

Starting a business

Business registration is an area where Afghanistan is close to global best practices. It takes only 3 procedures to fulfill all start-up requirements and the process is usually completed within 8 days. To operate legally, an investor may register through the Afghanistan Investment Support Agency (AISA). AISA was set up in 2003 with the mandate of promoting investment in the country. Before its inception it took 28 procedures and 90 days to complete start-up requirements. The creation of the AISA registration process now puts Afghanistan in 17th place worldwide on the ease of starting a business—an improvement over 2005 when it ranked 22nd.

What to reform

AISA is relatively new and would-be entrepreneurs need to be made more aware of its services. Alternative ways to register through the previous system should be discontinued to avoid confusion and duplication. Start-up costs are also relatively high in Afghanistan—67% of income per capita. Although an improvement over 2005, when costs were 75% of income per capita, they are still well above the South Asia average of 47% of income per capita. Registration fees comprise more than 80% of the costs. Reducing these fees would place Afghanistan in line with lower-cost countries such as Sri Lanka, the Maldives and Pakistan, and encourage more businesses to register formally.

While the general registration process was streamlined, industry-specific start-up barriers remain. In many sectors, investors must also obtain a license from the ministry responsible for the industry in which it plans to operate, such as in the pharmaceutical, trade,

banking, insurance, foreign exchange, transportation, construction, hospitality, travel and real estate sectors. In some of these sectors, there is no rationale for requiring an additional license, and a simple business registration should suffice. In others, the rationale is strong (such as in the pharmaceutical industry) but considerable scope exists for streamlining the licensing process. In Afghanistan, investors also often have to personally transmit the paperwork from office to office and wait while each bureaucrat works on the application.

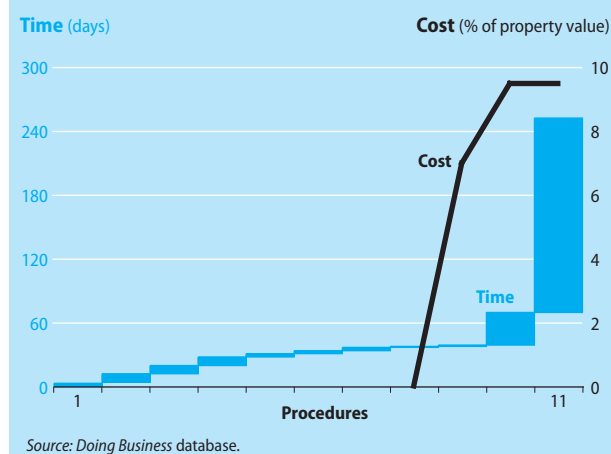
Employing workers

Afghanistan ranks 74th on the ease of employing workers. The cost of hiring is zero, as there are no social security payments or payroll taxes associated with hiring a new worker. In Pakistan and India, such costs amount to 12% and 17% salary respectively. The cost of firing is low—an employer must only give 1 month's notice when dismissing a worker. By comparison, costs of firing amount to 56 weeks' wages in India and 90 weeks' wages in Pakistan. Overall the rigidity of employment score is low at 46 out of a possible 100.

What to reform

Although employment regulations in Afghanistan are flexible overall, some specific rigidities dampen incentives to create formal jobs. In particular, Afghanistan's performance on the difficulty of hiring index, at 67 out of 100, is relatively high (the South Asian average is 42 out of 100). Term contracts are significantly restricted based on the nature of the task and the length of the contract. Loosening these rules will encourage the creation of more formal sector jobs. Outside the scope of

FIGURE 2.1

Registering property in Afghanistan**Procedures**

1. Submit two signed copies of Circular Form to the Head of Makhzan (judge)
2. The signed Circular Form is then submitted to the Chief of Makhzan
3. Circular Form sent to Imlak (Municipal Land Office) for certification
4. An Imlak committee establishes the value of the land
5. The Circular Form is submitted to the local Tax Collection Office
6. The Circular Form is submitted to the provincial Tax Collection Office
7. Submit the Circular Form to the Human Resource Directorate
8. The completed Circular Form is submitted back to the Primary Court judge
9. Seller pays property taxes at a designated bank
10. Submit the completed Circular Form to the Primary Court
11. The buyer obtains a copy of the deed

the *Doing Business* indicators—which focus on private sector employment—an important priority is to develop a sound mechanism for retrenchment of workers in state-owned enterprises. This is necessary to facilitate state-owned enterprise reform, including liquidation and privatization.

Registering property

Afghanistan ranks 169th globally in 2006 on the ease of registering property—the same as in 2005 and well below the South Asian average. It takes 252 days to complete the 11 procedures required and costs 10% of the property value (figure 2.1). The greatest bottleneck is in the time needed for the primary court to process the deed, which can take up to 1 year in some cases. Such delays are common when courts are involved in property registration. The complexity of the procedures—requiring visits to different levels of the courts, the land office, the tax collection office, the human resource directorate and the bank—discourages formal property registration.

What to reform

Most private land in Afghanistan does not have a clear title. Many land title records have been destroyed over the years, particularly during the recent conflicts in Afghanistan. The land courts that are in charge of land titling and property transfer are said to be among the most corrupt in Afghanistan. Reforming both land ownership and land registration rules are urgent priorities. Without secure property rights, businesses invest less and are constrained in getting credit. The first steps toward

reform in Afghanistan can be to rebuild the administration of property deeds, design effective property dispute resolution mechanisms and implement a transparent means for enforcing decisions. Reducing the complexity of the property registration process is also an important element in securing property rights. Though land registration pilot projects have been proposed in Afghanistan, their scale will need to be substantially increased to address urgent national needs. The registration system does not require sophisticated technologies—Thailand is an example of best practices with paper-based registration that requires only 2 procedures and 2 days. Stamp duties and taxes should also be reduced to encourage formal registration. Typically reductions in fees lead to more revenues, as more properties are registered and with less underreporting of property values.

Getting credit

Afghanistan scores zero on all four *Doing Business* indicators on the ease of getting credit. Lenders look at the borrower's credit history and collateral when extending loans. But in Afghanistan there are no credit registries to provide lenders with information on the borrower's credit history. There is no functioning secured transactions law to allow creditors to take and enforce collateral effectively. And there are no functioning property registries to support the use of land as collateral. Although discussions have been held on the possibility of establishing a basic credit bureau, none has been established.

What to reform

The government could start by creating a simple credit registry to facilitate the exchange of information on repayment patterns among financial institutions. Registries are inexpensive to establish—less than \$2 million—and can be expanded in scope as the market develops. Although land reforms will take time to implement, the government can support the development of secured lending by introducing a collateral law for movable property. Small businesses typically have 70% of their assets in movable property—including equipment, inventory and accounts receivable. Access to loans will increase if Afghanistan adopts a secured transactions law that allows all of these assets to be used as collateral provides for a unified registry of security interests and permits out-of-court enforcement of collateral agreements.

Protecting investors

Afghanistan does not have an active equity market. Laws provide none of the protections for shareholders measured in the *Doing Business* protecting investors indicator—Afghanistan is ranked 173rd out of 175 economies on this measure. There are no requirements for insiders to disclose transactions involving conflicts of interest, no penalties for managers and directors who misuse their position, and no procedures available for shareholders to seek redress in cases of self-dealing.

What to reform

Complex minority investor protections are more appropriate for countries with stock exchanges and developed markets than for countries with nascent financial institutions, such as Afghanistan. Afghanistan can benefit, however, from a baseline of simple protections for minority investors. First, Afghanistan can adopt simple board approval procedures for large transactions involving company insiders. This will structure the decision-making within a company and limit directors' ability to misuse company funds. Periodic reporting to investors on the major actions of the company would also increase transparency of company actions. And finally, if an investor feels the company is being operated in a way that inappropriately benefits the directors or managers personally, that investor should be permitted to sue those directors and managers for any damage caused to the company. Through these three steps, Afghan law can provide visibility into company operations and redress for any abuse. Such reforms will encourage investors to entrust their money to Afghan companies.

Paying taxes

Afghanistan ranks well—in 30th place—on the ease of paying taxes. Only two tax payments are required in a year, for corporate income tax and a business receipts tax. It takes about 275 hours of work to fulfill annual tax requirements, compared with 400 hours in Bangladesh and 560 hours in Pakistan. The tax burden is relatively low at 36% of profits compared to 40% in Bangladesh, 43% in Pakistan and 81% in India.

What to reform

Although Afghanistan ranks well on the ease of paying taxes, there remains a degree of uncertainty on tax policy, caused primarily by a lack of information. In 2005, the government reversed its position on tax holidays offered to investors. Many new investors were lured to Afghanistan with the promise of a 4- or 7-year tax holiday. Now, at least some of them have been informed that not only are they going to lose the tax holiday, but they also must pay tax retroactively for past years. The government has stated that the phase-out of the tax holiday is not retroactive and that only firms that did not complete the formalities to receive the tax holidays in a timely manner or were promised them by unauthorized persons are losing them. But many firms did not understand what the process was or who was authorized to grant them a holiday. This experience illustrates the need for adequate information about policy and procedures, to counter the already substantial risk and uncertainty of doing business in Afghanistan.

Trading across borders

In 2004 the government passed a customs reform package that makes Afghanistan one of the most open economies in the region. Among other reforms, the new law simplified the tariff structure and reduced the range of tariffs from a maximum of 150% to a range of 3 to 16%. The average tariff rate is 5%. In addition, the Ministry of Finance with the Ministry of Commerce is implementing a Customs Modernization Program to clarify roles and responsibilities among agencies and improve customs service.

However, there is still much to do. Afghanistan ranks 152nd on the ease of trading across borders, well below the South Asia average. Importing requires 88 days and 11 documents (table 2.1). Businesses report that customs officials continue to use wide discretion on the valuation and inspection procedures, which leads

TABLE 2.1

Long delays for importing in Afghanistan

	Days	Documents	Cost (US\$ per container)
Pakistan	19	12	1,005
Maldives	21	9	1,784
Sri Lanka	27	13	789
Nepal	37	10	1,800
India	41	15	1,244
Bhutan	42	14	1,950
Bangladesh	57	16	1,287
Afghanistan	88	11	2,100

Source: Doing Business database

to corruption and delays. The situation is slightly better for export which takes 66 days and 7 documents. However, the cost of importing and exporting to and from Afghanistan is much higher than the average in South Asia. For example, a 20-foot container costs \$2,500 to be exported from Afghanistan. In Nepal, the second most expensive South Asian country to export from, the same container only costs \$1,600 to export. The 2005 World Bank Investment Climate Survey, a cross-country study of firms, found that customs procedures in Afghanistan are significantly slower than among its neighbors, which further erodes the competitiveness of Afghan products.

What to reform

Afghanistan can boost trade and reduce smuggling and corruption in customs by cutting red tape in the import and export process. Large gains can be made with simple reforms, such as standardizing paperwork and eliminating unnecessary documentation. But broader reforms are also needed. Inland transportation is another large bottleneck in the trading process, taking 15 days. Efficient, safe and reliable trade corridors will significantly cut delays. Trade-related standards and procedures need to be harmonized. Finally, the institutional responsibilities for trade, such as the division of responsibilities between the Ministries of Finance and Commerce need to be clarified.

Enforcing contracts

Afghanistan ranks 165th on the ease of enforcing contracts. It takes almost five years or 1,642 days to enforce a commercial contract and costs 25% of the value of the claim. It is no surprise then that businesses use mostly informal mechanisms, including force, to resolve disputes. There are no formal alternative dispute resolution mechanisms such as arbitration or mediation. The formal court system suffers from a lack of qualified legal professionals, no method to hold judges accountable,

and reportedly endemic corruption. Consequently, businesses do not rely on the formal judicial system. Only 3 of the 338 firms in a recent Investment Climate Survey reported using the commercial courts to settle a payment dispute in the past two years.

What to reform

Establishing fast, fair and affordable courts is a long-term goal for Afghanistan. In the short term, a commercial arbitration system can be introduced to resolve disputes as courts develop. But as commercial arbitration is rarely faster and cheaper than the judicial process, it is not a long-term solution. When establishing rules of civil procedure for the developing court system, Afghanistan can encourage efficiency by: giving judges the authority to impose strict deadlines for the exchange of evidence and arguments, limiting the disputed issues at a pre-trial conference, limiting the opportunity for parties to change claims and introduce counterclaims, imposing a maximum length for arguments and sanctioning dilatory tactics. Summary proceedings and other types of fast track procedures can be introduced to dispose quickly of undisputed claims or claims that cannot be seriously disputed. An efficient system of enforcing judgments through private enforcement officers is also critical to the efficiency of the entire judicial process.

Closing a business

Afghanistan is recorded as “no practice” on the ease of closing a business, as there have been no bankruptcy cases in the country. Businesses simply close operations, leaving creditors with no option other than to attempt recovery through ordinary enforcement proceedings. There is no bankruptcy law.

What to reform

Bankruptcy law is most relevant in countries with developed financial systems and where businesses have several creditors who would compete for recovery of limited funds of an insolvent firm. In poor countries, reformers would do better to focus on improving foreclosure of secured debt outside of bankruptcy. Afghanistan can improve a lender's chances of recovery from an insolvent business by introducing a secured transactions law that allows for out-of-court enforcement. As a next step, the government can introduce a bankruptcy law to handle more complex insolvencies with several claimants, which may emerge as the economy develops.