

Bhutan ranks 138th out of 175 countries on the ease of doing business. While wide-ranging reforms have been initiated in Bhutan, implementation is still far from complete. The cost of delaying reforms is high in an increasingly international competitive environment. Progress in reforming business regulations will lead to more investment, job creation and growth.

Starting a business

Bhutan ranks 79th on the ease of starting a business, ahead of only India in the South Asia region. No minimum capital requirement applies and start-up cost is one of the lowest in the region, at 17% of income per capita. However, entrepreneurs have to complete 10 separate procedures taking 62 days, well above the regional average of 8 procedures and 33 days, and the OECD average of 6 procedures and 17 days.

What to reform

The Department of Industries in Bhutan has begun reforms to simplify the registration process. The initial target is to cut registration time to 47 days. Currently, entrepreneurs are required to obtain clearances from the police, the Department of Industries, the city council, the company registry and the Ministry of Trade. Bhutan can greatly simplify start-up by creating a single access point, by locating representatives from the different agencies in one building where the entrepreneurs can obtain all of these clearances in one visit. Ideally, the government can set up an online registration system, which unites different agencies and automatically forwards an application from one agency to another. Strict time limits combined with a silence-is-consent rule, which

grants authorization automatically after a specific time has lapsed, can further reduce delays and encourage businesses to register formally.

Dealing with licenses

Licensing is time-consuming and bureaucratic, placing Bhutan at 145th position worldwide, ahead of only India in the South Asia region. Fulfilling the licensing and permit requirements to build a warehouse takes 26 procedures and 204 days. Bhutan fares poorly when compared with other South Asian countries.

What to reform

As part of its reform of business registration, the government is also streamlining licensing requirements. An amendment to the Companies Act is being drafted, existing rules and regulations consolidated and capacity within the Registrar of Companies strengthened. The current process is characterized by a complex set of inspections, which should be simplified through the reforms. As with business start-up, creating strict time limits for licensing and a silence-is-consent rule, whereby licenses are automatically approved after a set amount of time has passed, can further reduce licensing delays.

Employing workers

Rigid labor markets constrain private sector growth. Bhutan ranks 116th worldwide on the ease of employing workers. Regulations governing labor markets are rudimentary in Bhutan. Employment of Bhutanese nationals falls under the Rules and Regulations on Employment of Bhutanese Nationals in the Private Sector (1997). All-

though procedures for dismissing workers are relatively flexible, the cost of firing in terms of advance notice requirements, severance payments and penalties is one of the highest, at 95 times the weekly wage. The South Asian regional average stands at 72, which is more than double the OECD average of 31. Restrictions on term contracts discourage new job creation. The minimum wage officially applies only to Bhutanese public sector workers, with limited impact on private businesses.

Part of the inflexibility in Bhutan's labor markets can be explained by the segmented nature of the labor market: it is estimated that non-nationals represent approximately 50% of total formal sector employment. Stringent restrictions exist for recruiting foreign workers. When permitted, recruiting foreigners entails time-consuming procedures. To address the duality and gaps, the government is developing a more flexible labor policy, including laws and regulations to reduce constraints for young people—the most greatly affected by the rigid labor institutions—in finding jobs. A critical element of reform involves the parliamentary ratification of the Labor and Employment Act that aims to balance the legitimate needs of workers with the objective of promoting private sector activity.

What to reform

Improving the functioning of labor markets is a priority for the government. A range of reforms to streamline the process for recruiting foreign workers were implemented recently. In particular, an online recruitment system has cut the time to obtain permits for foreign workers from 3 months to 3 weeks. And a one-stop service center was established, allowing applicants to complete the formalities for foreign worker recruitment in one place.

The government has also prepared a Labor and Employment Act to balance the legitimate needs of workers with the promotion of private sector activity. Once effective, this Act will: (i) allow Bhutanese, particularly youths, to be employed in a wider spectrum of economic activities, (ii) allow for more flexible working hours; (iii) allow night work in industries requiring round-the-clock work scheduling; and (iv) help streamline processes and reduce the time required for recruiting foreign workers.

Registering property

Bhutan ranks 41st on the ease of registering property. It takes 5 procedures and 93 days to transfer ownership of a property just outside urban Thimpu (figure 2.5). Delays are longer than in Nepal (5 days), Pakistan (50 days), India (62 days) and Sri Lanka (63 days). But costs to register property are negligible, compared to the South Asia average of 5% of the property value.

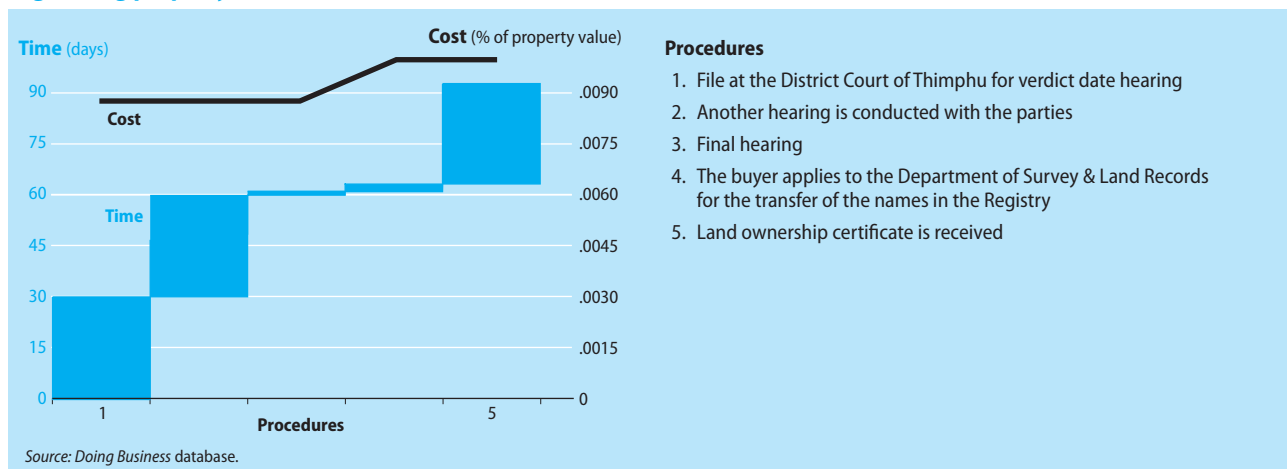
What to reform

Reforms can start by taking property registration out of the courts and making it a purely administrative process. In rural Thimpu, a judge reviews and approves the application for property transfer. This causes a 30-day delay for businesses registering property. It also takes time away from the main task of judges—resolving disputes. The buyer then makes yet another application to transfer property to the Department of Survey and Land Records. By contrast, in central urban Thimpu courts are not involved in transferring property. There, the City Corporation records property transactions and the entire registration process takes 44 days.

Delays can also be reduced by continuing the pro-

FIGURE 2.5

Registering property in Bhutan



Procedures

1. File at the District Court of Thimphu for verdict date hearing
2. Another hearing is conducted with the parties
3. Final hearing
4. The buyer applies to the Department of Survey & Land Records for the transfer of the names in the Registry
5. Land ownership certificate is received

cess of computerization of titles in the Department of Survey and Land Records. The process started in the 1990s and approximately 70% of titles are now digitized. These efforts have sped the registration process and should be completed. The City Corporation in urban Thimpu can also cut delays by following the example of its rural counterpart in computerizing records.

Getting credit

While Bhutan's financial sector is stable, it lacks depth. Bhutan ranks 159th out of 175 on the ease of getting credit. While the establishment of a credit information bureau has been initiated, legal rights for borrowers and lenders are still weak. Developing financial markets is a major challenge. There are only 2 banks and 2 non-bank financial institutions in Bhutan. The loan market is thin, substantial assets are held abroad and there is little private and international participation in banks. The government remains the dominant shareholder in financial institutions. Some capital controls are imposed. Financial reforms to strengthen provisioning requirements and capital adequacy are underway. The interest rate spread is about 10%, higher than the regional average of 7%.

What to reform

The rights of creditors to take and enforce collateral efficiently should be strengthened. Developing depth in the financial sector by introducing new financial products—such as credit cards and ATM machines (first introduced in April 2004)—is needed. Setting up more efficient payment mechanisms and increasing competition by opening the market to new non-bank financial institutions will further encourage lending. Finally, building the capacity of the Royal Monetary Authority to supervise banks and regulate insurance companies effectively is important for financial market development.

Protecting investors

Bhutan ranks 118th on the protecting investors index, below the South Asia average and ahead of only Afghanistan. Although transactions involving conflicts of interest must be disclosed in periodic filings, there are no requirements for insiders to immediately disclose such transactions. The procedures available for shareholders to seek redress in cases of self-dealing are also weak, with Bhutan scoring only 4 out of 10 on the ease of shareholder suits measure.

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 Bhutan. Bhutan can benefit, however, from enforcing a baseline of protections for minority investors. In particular, enforcement can be strengthened by providing greater access to evidence during trial. The court procedure code currently exempts witnesses from having to turn over evidence relevant to the case. This opens a wide loophole for defendants looking to hide evidence of their wrongdoing. Protections in other areas, either through disclosure or detailed director obligations to the company, are less effective if they ultimately cannot be enforced in court. By reforming such loopholes, Bhutan can encourage investors to entrust their money to Bhutanese companies.

Paying taxes

Bhutan ranks 68th on the ease of paying taxes, middle of the range for the South Asia region. Every year entrepreneurs must make 19 tax payments and spend 274 hours complying with tax rules. They pay 43% of profits in taxes. Tax revenue accounts for only around 50% of total revenue, with the majority of non-tax revenue stemming from power exports to India. The tax base is narrow, but is expanding with growing taxation of private businesses and the introduction of an income tax in 2002-03. The government provides tax incentives to promote private sector development in manufacturing, services and export-oriented industries for a period of three years. Revenue from taxes on trade is small.

What to reform

Tax administration is improving in Bhutan. The cost of generating revenue is not unduly high. For example, as most items are imported into Bhutan, the sales tax is mostly collected at the point of entry, lowering administrative costs. Corruption in tax administration is not known to be a major problem. Further improvements can focus on simplifying tax compliance for business. The number of payments and number of different taxes a company has to pay can be reduced by consolidating different types of taxes and eliminating minor taxes that raise little revenue but increase hassle for business. The government can also address gaps in monitoring and the use of personal identification numbers.

Trading across borders

It takes 39 days and 10 documents to fulfill all procedures to export goods in Bhutan. Importing is no easier, requiring 42 days and 14 documents. Bhutan ranks 150th on the ease of trading across borders, far from the top performers in the region.

Although trade administration is an obstacle, Bhutan is otherwise relatively open. Bhutan has a free trading regime with India, which is its main trading partner and accounts for over 90% of exports and imports. Average tariffs are about 24% and there are 7 tariff bands. Bhutan does not have any taxes on exports. The South Asia Free Trade Agreement (SAFTA) became operational in January 2006 and Bhutan is also in the process of negotiating accession to the World Trade Organization. Five railway routes have been identified from India to Bhutan, and with the establishment of a dry port and direct transshipment possibilities through India, future trade policy with the rest of the world will become more meaningful.

What to reform

Bhutan's growing membership in various trade associations is likely to open up new markets for Bhutanese products. It can expand trade even further by tackling administrative hurdles to import and export. Trade agreements are most effective when they go beyond simply liberalizing tariff regimes—especially for a landlocked country that depends on efficient border procedures of its neighbors. Bhutan can pursue various border cooperation agreements with its neighbors, in particular its major trading partner India. This will avoid multiple inspections of cargo on both sides of the border, allowing trade to flow freely across borders.

Bhutan can further simplify trading procedures by introducing a unified customs declaration form, consolidating several documentary requirements for different government departments. Also, Bhutan could move away from a 100% physical inspection regime to a computerized risk management system, where less than 20% of all imports are selectively targeted for inspection. Finally, Bhutan can cut delays in trade by improving road infrastructure on the main trade corridors and developing a dry port. Ongoing work on the Thimphu-Phuentsholing Express Highway and improvements to railway routes between Bhutan and India are positive steps in this direction.

Enforcing contracts

Bhutan ranks 56th on the ease of enforcing contracts. It takes on average 275 days to resolve disputes through the courts. Bhutan's ranking on contract enforcement improved since last year because of a drop in costs. While court fees are negligible in Bhutan, lawyers previously were charging their clients exorbitantly high amounts. Last year, the Bhutanese authorities took reform measures to limit fees that lawyers can charge. As a result, today the total cost of enforcing contracts amounts to 20% of the value of the claim, compared with 114% of the value of the claim in 2005.

What to reform

Establishing fast, fair and affordable courts encourages trade beyond established business partnerships. To further cut delays, the number of appeals allowed can be reduced. The judiciary can also consistently grant summary judgment when appropriate, as is provided for in the Code of Civil Procedure. More generally, the government needs to build judicial capacity by increasing the number judges and lawyers skilled in commercial law.

Closing a business

Bhutan is recorded as “no practice” on the ease of closing a business, as there are no bankruptcy cases in the country. Although Bhutan has a bankruptcy law, it is not applied. On average the company registry has recorded 3 business closings per year over the last 5 years. None have been closed through bankruptcy proceedings. Instead businesses simply discontinue operations, leaving creditors with no option other than to attempt recovery through ordinary enforcement proceedings.

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. Bhutan can increase a lender's chances of recovering from an insolvent business by allowing for out-of-court enforcement of collateral agreements and providing creditors with priority to their collateral.