the Doing Business

⁸ The Goals of Insolvency Index is calculated as the simple average of the cost of insolvency (rescaled from 0 to 100, where higher scores indicate less cost), time of insolvency (rescaled from 0 to 100, where higher scores indicate less time), the observance of absolute priority of claims, and the efficient outcome achieved. The total Goals-of-Insolvency Index ranges from 0 to 100: a score 100 on the index means perfect efficiency (Finland, Norway, and Singapore have 99), a 0 means that the insolvency system does not function at all.

Database of the World Bank (Table 4 above). It takes much longer to declare a firm bankrupt in India and even then chances of achieving an efficient outcome are low.

23. Labor market restrictions on hiring and firing workers remain one of the greatest challenges of doing business in India (World Bank, 2003a). A core exit issue concerns labor retrenchment.

- The Industrial Dispute Act (1947) Chapter VB stipulates that any firm with 100 workers or above obtain permission from its state government for closure. Given the sensitivity of labor issues and outdated labor law, such permission is inherently a political decision and rarely granted in reality. For example, in the state of Karnataka, during the 1990s, only about 10 factories were given permission to close down. In the case of Andhra Pradesh, during the last 20 years, permission under Chapter-VB has been given only to public sector enterprises that are being privatized and to only one private sector company (following the ban on production and sale of liquor in the state) (World Bank, 2003c).
- Contract labor is not subject to these retrenchment laws, but flexibility in hiring contract workers is limited by the Contract Labor Act which allows the use of contract labor only for activities of a temporary nature. Amendments to the Contract Labor Act is now being considered that would permit use of contract labor for all activities (World Bank, 2003a). (see also para 37)

C. Regulation over Operations

24. Regulations over operations of ongoing business rest with state governments, while the central government laws are important frameworks for state regulations. An Indian state government regulates the operation of business through a number of main channels.

- The first channel is through the regulations of labor. There are two principle problems with the regulations. First, the federal Contract Labor Act 1970 restricts the hiring of contract labors. Second, the regulatory maze is complex, leading to high compliance cost and rent-seeking (Tables 7 and 8, also Annex 3). The state governments also requires a business to submit a whole range of returns and registers as required by the central labor laws for which the states provide implementation rules. In the state of Karnataka, for example, a business needs to submit 24 returns/registers, with several of them monthly or quarterly. In Tamil Nadu, there are 53 such returns and registers. These returns duplicate information and often tend to overlap, resulting in high compliance costs, particularly for small businesses.
- The second channel is through the inspection process per the laws and regulations of both central and state governments. The most important inspections concern labor and environment, but there are other areas where the government regulations often are outdated.
- The third channel is through renewal of business permits, i.e. established business would need to go through the same procedures as described above for application for a new business.

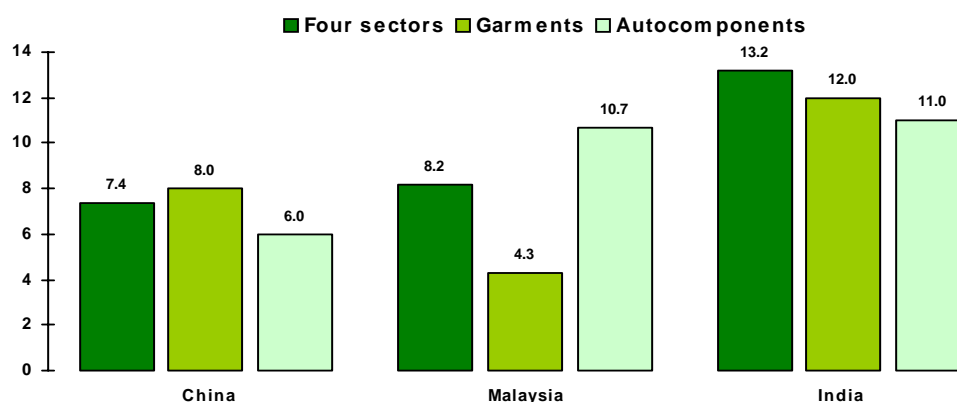
25. The Firm level Analysis Competitiveness Survey (FACS) conducted jointly by the World Bank and CII in 2002 discussed two particularly useful measures of the regulatory environment for business: (i) the amount of management time spent dealing with government officials; and (ii) the frequency of making irregular payments.

- The amount of time spent with officials provides a direct measure of the regulatory burden faced by entrepreneurs and one that is given considerable weight by firms. The measure is also correlated with general costs of corruption, as time with officials often indicates the likely openings for demands of irregular payments. On this dimension, India does not compare so favorably. In China the amount of time is just over 9%, in Latin America, it is about 11%,

while it is 12% in transitional Europe. In India, it is 16%. Clearly this is an area of relative weakness for India. The opportunity cost of managers' time is considerable. Figure 3 illustrates that compared to China and Malaysia, the amount of management time in India spent in regulatory matters in four sectors (Garments, textiles, electronics (consumer goods and electrical white goods) and auto components) is almost double the amount spent in China and considerably higher than Malaysia (World Bank-CII, 2003).

- As for the frequency of making irregular payments to officials, the rate is about 90% for India, Indonesia, the Philippines and Thailand, while it is almost half that in Malaysia. The share that reported doing so 'always' or 'mostly' is highest in Thailand and comparable in India and Indonesia. The 'frequency of payments' is much less correlated with 'business costs of corruption' than is the burden associated with the 'time senior management spends with government agencies and regulators.'

Figure 3: Management time spent in regulatory matters (%)



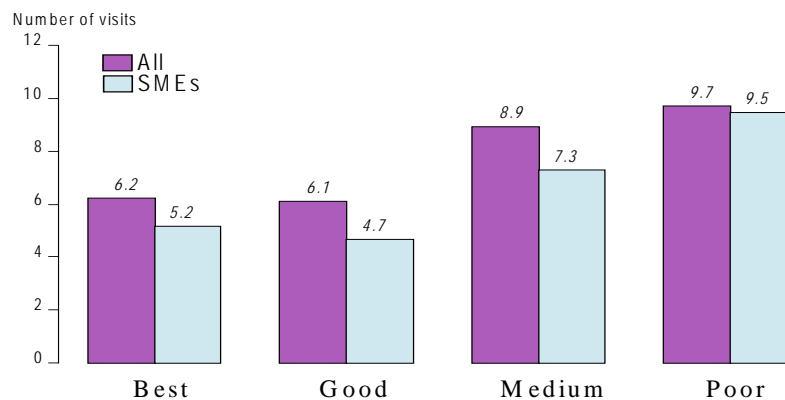
- The FACS 2002 also revealed that about 16 per cent of the management time in India is spent on dealing with government officials on regulatory and administrative issues. Indian states with better investment climate tend to impose lesser burden on the management than the others. The average number of visits per year by the government officials has been as low as 5.5 in Tamil Nadu compared to 13.4 in Andhra Pradesh. While the average regulatory burden on small and medium enterprises (SMEs) is less than the larger units, the regulatory burden per employee is over 14 times more in the SMEs compared to large units, attesting to the undeserved harassment being suffered by the latter (World Bank-CII, 2002).

26. Even if the direct cost of inspection were negligible, the average frequency of visits in a state is still a good proxy for the overall quality of governance or for the overall cost of regulation. A visit less or a visit more may not make or break a business in its own, nevertheless, inspection visits often mean loss of valuable management time as well as shop floor time. On an average, with a frequency of 10 visits a year, businesses in poor investment climate Indian states seem to bear significantly higher regulatory burden than their counter parts in good-to-best climate states, where visits average about 6 a year (Figure 4).⁹

⁹ Visits by sales tax inspectors are excluded from these figures. CII/Bank calculated for firms covered by the supplemental survey that visits by tax inspectors accounted for 60 percent of all visits by government officials on the average (CII/Bank 2002).

27. According to a recent study by the World Bank¹⁰, India made the most progress among South Asian nations in improving its investment climate during 2003-04. Although it was not among the top 20 economies in terms of ease of doing business, India was rated among the top 10 reformers in the world. It is still early days to assess impact of reforms in India particularly on issues such as access to credit, enforcement of contracts, etc. Despite positive reforms, while South Asia lagged behind other regions in enacting investment climate reforms and India still ranks in the bottom quartile on the ease of doing business.

Figure 4: Annual average number of inspection visits by government officials in Indian states (ranked by investment climate)



III. REFORM OF REGULATORY FRAMEWORK -- EXPERIENCE IN FIVE INDIAN STATES

28. The five Indian states selected for this review are Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. The reasons for selecting these five states are outlined in para.2, basically reflecting the leading roles these states are playing in attracting foreign and domestic investment in India and in leading reforms on business deregulation. The key deregulation reforms of these states in business entry, exit and operations are summarized below.

A. Streamlining Entry Regulations

29. **Clearances and approvals.** As already summarized in section II (paras.16-20), to set up a new industry in India, a firm needs to apply for a variety of clearances and must adhere to a number of regulations in India. There are a set of general regulations at the federal level (Government of India) which every investor has to satisfy following which the thrust of project implementation shifts to the level of the sub-national government where the industry will be located. Assuming that an investor has explored various competitive locations within India and finalized on a certain site, there are several procedures that an investor has to follow in order to operationalize the project and start production in the selected state. Entry approvals are more of an issue with small and medium sized enterprises compared to the larger firms. The benchmark survey in Karnataka also revealed that despite the government's efforts in the past few years to simplify entry procedures, bureaucratic delays and complexities in getting clearances persisted, and that most industries had trouble getting their clearances from the land agency and power connections (PAC, 2002).

30. **Single Window Agency.** As investors have to be in contact with numerous government authorities to go through their administrative procedures before operations can begin, a delay in any of

¹⁰ Doing Business in 2005: Removing Obstacles to Growth, The World Bank, September 2004

these steps will translate into additional costs and foregone revenue, and any permit, approval or clearance not forthcoming can jeopardize the entire project. Given the complexity of this process, the concept of an One-Stop Shop (OSS) or Single Window Agencies (SWA) seems very appealing. The basic idea is that an investor would only have to be in contact with one single entity to obtain all the necessary paperwork in one streamlined and coordinated process, rather than having to go through a labyrinth of different government bodies. In practice, however, such single window mechanisms do not automatically result in a streamlined process without deeper institutional reforms (Box 1).

Box 1: International experience with One Stop Shops / Single Window Agencies

Experience shows that, even under the best circumstances, the creation of an OSS will not automatically result in a streamlined and efficient process of implementing investment projects. Clearly no agency can just take charge of all the various administrative procedures and simply shorten the timeframe and procedural steps applied. Instead an OSS will necessarily have to work closely together with all the other authorities to carefully adjust and re-engineer individual processes such that they are less burdensome for investors without compromising other policy objectives. This is a time-consuming political process which cannot be achieved overnight. However, a strong OSS can serve as the key catalyst in such a policy reform process. Nevertheless, the most outstanding and well-known examples where such an OSS system works reasonably successful are: (i) Economic Development Board (EDB) of Singapore; (ii) Malaysian Industrial Development Authority (MIDA); and (iii) Industrial Development Authority (IDA) of Ireland.

In all three cases, investors can rely on the agencies to provide practically all the approvals and clearances needed. The EDB and IDA in fact managed to obtain direct control over a number of approval procedures such that investors only have to deal directly with a small number of separate authorities, and even in those cases both agencies tend to be highly effective in ensuring cooperation. MIDA, on the other hand, started as a pure coordination mechanism and experienced the typical starting problems of an OSS. But with the strong and direct support of the Prime Minister, the involvement of MIDA on behalf of an investor effectively guaranteed approvals and permits to be forthcoming without difficulties.

Strong political commitment key. In evaluating the particular effectiveness of the OSS/SWAs, it is key to recognize that they receive their power and effectiveness not through a particularly strong and all-embracing legal mandate, but rather through political clout and seniority. Common to all these cases is that the agencies received the full support from the most senior levels of government, and that all governments made the attraction of FDI a central pillar of their economic development strategies. Hence, when these agencies approach particular authorities on behalf of investors, this practically amounted to the same as a direct request from the Prime Minister's office, making the handling of these applications an immediate priority. In addition, it is important to recognize that these agencies also benefited from an environment where less licenses, approvals, permits or clearances were necessary. For this to happen, besides creating these agencies, the governments also introduced a series of other reform measures, all geared towards eliminating obstacles to investment. Thus, establishing an effective OSS requires the full attention and support by senior government as a key priority. Only then can the agency effectively design a streamlined process to implement investment projects without becoming immersed and distracted by intra-governmental politics.

Source: Foreign Investment Advisory Services, The World Bank Group, 2000

31. Most public surveys of businesses have highlighted the time consuming approval and regulatory procedures that are affecting the investment climate of Indian states. As a result, most state governments have established a nodal agency, which acts as an interface between potential investors and government agencies. The five Indian states being reviewed in this study have also set up such a nodal investment promotion and facilitation agencies that have tried to help streamline business approval processes and expedite implementation of projects (Table 5). States such as Andhra Pradesh and Karnataka have enacted laws to provide statutory backing to the single window clearance system and establishing the nodal agency. In the other three, namely Tamil Nadu, Maharashtra and Gujarat, the nodal investment facilitation agency has been set up through government resolutions. These are recent developments and it may be early to assess the effectiveness of these agencies.

32. Karnataka has enacted the Industries Facilitation Bill, 2002 which provides statutory backing to the single window committees at the three levels in the state and institutionalizes issues such as use of the CAF, computerized random sampling mechanism for inspections, deemed clearances and self-certification. Andhra Pradesh has enacted the "Industrial Single Window Clearance Act No. 17 of 2002" to expedite the processing and issuance of various clearances required for setting up industrial undertaking in the state. To further institutionalize its commitment to being an investor friendly

government, Andhra Pradesh has created a special agency called APFIRST¹¹ to promote investment and development in key sectors in the state. This agency is staffed with high quality talent from the private sector to allow it the operational flexibility and efficiency of a private sector company with deep linkages to the government to ensure successful implementation of suggested reforms.

Table 5: Investment facilitation agencies in comparative states

	Andhra Pradesh	Gujarat	Karnataka	Maharashtra	Tamil Nadu
Nodal investment promotional and facilitation agency	AP Industries Commissionerate	Industrial Extension Bureau (IndextB)	Karnataka Udyog Mitra (KUM)	Udyog Sarathi	Tamil Nadu Industrial Guidance Bureau
Whether Single Window Agency (SWA) is backed by legislation	Single Window Clearance Act No. 17 of 2002	Govt.Resolution No.GIP-102002-708-I dated 28-6-2002	Karnataka Industries Facilitation Bill 2002	Govt.Resolution dated 25.1.1996.	Govt.Order No.588 dated 10-9-1998
Structure of SWA by investment limits	District Level Authority headed by District Collector for cases up to Rs. 1 crore; State Investment Promotion Committee headed by Chief Secretary for cases up to Rs. 25 crores; State Investment Promotion Board headed by CM for cases beyond Rs. 25 crores	Less than Rs. 5 crore by the District Industries Development Center (DIDC); Rs.5-50 crore by the Industries Commissionerate; Rs.50-100 crore – Inter Departmental Committee headed by Chief Secretary; and more than Rs.100 crore – Gujarat Industrial Promotion Board (GIPB) headed by the CM	District level SWA, headed by Deputy Commissioner, for investments up to Rs. 3 Cr; State level SWA, headed by Principal Secretary to Govt, Commerce & Industries Dept, for investment approvals of Rs. 3-50 Cr; for over 50 Cr, High-level committee (HLC) headed by Large & Medium Industries Minister	Udyog Sarathi (est 1996), under MIDC, and headed by Chief Coordinating Officer (Class I). At district level SIGMA Kaksha in District Industries Centre provides assistance to SSI	State Level Investment Promotion Board (SIPB), chaired by the CM, for projects over Rs. 100 crores; Project Approvals Authority (PAA), chaired by the Chief Secretary, for projects under Rs. 100 crores.
Industrial land acquisition and development agency	Andhra Pradesh Industrial Infrastructure Corporation (APIIC)	Gujarat Industrial Development Corporation (GIDC)	Karnataka Industrial Areas Development Board (KIADB); land can also be allotted by KSSIDC, KSIIDC (Karnataka State Industrial Investment and Infrastructure Development Corporation), and KEONICS.	Maharashtra Industrial Development Corporation (MIDC). Land is acquired under MIDC Act for industrial purpose with the help of Revenue Department and is developed by MIDC.	Land is allotted by SIPCOT (State Industries Promotion Corpn of Tamil Nadu), TIDCO (Tamil Nadu Industrial Development Corpn), and SIDCO (Small Industries Development Corpn).

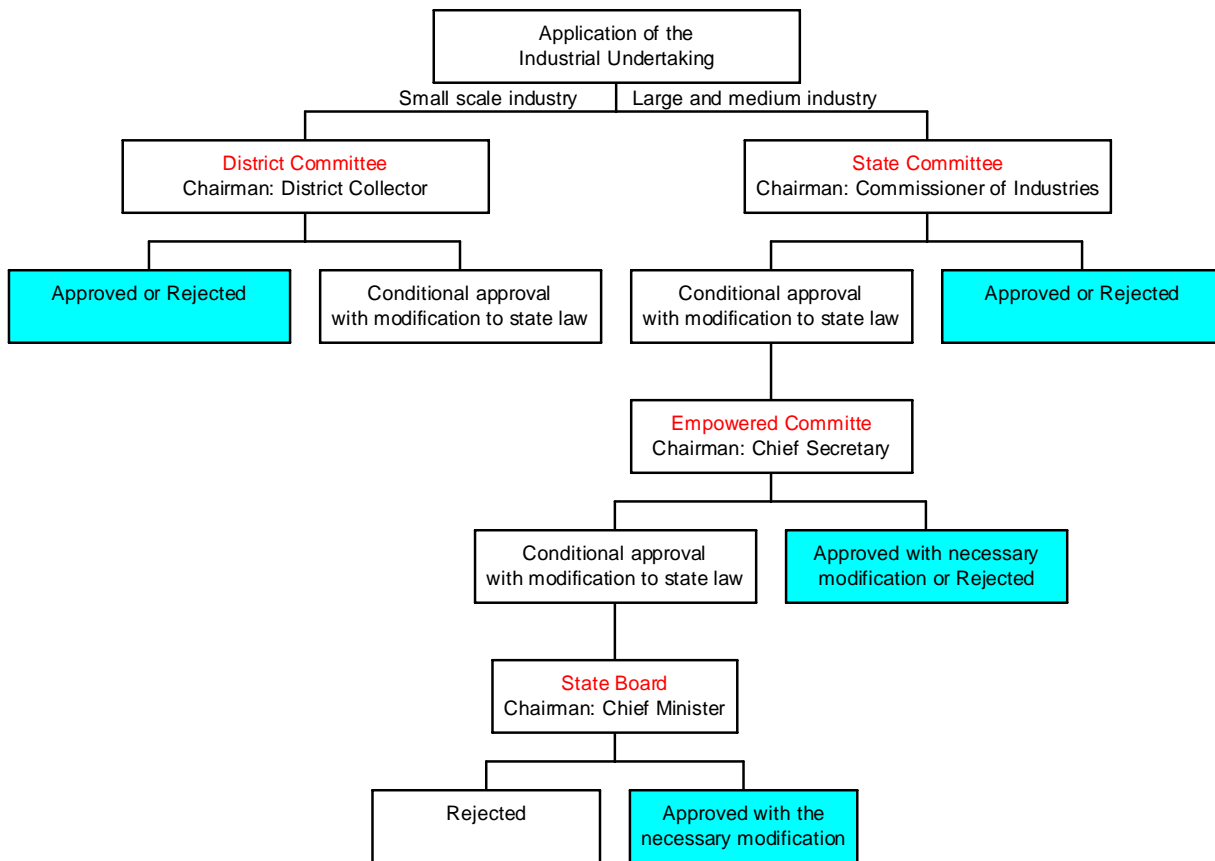
Source: World Bank staff, various state governments

33. The Andhra Pradesh's Single Window Clearance (SWC) Act does not ensure a simple, flat, and decentralized structure, but rather the provision of deemed approval and, to a limited extent, the time limits set under the Act for various clearances (Figure 5, World Bank, 2004). For example, approval from

¹¹ Further details on APFIRST are available at www.apfirst.com

the power company about the feasibility of providing power and the final power connection to the industrial undertakings has to come within 7 and 25 days, respectively, failing which it is deemed approved subject to payment of required fee. The same condition applies to water supply. The clearances from gram panchayat and licenses from Municipality, if not made available within 7 days, are deemed to be cleared. Apart from the issue of acquisition and alienation of land, which has a set time limit of 45-60 days under the SWC, the time limits for all other clearances are between 7 to 30 days (details in Annex 2).

Figure 5: The approval system under the Single Window Clearance (SWC) system



Source: World Bank, 2004

34. Most of these state governments have had SWAs in place for years, however they have been strengthened in the past 2-3 years due to their prior ineffectiveness. Maharashtra and Gujarat have always been in the forefront of industrial development in India. Most business received their clearances and approvals in a relatively short period of time and project delays were more on account of other factors such as inability to attain financial closure, etc. In the southern states of Karnataka and Andhra Pradesh, SWAs have been providing only in-principle clearances. Particularly in Andhra Pradesh and Karnataka, actual clearances/approvals on paper were received only after interactions with individual departments, with substantial rents being sought and inordinate bureaucratic delays being created.

35. Reforms are underway to improve the effectiveness of the SWAs.

- States such as Andhra Pradesh and Karnataka are moving away from providing initial in-principle clearances and focusing on expediting actual clearances. Deemed clauses for certain approvals have been introduced in the laws enacted by Andhra Pradesh and Karnataka, which aim at time-bound clearances for new businesses (see also Annex 2). However, deemed

approval may not automatically lead to speedy approval decisions. For example, many of the laws and bye-laws in these two states concerning town planning and environment have not changed. So in the case of Andhra Pradesh, when a project does not meet certain law or bye-law of a concerned department, it often gets rejected, instead of being delay until a way to address the underlying law and bye-law is found as in the earlier system.

- In Tamil Nadu, for investment over Rs.25 crore, a sequential (i.e., approval by first steps is required for approval by the second step) and protracted approval process covering a dozen departments/agencies has been replaced by a parallel process, with time-bound approval specified for each of the parallel steps. Further, investors do not have to interface with a dozen departments/agencies but the Guidance Bureau that trouble-shoots, coordinates various official agencies, and uses web for tracking the status of application.
- Adequate time is being given from the time of submission of completed forms to the nodal agencies with all relevant information and discussion in the SWA so that all departments can take an informed decision on the matter.
- Most state governments are insisting that in case of inability to of a SWA member to attend a meeting, another official from the department must be authorize to attend the meeting and be provided full powers so that decision making on the project does not get delayed. If not, clearance from that department will be assumed to have been provided.
- State governments are increasingly adopting e-governance techniques to streamline business approval procedures¹².

36. **Application forms.** Apart from dealing with a myriad of laws, regulations and government departments, start-up as well as expanding businesses in India also have to complete a number of application forms – often repeating vast amounts of information. There are a number of forms which cannot be easily merged/combined as they deal with federal laws/procedures and need to be kept separate. Poor information management systems and lack of co-ordination across departments have resulted in multiplicity of application forms. This has been recognized by most state governments and they have introduced Combined/Common Application Forms (CAF). In fact Tamil Nadu has one consolidated CAF which is being used by all departments and is also available online. On the other hand, Maharashtra does not have a CAF, however the procedures are relatively streamlined and less time-consuming (Table 6).

Table 6: Combined Application Forms (CAF)

	Andhra Pradesh	Gujarat	Karnataka	Maharashtra	Tamil Nadu
Application forms to be filled by new industries/investors	one (CAF)	one CAF; 6 to 30 other forms	one CAF, plus 6 other forms	It depends on the nature of activities of the unit and clearances required under various Acts. However, Minimum 35 and maximum 77 clearances from various departments are required for setting up an industry.	one (CAF)
Concept of Combined Application Form (CAF)	CAF available online; includes 19 different forms	CAF available online since 2002	CAF and other available online; can also be submitted online.	There is no common application form. However, required application forms are available online / website.	CAF available online; other forms also available.

¹² For instance Maharashtra (http://www.midcindia.org/res_centre/mah_proc.com), and Gujarat (<http://www.gujaratindustry.gov.in/>) provide comprehensive information for investors in terms procedures and nature of documentation required for setting up a business in the respective state.

B. Facilitating Exit

37. As already mentioned, the exit issue is largely with the purview of the central government. There have been efforts, albeit slow, by the central government to amend legislation and speed up the bankruptcy procedures. The Sick Industry Companies Act (SICA) amendment in 2003 seeks to establish a National Company Law Tribunal (NCLT), which will take over the authority currently vested by the Companies Act with the Company Law Board (CLB) and courts. Also, the Sick Industrial Companies Act is to be repealed and corresponding provisions incorporated in the Companies Act. Based on the amendment, the Board for Industrial and Financial Reconstruction (BIFR) and the Appellate Authority for Industrial and Financial Reconstruction (AAIFR) will no longer exist and all matters regarding sickness and rehabilitation of companies will now be handled by the NCLT. There will be an Appellate Tribunal above the NCLT and any order of the former, will be appealable to the Supreme Court on any question of law. The immunity that sick companies enjoyed from legal proceedings is no longer available under the new dispensation. The NCLT will restructure, amalgamate, and wind down companies (previously performed by the high courts and district courts) and revive and rehabilitate sick companies (previously assigned to the restructuring bureau). Under the new framework, courts will no longer have any powers in mergers and liquidations, and this should help expedite the restructuring and liquidation of sick companies.

38. The definition of sick company has also changed significantly. A sick company will now be defined as one where (i) more than 50 per cent of the average net worth for four years is eroded; and/or (ii) if a company fails to repay its debts within three consecutive quarters on its demand from the creditors. Further, SICA will no longer have provisions to override all laws, barring FERA and the Urban Ceiling Act. As per the Securitisation Act, secured creditors can take over the assets of a defaulting company even if a reference is pending before the BIFR or its successor, the NCLT. SICA has still not been repealed and the BIFR will continue to govern sick companies till it is repealed. The BIFR is likely to be repealed as the NCLT is constituted. The recent law on the enforcement of creditors' rights should help industrial restructuring, unlocking the resources tied up in non-performing enterprises for more productive use. But to help the restructuring of small firms, the law needs to be extended to cover them.

39. **Labor retrenchment.** The Industrial Dispute Act section VB governs labor-related issue in business closure and retrenchment. Among state governments, Maharashtra has taken the lead in trying to amend some of the rigid labor regulations that contribute to the slow exit of inefficient firms. According to section 5.20 ("Labor Laws and Procedures") of the Industrial Policy 2001, the Government of Maharashtra initiated a review of labor laws and procedures, including central statutes. It plans the following amendments to the Industrial Disputes Act:

- Limit the applicability of Chapter V-B of the Industrial Dispute Act to industries employing 300 or more workers, instead of the present 100;
- Waive the condition of prior government permission for retrenchment under Section 25-N in cases where substantially higher financial payment is made to the retrenched workers;
- Delete Section 25-M (prior government permission for layoffs); layoffs in such cases will be governed by Section 25-C.

40. In Andhra Pradesh, faster resolution of labor disputes and creation of a peaceful industrial environment in the state is a priority for the government. The state government has recently prepared draft legislation, called "The Special Enclave Service Condition and Dispute Resolution Act, 2003," which is expected to speed up resolution of industrial disputes and remove some of the rigidities in the functioning

of the labor market in the state. The government has also taken steps to liberalize the contract labor regulations.

C. Rationalizing Regulations over Operation

41. As already summarized, a state government regulates the operation of business through a number of channels, particularly labor regulations and post-project inspection (para.22). These are time-consuming and in most Indian states, they take up an considerable amount of the time of senior management (Figure 3).

42. **Labor regulations.** The labor regulations are particularly complex concerning returns and registers in compliance with the central and state labor regulations, regulation of the use of contract labor and a wide range regulations which are outdated and overly restrictive according to international experience.

43. **Annual returns and registers.** Businesses in India have to maintain multiple registers/records under different provisions of applicable Acts/Rules as well as multiple returns to be filed under different provisions of applicable Acts/ Rules (Table 7). Apart from the harassment by the inspectors, maintenance of these multiple returns and registers are particularly cumbersome for small and medium enterprises (SMEs) with a limited number of professional, managerial staff.

Table 7: Returns/Forms to be Maintained by a Medium Size Company

S.no	Department	Nature of Returns	Responsibility (Dept.)
A	Inspector of Factories		
1	Form No. 20	Annual Return	
2	Form No. K.L.&M	Annual Return	
3	Form No. 21	Half Yearly Return	
4	Form No. 2	Annual Return	
5	Form No. 17	Notice of Accident	
6	Form No. IV	Annual Return	
B	Labor Department		Personnel
7	Form No. V	Annual Return	
8	Form No. D	Annual Return	
9	Form No. III	Annual Return	
10	Form No. XXV	Annual Return	
11	Form No. I&IV	Annual Return	
12	Form No. D	Annual Return	
C	Employment Exchange		Personnel
13	Form No. ER-I	Quarterly	
14	Form No. ER-II	Bi-Annual Return	
D	Provident Fund Office		Personnel
15	Form No. 12A, 5 & 10 & 3	Monthly Return	
16	Form No. 3A & 6A	Annual Return	
E	ESI Department		Personnel
17	Form No.6	Half-yearly return	
18	Form No.2	Monthly Return	
F	Apprentice Advisor		Personnel
19	Form No.APP-2	Half-yearly	
20	Form No.1A	Yearly	
21	Form No.APP4	Yearly	
G	Pollution Control Board		Personnel
22	Concept Air & Water	Yearly Return	
23	Environment Statement	Yearly Return	
24	Water Consumption	Yearly Return	
H	National Sample Survey		Personnel
25	Statistical Date	Annual	
I	Commercial Tax Office		Accounts
26	Entry Tax Form No. 3	Monthly	

S.no	Department	Nature of Returns	Responsibility (Dept.)
27	Entry Tax Form No. 5	Monthly	
28	Sales Tax Form No. 3	Monthly	
29	Sales Tax Form No. 4	Monthly	
J	Income Tax Office		Accounts
30	TDS Salary Form No. 24	Yearly	
31	TDS Salary Form No. 18	Yearly	
32	TDS Form No. 21	Yearly	
33	TDS Form No. 26c	Yearly	
34	TDS Form No. 16K	Yearly	
35	TDS Form No. 26K	Yearly	
36	TDS Form No. 26J	Yearly	
37	TDS Form No. 27A	Yearly	
38	Com. Income Tax Form No. 1	Yearly	
K	Central Excise		F G S
39	Form No. TR-12	Monthly	
L	Director Statistics		Costing
40	Production Return	Monthly	
M	Labor Department		Administration
41	Form No. G	Annual Return	
42	Form No. AA	Renewal of License	

Source: GoI, 2002

44. There exists considerable scope for consolidating these returns and registers and efforts have been/ are being made as well as some are underway to simplify, rationalize and introduce Combined Monthly/Yearly Returns and Combined Registers/Records.

- *Karnataka.* Common registers and returns have been introduced by the Labor, Forest and Commercial Tax departments. Eight Muster Roll cum Register of Wages have been merged, six Overtime Working and Payment registers have also been combined into one and ten Registers of Fines/Deductions have been consolidated into one. There were a dozen annual/half-yearly and monthly returns to be filed; these have been reduced to four. Acts and rules governing each of the 24 returns had to be amended individually.
- *Andhra Pradesh.* Through a Government Order (GO no.476) issued in 1998, a common annual return has been developed and is in use following consultation with the Factories and Labor and Employment departments as well as small scale industries. Only a single simplified annual statistical return needs to be submitted to the concerned District Industries Centre (DIC) with copies to the concerned Assistant Commissioner of Labor and Inspector of Factories. Further, a GO was issued in 1999 prescribing only two registers to be maintained by small scale industries – Attendance Register and Salaries and Wages Register in order to meet the requirements of eight central and state acts¹³. The simplified Common Annual Return form, which is only one and a half-page long, takes only 30-40 minutes to complete as compared to the few days necessary to comply with this requirement prior to 1995. The new policy has significantly brought down the burden of paperwork facing the firms.
- *Tamil Nadu.* A significant reform in Tamil Nadu is ongoing by combining 53 registers and returns (monthly, quarterly, annually) as required by different labor laws by GoI (e.g., the Factory Act, the Contract Labor Act, the Payment of Wage Act, and the Minimum Wage Act, with 23 central acts in total) and related seven legislations/rules by GoTN into one Common Annual Return with only seven pages.

¹³ These acts are: (i) The Factories Act; (ii) The Payment of Wages Act; (iii) The Maternity Benefits Act; (iv) The Workmen Compensation Act; (v) The Minimum Wages Act; (vi) The AP Shops and Establishments Act; (vii) The Payment of Gratuity Act; and (viii) AP Labour Welfare Fund Act.

- *Gujarat.* Since 2002, the Labor Department has prescribed an Annual Consolidated Return. Even in the case of large units which have the necessary resources to bear the cost of implementation of labor laws, the Annual Consolidated Return should suffice and they will be inspected only once a year.

45. Greater flexibility in labor regulations. This is a very sensitive political area. Reform direction has generally focused on greater flexibility in contract labor use and consolidation of labor laws to streamline regulation.

46. The Government of Mararashtra intends to amend the Contract Labor Act by excluding (i) certain activities (cleaning services, gardening, etc.) from its purview; and (ii) 100% Export Oriented Units (EOUs). The Government of Maharashtra also amended the Industrial Dispute Act Section 9-A to obviate the need for giving notice of change unless such change affects the number of hours of work, holidays or emoluments of workers, and bring supervisory personnel earning up to Rs.6,500/- p.m. within the purview of the act, instead of the current limit of Rs. 1,600/- p.m. Further, the Government of Maharashtra has also announced its intention to:

- Review the Maharashtra Recognition of Trade Unions and Prevention of Unfair Labor Practices (MRTU and PULP) Act
- Rationalize and reduce the number of minimum wages under the Minimum Wages Act
- Rationalize and reduce the number of inspections under labor laws
- Reduce labor law related paperwork
- Relax the Mumbai Shops and Establishments Act for IT units.

47. **Inspections.** There is an exhaustive list of about 65 inspectors from the state and central government that businesses in India may be subjected to. These inspectors primary mandate is to ensure compliance with the 55-60 central and state level Acts governing industry/business (The list of inspections, Registers and Returns to be Maintained under central acts are listed in Annex 3).. The major list of inspectors under different legislations in India are listed in Table 8.

Table 8: List of Inspectors Under Different Legislations

A	Labor Laws Related	1	Employees State Insurance Fund Inspector
		2	Factories Inspector
		3	Labor Inspector
		4	Provident Fund Inspector
B	Other Acts Related	1	Apprenticeship Advisor
		2	Chef Inspector of Boilers
		3	Controller of Weights and Measures Inspector
		4	Electricity Inspector
		5	Fire Inspector
		6	Food Inspector
		7	Hazardous waste Inspector
		8	Mines Inspector
		9	Municipality Inspector (For units located in Municipal Areas)
		10	Professional Tax Assessor
		11	Public Health Inspector
		12	Shops and Establishment Act Inspector

		13	State Sales Tax Inspector
C	Other Inspectors	1	Small Scale Industry Inspector (if SME)
		2	State Excise Inspector (if involved in the production of State Excisable products)
D	Central Government Inspector	1	Air Inspector
		2	Central Excise Inspector
		3	Customs Inspector
		4	Income Tax Inspector
		5	Export Inspection Council Inspector for Export Units
		6	Banks Inspector (For mortgaged stock etc.)
		7	SIDBI Inspection Team (For credit from SIDBI)
		8	Water Inspector

Source: GoI, 2002

48. State governments in India have attempted to streamline the inspection procedures in order to reduce harassment of businesses while ensuring compliance with rules of the land.

- *Karnataka.* With the idea of ensuring compliance of all the statutory provisions of different Acts and Rules, the Department of Labor, Inspectorate of Factories and Boilers and the State Pollution Control Board in Karnataka have started random inspection of the establishments in 2002. Prior to this reform, given the shortage of inspecting staff, a sample of industrial units in the State were being inspected. However since these lists were drawn up manually, discretionary powers were high and chances of frequent harassment of the same units was possible. To avoid repeated inspections by these departments at different levels and also to avoid discretionary choice of establishments for inspection, a computer generated mechanism for randomized inspection has been evolved. As the database of industries to be inspected is consolidated, the random sample is expected to be drawn jointly and conducted by a team of inspectors in order to reduce frequent visits to the same industry site. These inspections will be conducted once in a year, with prior notice. Surprise inspection will also be conducted based on written complaints, with the approval of higher authorities. It also revealed that while the frequency of inspections were not that much of an issue, the inspecting agencies were harassing and fraught with corruption (PAC, 2002).
- *Andhra Pradesh.* Through various government orders passed in 1998, the Government of Andhra Pradesh has simplified inspection procedures by (i) reducing statutory inspections to one per year and authorizing inspectors to carry out inspection under more than one Act; (ii) preparing an annual schedule in advance of inspections in specific industrial areas and communicating the same to the concerned industries; (iii) ensuring that all inspections, other than statutory inspections, will be permitted only on the basis of written, signed and verifiable complaints of violation of any rule or regulation by a unit; (iv) providing for the inclusion of a small scale industry association member as an observer during such inspections; and (v) providing for surprise inspections only by gazetted officers and that too with the permission in writing from the Regional authority or Head of the department. Similar to the Government of Punjab, Andhra Pradesh has attempted to outsource select inspection functions by appointing accredited agencies to carryout statutory inspections on payment of fees in technical areas. Any inspections other than the one specified in the law or inspections not reported to senior officers are to be treated as “unauthorized” and the erring official is made liable for action (Government Order Ms. No. 33, August 2002).
- *Gujarat.* The Government of Gujarat is developing a Single Business Act which is intended to encompass the essence of almost all the basic laws of relevance to industries under one umbrella. For this purpose, a pool of private agencies with experts in the relevant fields would be accredited to carry out the task of inspecting particular units and issue necessary certificates as required by law. A joint team of government inspectors from different departments however, will inspect the

unit once in a year only. Stiffer penalties would be imposed for the abusers as well as accredited agencies issuing fake certificates including cancellation of licenses. The Boiler's Act will be modified in order to reduce the frequency of inspection from once in a year to once in four years depending upon the technical specifications of the boiler. The Government appreciates that outsourcing has come to stay as an integral part of global business activity. In order to facilitate cost effective management, outsourcing through liberal enforcement of Contract Act would be considered.

49. **Self-certification.** With the objective of imposing self-responsibility with the entrepreneurs, the concept of Self Certification is being accepted both at entry and operational levels. The Government of India have already declared that in order to provide an internationally competitive and hassle free environment for external trade, all the import/export operations of the Special Economic Zones (SEZs) will be on self-certification basis.

- *Andhra Pradesh.* Barring major hazardous industries, self-certification by industries to comply with labor laws is sufficient under provisions of certain labor laws (GOs issued in 2001 and 2002).
- *Tamil Nadu.* Proposals are under consideration to permit self-certification under the following labor laws and rules – (i) Tamil Nadu Shops and Establishments Act, 1947; (ii) Payment of Wages Act 1936; (iii) Minimum Wages Act, 1948; (iv) Contract Labor (Regulation and Abolition) Act, 1970; and (v) Payment of Gratuity Act, 1972.

IV. LESSONS LEARNED

50. Improving the investment climate and promoting private sector- led growth has been a central element of the reform at the central and state government level in India. There is momentum in India, particularly at the level of the state governments, to carry out structural reform to accelerate growth and improve social indicators. This builds on the Government of India (GoI)'s emphasis on reforming the states to achieve development outcomes, as states have greater freedom to not only determine their own priorities but also the modalities of public intervention and provision of goods and services. In general, it is still too early to assess the impact of the business deregulation measures initiated at the state level. However, several lessons have emerged from the experience of the states in improving governance and streamlining regulations of business entry/exit and operation.

51. *Complex nature of institutional reform.* Due to the legacy of a socialist command and control economy in India, government regulations of private investment and operations have over the decades evolved into complex layers of bureaucracy. Quick solutions are not easy and the complexity of reforms cannot be underestimated. Reform could take years, involving the restructuring of the existing institutional structure which is complex, duplicating and well entrenched spanning many departments and agencies. For example, to obtain the government's approval required for the site and building plan in Karnataka (only one chain of the entire application process for starting a new business), an entrepreneur needs to seek permission from three authorities: the Inspectorate of Factories and Boilers under the Karnataka Factory Rules 1969, the Gram Panchayats or other local authorities, and the land development agency.

52. *Importance of inter-departmental co-ordination and co-operation.* Improving the investment climate for business is not the prerogative or the concern of the Industry Department alone. Given the complex institutional nature of the reform, sustained efforts are required so that reform will overtime generate impacts. This involves active dialogue with the private sector, coordination across all departments, frequent monitoring of the reform process and trouble shooting problems. Again, in the case

of Karnataka, to consolidate 16 state application forms into one implies changing legislation or regulation behind each one of the 16 application forms. Extensive consultations were carried out by the Industries Department with the Labor Commissioner, the Inspector of Factories and Boilers, and the Department of Environment.

53. *Consolidating and updating extant laws.* Several legislations in India regulating industry and commercial business were enacted decades ago. The economic environment has undergone a near total transformation, but the regulatory framework has not changed as much. In fact the introduction of newer pieces of legislation often results in multiple laws governing the same set of issues. This not only makes enforcement very costly but also makes compliance difficult as the requirements prescribed under each legislation have to be separately complied with. In order to make the administration and compliance of these laws effective, the extant laws need to be consolidated and updated by weeding out legislations that have outlived their utility and bringing others in line with current technological, environmental, competitive and social requirements.

54. *Importance of implementation.* Change in legislation or the announcement of a decision is only the first step; the real test is its implementation. The reform and changes required for streamlining government functions are very different from some macroeconomic reforms such as removal of quantitative restrictions on imports or reduction of import tariff where the announcement of a decision by a legislation or Cabinet decision would be sufficient. In improving investment climate and business deregulation, changing legislation or announcing policy decision is just the beginning step, which must be followed by painstaking strategy and actions. But even that varies across states. While Andhra Pradesh enacted the Single Window Clearance Act and initiated implementation within a year, Karnataka is taking much longer due to various procedural delays including the required Presidential assent to the proposed deregulation legislation.

55. To take another example of streamlining application forms for setting up a new business, to consolidate multiple application forms into a Common Application Form involves changes in legislations or regulations in India. For instance, in Karnataka, legislation or regulation underpinning each application form must be amended to enable the change. Given the complexity of the Indian system, depending on the nature of such legislation, some legislation could be approved by the state government's law department directly, some must go to the Cabinet, and some would require the approval of the state legislative assembly.

56. After the adoption of the Common Application Form, the institutional set up must be streamlined to facilitate faster approval of the set up of a new business. A Common Application Form does not automatically eliminate approval steps behind each old application form. Efforts must be made to streamline the institutional structure and approval process, so that the reform reaches the heart of the problem. In the India system, each paper file would have to go through multiple layers of transaction within a department (in Karnataka, it is nine). These layers must be streamlined. The reform process described above applies to all aspects of government regulations of business entry, exit and operation.

57. *Required change in mindsets.* Reducing and eliminating administrative/bureaucratic barriers to entry and streamlining regulations of operation are only parts of the reform process. While the overall policy environment and quality of infrastructure are critical, changes in mindset is equally important. Business approvals and operation policies involve considerable human interface. Although state governments are increasingly adopting e-governance techniques to reduce delays, provide real time approvals of applications, and contain discretionary powers, human interface cannot be completely avoided. This requires mindset changes on the part of government as well as industry.

58. *The role of the private sector.* It is possible to be skeptical about the consideration of contracting out the provision of industrial licenses or inspections to the private sector. It is entirely possible that private sector providers would have similar incentives as public sector officials for collecting rents/bribes, and in fact might be better resourced to do so. It is not clear how safeguards that could be put in place to avoid a transfer of rent-seeking from the public to private sector and this issue needs further research. However, unlike the public sector providers - who often have a perpetual monopoly upon a particular function – the private sector providers can be replaced for poor performance and newer agencies can be appointed.

59. It is important to recognize that self-regulation is not a panacea and cannot replace public functions of standard setting, monitoring and enforcement. However, they can be used to help government agencies in minimizing the incidence of standard violations and a more effective allocation of limited government resources for inspection purposes (by reducing the risk in self-regulated parts of the industry). An important element is that the incentive for strong self-regulation has to come from the private sector itself (such as elimination of child labor in apparel or toy manufacturing). Moreover the industry must be highly visible and subject to potential consumer reactions to standard violations (for example, apparel, toys, footwear, chemicals, natural resource-based like coffee, tea, oil, mining, timber, and fishery). Most importantly, reliable third-party monitoring mechanisms (preferably internationally recognized) must be in place. Under such circumstances the government can collaborate with the industry to ensure that these standards are in line with national legislation and to assure itself of the objective nature of the self-regulatory as well as monitoring scheme in place. If satisfactory, the relevant authority can reduce its inspection function to spot-checks only, re-allocating its human and financial resources to other areas/industries of concern.

60. *Subnational reform in the federal context.* Reform at the federal level reinforces the state level reform. However, slower reforms at the federal level also slow down the state reform. Some of the most important reforms concerning the investment climate in India are largely or exclusively within the purview of the central government—these include the exit and bankruptcy procedures, labor market reform, removal of small-scale industry reservation list, and the introduction of value added tax to replace the current sales tax system which has multiple layers, generates cascading, and imposes high effective tax on inputs.

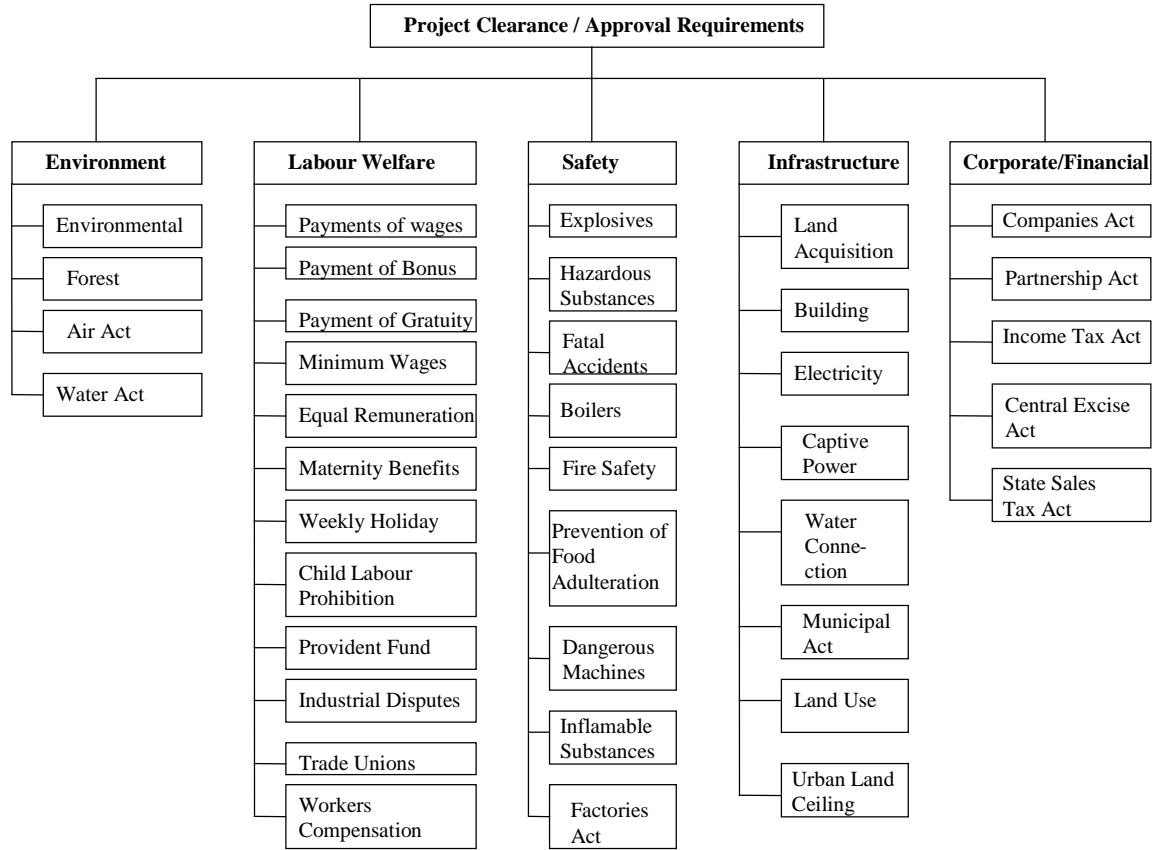
61. *Placing subnational reform in business regulatory framework within the broad context of state reform.* The quantity and quality of investment flowing into India or any other country depends upon the returns that investors expect and the uncertainties around those returns. These expectations are guided by three broad and interrelated components that shape these expectations – macroeconomic framework, regulatory environment and quality of infrastructure. Regulatory reform in the areas of entry, exit and operation must be supported by critical reforms in other areas. These include: (i) fiscal reform to reverse the fiscal deterioration experienced by many Indian states to improve fiscal transparency, and create fiscal space for infrastructure and human development; (ii) a regulatory, policy and institutional framework for public and private partnerships addressing severe infrastructural bottlenecks; and (iii) power sector reform that will be able to bring industrial power tariff in line with the international competitive level and to resolve the problem of poor-quality and inadequate power supply.

62. Reforming the regulatory framework governing business entry, exit and operation is institutional in nature, thus complex and time-consuming. Improving the investment climate in a state requires sustained reform efforts and progress needs to be well monitored. There are important lessons to be learnt from those states which are taking the lead in this change process. The ICRIER study (2004) shows that there is scope for initiating reform measures to improve the overall or particular dimensions of the investment climate in almost all the states. States that foster a market friendly investment climate would attract greater investment and grow faster while others will lag behind.

63. Finally, now that regulatory reforms are underway in various states more focus needs to be given to monitoring the impact “on the ground” of these reforms. The investment climate survey carried out by the Bank twice in ten states is a useful instrument in this regard. But states need to develop their own monitoring mechanisms as well. For instance in Karnataka, a benchmark survey was undertaken by Public Affairs Centre in 2002 to review the constraints facing businesses in the state and the government is planning to launch a follow up survey in 2005 to review progress after about 18 months of implementation of the Karnataka Industries Facilitation Bill, 2003.

Annex 1

Downstream Approval Requirements



Annex 2

Time Limits for various Approvals and Clearances in Andhra Pradesh (AP)

Name of the Clearance	Time Prescribed under Single Window Act, 2002
Permission of Gram Panchayat for setting up unit	7 days
Building permission/License from Municipality	7 days
Approval for change of land use for industrial purposes	45 days
Power Feasibility Clearance	7 days
Actual power connection *	23 days
Allotment of land / shed allocation in industrial estate (IEs)	7 days (up to 1000 sq.mts) 21 days (above 1000 sq.mts)
License for possession and use of Rectified Spirit and Denatured Spirit	7 days
Letter of intent for distillery	30 days
Registration under AP General Sales Tax and Central Sales Tax *	7 days
NOC from Fire Services Department	15 days
License to obtain and use Chlorate of Potash	7 days
Sanction of Water Supply through state water supply board *	7 days
Actual water connection *	23 days
Sanction of Water Supply through other agencies *	7 days
Actual water connection *	23 days
Permission to draw water from rivers/public tanks	30 days
Sanction of loan/equity from AP Industries Development Corpn.	21 days
Acquisition of land other than IDA, industrial estates	60 days
Alienation of Government Land	
(a) District Collector	15 days
(b) Chief Commissioner of Land Administration	30 days
(c) Government	45 days
Foodgrain License	7 days

* AP Single Window Act provides a deemed clearance clause, i.e. if the necessary clearances are not provided within the specified time limit, the approval would be deemed to have been given subject to payment of the required fee.

Annex 3

Inspection, Register Maintenance and Returns to be Maintained under Central Acts

S.no	Name of the Act	Inspection Section	Register Section	Returns to be filed Section
1	Air (Prevention and Control of Pollution) Act, 1981	24-26		Rule 14 of Environment Protection Act
2	Apprenticeship Act, 1961	29	29	29
3	Child Labour (Prohibition and regulation) Act, 1986	17	11 and Rule 16	
4	Contract Labour (Regulation and Abolition) Act, 1970	28	29	Rule 82
5	Dangerous Machines (Regulation) Act, 1983	27-30	18	State Rules
6	Employees Provident Fund and Miscellaneous Provisions Act, 1952	13		EPF Scheme Para 33, 35, 36, 55
7	Employees State Insurance Act, 1948	45	44	44
8	Employment Exchange (Compulsory Notification of Vacancies) Act, 1959	6		5
9	Environmental protection Act, 1986	10	20	20, Rule 14
10	Equal Remuneration Act	9	8, Rule 6	
11	Factories Act	7,9		
12	Indian Boilers Act, 1923	5,17		
13	Maternity Benefits Act, 1961	15-17	20	
14	Minimum Wages Act, 1948	Rule 26-B/19	18/ Rule 26	Rule 21
15	Motor Transport Workers Act, 1961	4-6	AP Rules 17,28,30,33-38	AP Rules 39
16	Payment of Bonus Act, 1965	27	26 & Rule 4	Rule 5
17	Payment of Gratuity Act, 1972	7-A, 7-B	AP Rules 6	AP Rules 5
18	Payment of Wages Act, 1948	14, 14A	13A	
19	Prevention of Food Adulteration Act, 1954	9-11		
20	Standard of Weights and Measures Act 1976	29		
21	Water (Prevention and Control of Pollution) Act, 1974	20,23		Rule 14 of Environment Protection Act

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