

## REGIONAL PERSPECTIVES: SOUTH ASIA

Private investment averaged 16.5 percent of GDP in the five-year period from 1998 to 2002. Foreign direct investment averaged 0.65 percent of GDP during the same period, the lowest of the developing regions. Including informal employment in agriculture, the informal sector represents 93 percent of total employment in India.

### Selected investment climate indicators

An annex in the Report contains indicators from the World Bank's Investment Climate Surveys and the Doing Business Database, with explanations of how the indicators were constructed. Findings for the region include:

#### Investment Climate Surveys

- The Investment Climate Surveys in Bangladesh (2002), Bhutan (2002), India (2000, 2003) and Pakistan (2002) cover 3900 registered firms. In addition, 1000 micro and informal firms were interviewed in Bangladesh, India and Pakistan.
- **Corruption** is identified as the number one constraint by firms in South Asia. Almost all firms in Bangladesh report that bribes are paid, averaging almost 3 percent of total sales. The only region that reports corruption is more of a constraint is Latin America, where bribes can be over 5 percent of sales in Ecuador, Nicaragua or Guatemala.
- An **unreliable electricity supply** was reported as the second leading constraint. Over 40 percent of firms rank electricity as a major or severe constraint to the operation and growth of their business—compared to less than 10 percent in Eastern Europe and less than 25 percent in Latin America and East Asia. Average losses from electricity outages average over 10 percent of sales in India and over 6.5 percent in Pakistan.
- **Insecure property rights** are also a large concern. In Bangladesh, 83 percent of firms lack confidence that courts will uphold their property rights. In Pakistan it is 63 percent of firms.

#### *Doing Business Database*

- **Resolving a bankruptcy** takes 3.2 years on average across all regions. South Asia's average is 4.8 years, with procedures taking 10 years in India.
- **Registering a business** takes 24 days in Pakistan, 35 in Bangladesh, 50 in Sri Lanka and 89 in India.

### The potential returns to investment climate improvements are large:

Linking the surveys objective measures of policy-related costs and risks to firm performance measures, it is possible to simulate possible contributions of changing investment climate conditions.

- In India, firms in states with poor investment climates have 40 percent lower productivity than those in states with good investment climates.
- And, if the climate for firms in Dhaka matched that of Shanghai, Dhaka could reduce its productivity gap by 40 percent, and wages could rise by 18 percent. For Calcutta, the effect is even larger: 80 percent of the productivity gap could be closed and wages could rise by 38 percent.

The Report looks at **India's experience** over the last decades to make two points.

- First, it demonstrates the significant impact of investment climate improvements in increasing growth and poverty reduction. India's reforms increased growth from an average of 2.9 percent a year in the 1970s to 6.7 percent by the mid-1990s, and the share of its population below \$1 a day fell from 54 percent in 1980 to 35 percent in 2000.
- Second, perfection is not required to realize these gains. The key is to address important constraints in ways that give firms confidence to invest and to follow initial reforms with ongoing improvements. Beginning in 1984, reforms encouraged exports, facilitated foreign technology transfers and helped rationalize the tax system. Quantitative controls on the import of capital goods were eliminated. Tariffs were cut by 60 percent. Taxes on profits from exports were cut by half. Fewer industries were subject to licensing. These initial reforms were followed by more dramatic reforms in the early 1990s. The Rupee became convertible, restrictions on foreign ownership were relaxed, additional quotas were abolished and tariffs reduced further. While the pace has slowed, reforms have continued. Licensing has been eliminated in all but seven industries. A new competition policy has been introduced. Its investment climate is still not perfect. But the persistence of its reform process has yielded enormous benefits.

The Report shows that the returns to **investment climate improvements can dwarf the impact of international aid flows**. The manufacturing value added in India equals all global official aid flows.