DISCUSSION PAPER

Overcoming Supply-Side Constraints in South Asia

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List of acronyms

AIAI	All India Association of Industries
BBC	British Broadcasting Corporation
EMS	Environmental Management System
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
ICT	Information and Communication Technology
IEA	International Energy Agency
IMF	International Monetary Fund
IPI	Investment Protection Index
ITC	International Trade Centre
LDCs	Least Developed Countries
MNEs	Multinational Enterprises
MW	Mega Watts
NGOs	Non Governmental Organisations
NICs	Newly Industrialised Countries
OECD	Organisation for Economic Cooperation and Development
RIS	Research and Information System for Developing Countries
RSI	Resource Systems Institute
SAFTA	South Asian Free Trade Area
SAPTA	South Asian Preferential Trade Agreement
SMEs	Small and Medium Enterprises
Tcf	Trillion cubic feet
UNCTAD	United Nations Conference on Trade and Development
UNESCAP	United Nations Economic Commission for Asia and the Pacific
US	United States
WTO	World Trade Organization

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Executive Summary

Fifty years of multilateral trade liberalisation have reduced tariff rates on merchandise trade substantially, both in industrialised as well as in developing countries. South Asian countries too have liberalised their economies during the last two decades. However, there is considerable frustration among the region's policy makers on the slow progress in achieving sustained export growth. They hold the external policy environment responsible for their failures while ignoring the domestic policy framework and supply-side capacities.

This discussion paper argues that successful integration in the international market depends on two factors: the ability of firms to produce goods and services required by the importing countries in the quality and quantity at competitive prices and the availability of efficient mechanisms to ensure that these products and services reach markets on time. In this regard, the domestic policy environment should be conducive for undertaking business activities. There are several critical factors that determine the supply-side capacity of firms in developing countries. They include an enabling policy and regulatory framework, efficient institutions and good governance, factors that improve productivity on the one hand and those that reduce transaction costs on the other. In addition, this discussion paper recognises the centrality of business firms in managing supply capacity. It recognises the importance of efficiently handling financial, natural, physical, human and social capital for addressing supply-side constraints.

The discussion paper identifies five critical factors that constrain South Asia's exports: political instability, inability to enforce the rule of law, poor state of education, gender bias, poor management of human resources, and poor quality of public infrastructure (such as roads, energy, inadequate information and communication technology, etc.). Quality and productivity, institutional structures, tax administration and rates, and enforcement of regulations relating to the credit market are important but not as critical as the previous factors. Despite the common belief, South Asia's governance structure is not a major hindrance to business performance in comparison to other countries and regions. South Asian economies need to address the most critical supply-side constraints to benefit from the global trade regime.

Chapter 1

Introduction

Tariffs on industrial goods have declined substantially as a result of successive rounds of multilateral negotiations under the aegis of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO) (Acharya and Daly, 2004). Notwithstanding tariff peaks and tariff escalation, particularly with respect to products of interest to developing countries, the overall import weighted Most Favoured Nation (MFN) average tariff on industrial products in industrial economies has come down to around 4 percent (Hertel and Martin 2000).

The process of trade liberalisation in South Asia began in 1977 when Sri Lanka introduced wide-ranging trade reforms. Other countries in the region started liberalising their economies in the latter part of 1980s and early 1990s, with further efforts to consolidate reforms made during the last decade. These policy reforms were quite broad and covered both external and domestic sectors. As the *South Asia Development and Cooperation Report 2004* highlights, "the South Asian economies were not mere passive spectators to this whirlpool but joined the process quite earnestly"(RIS 2004). Trade liberalisation in South Asia is attributed to several different modes, including multilateral trade liberalisation under the aegis of the GATT/WTO, regional trade liberalisation under the South Asian Preferential Trade Agreement (SAPTA) and the South Asian Free Trade Area (SAFTA), and liberalisation under bilateral free trade agreements. Parallel to trade liberalisation under these modes, domestic market reforms were introduced to meet structural adjustment requirements of the Bretton Woods institutions, viz., the World Bank and the International Monetary Fund (IMF). Whatever the mode of liberalisation, the overarching objective was to enhance economic efficiency and reap the perceived benefits of an open trading regime. As a result of these trade reforms, tariffs have declined although average tariff rates are still higher in comparison to most developing countries (IMF 2004).[1]

The impact of trade liberalisation on South Asian economies is debatable. At the macroeconomic level, economic growth rates have accelerated following trade liberalisation in almost all the countries in the immediate aftermath of the reforms. Similarly, trade liberalisation has also resulted in high growth rates of exports and imports across South Asia. Although the region's export basket has shifted from the domination by primary products to manufactured exports, reliance of exports on one or two commodities is a major concern for some countries.[2] India — the largest country in South Asia — has gained much prominence in exports by becoming the 20th largest country in the world in terms of merchandise exports with a share of 1.1 percent and the 22nd largest exporter of commercial services with a share of 1.5 percent (UNCTAD 2005). However, according to the World Bank, the total merchandise trade of South Asia as a percentage of world trade was only 1.11 percent in 2004 (World Bank 2006). The share of India during the same year was 0.79 percent while the combined share of other countries was 0.31 percent. This needs to be compared with the region's population as a share of the world total population, which was 22.8

According to the World Bank, the total merchandise trade of South Asia as a percentage of world trade was only 1.11 percent in 2004 percent in 2004. In terms of imports, South Asia's share was only 1.48 percent of total world imports in 2004 (World Bank, 2006). This suggests a huge discrepancy between the size of the population and the export share of South Asia in the global economy.

It may be noted that the total merchandise exports in the fifty countries designated as the least developed countries (LDCs), of which three are in South Asia, totalled US$ 57.8 billion in 2004 (UNCTAD, 2006). This represents a mere 0.63 percent of total merchandise trade in the world for a population of 740 million or 11.6 percent of the world population (UNCTAD 2006, World Bank, 2006). Although LDCs made some progress in 2004 compared to 2002 and 2003, the reality is that they are the most marginalised group in global trade. This begs the question: what lies beneath the abysmal export performance of South Asia? The question is even pertinent in a situation where many of these countries have implemented trade reforms, as RIS (2004) puts it, 'earnestly' and that tariff rates in the industrialised countries have also come down significantly notwithstanding the presence of tariff peaks, tariff escalation and non-tariff barriers (NTBs).

Liberalisation episodes in South Asia lacked the vigour in terms of pursuing the domestic reform agenda and the efforts in strengthening the supply-side capacity required to withstand the competition in international markets, to meet quality requirements and to maintain economies of scale

East Asian countries experienced high and rapid growth rates as a result of their open market policies. The rapid economic growth of the developing countries in Asia and the Pacific region is one of the most significant events of the second half the 20th century (James et. al. 1989). The economic performance in East Asia shows the benefits of the outward-looking and market-oriented policies. Research on the East Asian growth experience depicts that the initial conditions and the domestic policy measures pursued were critical in relaxing the constraints on their development performance. The differential economic performance of countries in South and East Asia is attributed to the quality of domestic policy framework pursued by East Asia more so than the initial conditions. However, another critical factor that determined the success of the 'Asian tigers' was their external orientation.

Within this comparative economic performance scenario, it is pertinent to ask what factors may have constrained economic performance of South Asia even when extensive trade reforms have been carried out. It is believed that the liberalisation episodes in South Asia lacked the vigour in terms of pursuing the domestic reform agenda and the efforts in strengthening the supply-side capacity required to withstand the competition in international markets, to meet quality requirements and to maintain economies of scale. Many enterprises that were producing goods and services primarily for the domestic market under protective environment were opened up to international competition without adequate time to adjust to globalisation. In some cases, governments expected trade liberalisation to correct all the market failure as in textbook cases. Policy makers perceived trade liberalisation to be synonymous with the creation of a 'level playing field', notwithstanding the fact that what ailed developing countries was their weak capacity to supply and therefore needed to create an 'uneven playing field', skewed towards developing country concerns.

Trade negotiations under the WTO framework aim to address trade barriers and improve market access for goods and services. These reforms are not enough for removing critical supply-side constraints. The WTO agreements have recognised the need to strengthen the supply-side capacity of developing countries, and therefore, have introduced special clauses for creating the 'enabling environment' and special and differential treatment (S&DT) for developing countries.

Such an enabling environment can contribute to economic growth in various ways. Small and medium enterprises (SMEs) in developing countries account for a major fraction of total exports. However, sustaining SMEs requires an enabling environment as they are unable to withstand competition in international markets with rising production costs. They are also vulnerable to price variations that may arise from exchange rate fluctuations or changes in actual international prices and to collusive behaviour of larger firms and price setting in international markets. In addition, they are in a weaker position to search for information, enforce contracts and property rights and to protect themselves from protectionist tendencies. As a World Bank research on SMEs in south-west China has shown, firms located in cities with better investment climates exhibited productivity rates of about 50 percent above the average, while firms located in cities with poorer investment climates had productivity rates of about 50 percent below average (World Bank 2005). An enabling environment also plays a critical role in attracting foreign direct investment (FDI). Investment usually flows to countries that already have a well-functioning business sector.

The determinants of export performance may be classified into internal and external components (Fugazza 2004). External factors are related to market access conditions and other factors affecting import demand, including transportation costs, geography and physical infrastructures. Internal factors refer to supply-side conditions such as access to raw materials, the availability of labour and capital, resource endowment and factor costs and access to technology. It is important to recognise that some of these variables are the outcome of economic policy and the institutional environment. Therefore, export performance could be enhanced not only by improving market access in foreign markets but also by creating an enabling environment that enhances supply-side capabilities. This discussion paper examines the major supply-side constraints facing South Asia and explores avenues to overcome these bottlenecks.

Issues for discussion

- What domestic and external factors hinder export diversification prospects of South Asian economies?
- What can be the role of developed countries to improve market access for developing country exports?

Chapter 2

Market Reforms, Export Potential and Performance

In the immediate post-war era coinciding with the emergence of newly independent countries, policy makers in South Asia believed that import substitution could help developing countries achieve industrialisation. Policy prescriptions of economists such as Arthur Lewis and Walt Whitman Rostow shaped growth policies in the Third World. Almost all Latin American and Asian countries implemented import substitution industrialisation (ISI), characterised by high tariff walls, quantitative restrictions, exchange rate controls and limits on foreign ownership of capital and capital flows. These policies continued for close to four decades in most of the South Asian economies.

These policies began to wither away with continued adverse growth performance in South Asia, characterised by slow growth and macroeconomic instability. East Asia succeeded in sustaining high growth rates because the open market policies allowed them to fully engage in international trade and gain access to developed country markets, import technology needed for industrialisation and achieve enhancements in productivity (Lee and Yamazawa 1990, James et. al. 1989).

Sri Lanka began reforming its economy in 1977, followed by Bangladesh in the early 1980s, the Maldives in the latter part of the 1980s and India and Pakistan during the 1990s. Nepal and Bhutan maintained open economic policies with respect to India, but practically closed to the rest of the world for a long period (RIS 2004). Adopting market-oriented reforms to take advantage of an open trading environment, improving efficiency and increasing productivity, transforming the socio-economic environment and reducing poverty were among the most significant objectives of the first phase of reforms. In a gradual manner, South Asian countries replaced quantitative restrictions with tariffs; reduced tariffs substantially; rationalised tariff structures and introduced few bands instead of a complicated list of differing tariff rates for commodities; removed preferential rates applicable to state owned enterprises, and also removed exchange rate restrictions[3] on current account transactions.[4] The second wave of liberalisation began in the latter part of the 1990s with programmes to consolidate the gains of early trade and investment liberalisation through the introduction of domestic reforms. These include liberalisation of investment for foreign investment with higher foreign equity participation, granting automatic approval to foreign investment projects subject to specific equity participation requirements; liberalisation of outbound investment; introduction of domestic competition laws in line with international norms; and liberalisation of exchange controls, including the introduction of full currency convertibility.

Have these market-oriented reforms benefited South Asia? The answer is 'yes' if one were to compare the recent economic performance with the past, but the benefits seem trivial if one were to juxtapose South Asia with the rest of the world. As RIS (2004) points out, the reforms resulted in rising gross domestic product (GDP) growth rates during the 1990s, averaging 5.9 percent annually and substantial export and import growth during the 1990s.

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Some countries have achieved export success by penetrating into niche markets while others perform much better in large-scale production of some commodities

Despite improvement in GDP indicators, erratic export performance is a common feature across all the South Asian countries. India achieved export growth rates of around 18–20 percent in 1993-96 and export growth rates between 11–17 percent during 2000–2004 (RIS 2004). In the same year, Sri Lanka recorded a negative rate of growth of 12.9 percent. The island nation depicted a mixed export performance during this period, with negative rates for three years and rates ranging from 3.4 percent to 20.6 in other years. Trends in export growth point to a fundamental weakness in South Asia's export competitiveness and its inability to withstand global competition as other countries have achieved economies of scale, technological advancement and the penetration into global production networks and value chains.

Compared to major exporters, South Asia's performance is not impressive. Other developing countries have achieved export success by penetrating into niche markets while others perform much better in large-scale production of some commodities. According to the trade performance index developed by the International Trade Centre (ITC), South Asian countries stood in the range between 122 and 129 out of 184 countries, with Bangladesh at 122, Bhutan and Pakistan at 124, and India and Sri Lanka at 129. South Asia, in general, ranked very poorly in a number of other indicators. India, with its large market size and resources base, ranked higher in a number of areas such as share in world market (34), product diversification (24), product spread (19), market diversification (32), and market concentration (14). All the other countries ranked low in all other categories (except Bangladesh that ranked 18 in the category of trend of exports).

Notwithstanding the achievements of India as well as the general structural transformation of other countries in terms of a marked shift from primary to manufactured exports[5], South Asia's export basket still comprises of a small share of skill-intensive exports and a high percentage of unskilled labour and resource-intensive products.[6] As the experience of NICs suggest, successful exporters specialise in high and medium technology manufactures and that specialisation in the former is increasingly related to export success.

In summary, South Asian countries liberalised their trade regimes with the objective of achieving economic efficiency and raising the living standards of their populations. As a result of the shift in policy regimes, South Asian economies have gone through a considerable degree of structural transformation in the liberalisation era. Whether trade liberalisation has benefited South Asia is still an open question. Market access in foreign markets is needed for increasing exports but that it will not be sufficient. South Asia needs to implement a credible policy towards creating capacity for exports. The next chapter identifies the critical supply-side constraints facing South Asia in relation to other countries that have been able to fully integrate with the global economy and achieve sustained economic growth.

Issues for discussion

- Analyse the changing composition of South Asia's exports to Organisation for Economic Cooperation and Development (OECD) members. Is there been a marked change from primary commodities to manufactures?

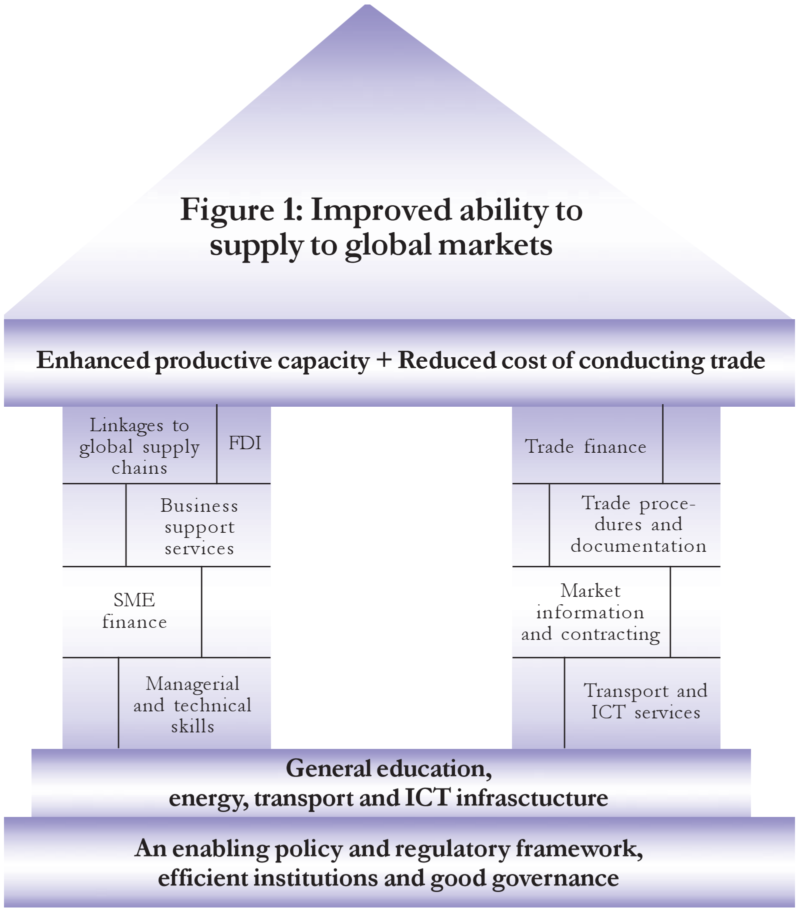
Chapter 3

Identifying Critical Supply-Side Constraints

3.1 Introduction

Successful participation in global markets depends on two factors; first, the ability of firms to produce goods and services required by consumers satisfying the 'inseparable triad' of price, quality and delivery; and second; the availability of efficient mechanisms to ensure that these products and services reach international markets on time (UNESCAP 2004).

As Figure 1 depicts, improved ability to supply to international markets depends on two key factors: enhanced productive capacity and reduced cost of conducting trade (UNESCAP 2004). The foundation of the supply-side capacity consists of an enabling policy and regulatory framework, efficient institutions and good governance. The first pillar consist of several 'bricks', which include managerial and technical skills, finance for small-scale enterprises, business support services, linkages to global supply chains and FDI. The second pillar consists of transport, information and communication technology (ICT), marketing services and contracting, trade procedures and documentation and trade finance. The next layer of this foundation consists of general education and basic infrastructure, which includes energy, road networks and ICT. The economic performance of firms depend on five types of resources under their control, viz. financial capital, natural resources, physical capital, human capital and social capital. Addressing one of these elements is not enough for improving the supply-side capacity and benefit from the relatively freer and rule-based market conditions under the WTO. Firms need to improve productivity and reduce transaction costs in international trade. It is important to recognise the importance of these building blocks for improving supply-side capacity but there is a need for a broader framework encompassing several additional elements. The environment within which enterprises operate in developing countries are so intertwined that it is difficult to pinpoint either any particular foundation or a direction that should be given priority at the beginning and in the latter part as economies reach maturity. One cannot argue over the supremacy of one set of factors over the



Source: UNESCAP. 2004. *Addressing supply-side constraints and capacity building. Document: E/ESCAP/SCITI/3*. 2 September 2004.

others since each and every element is important in determining the overall efficacy of an export venture. The forgoing analysis should be viewed with this in mind while following the general description of the schema proposed by UNESCAP.

The following section discusses the main factors responsible for supply-side capacity in the context of South Asia.

3.2 An Enabling Policy Environment

According to UNESCAP, one of the most important factors determining the supply-side capacity of an economy is its enabling policy and regulatory framework. The basic neo-classical premise asserts that the emergence of an exchange economy requires the provision of three pre-requisites by the government to create an environment conducive for the emergence of a market economy: maintenance of law and order, guarantee of property rights, and enforcement of contracts (Goldsmith 1995).

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These three factors provide the most fundamental determinants of trade and investment, thereby guaranteeing economic growth. Adam Smith asserted that the provision of these basic pre-requisites provide the foundation for the emergence of a market economy, which in turn facilitate economic growth and development through continuous interaction between the extent of the market and the forces of specialisation. Smith did not specifically advocate for international trade but his concern was on laying the foundation for a well-functioning market economy that enables countries to increase their wealth. International trade should allow firms to specialise in products to serve large market segments. The ability to be inserted in value chains, as it is the case in many producers in the world today, enables even small producers to specialise. This in turn gives them the ability to acquire modern technology. The present wave of globalisation allows specialisation to take place within and outside national borders. One of the critical elements in trade is the ability to overcome supply-side constraints. The provision of law and order is a much broader concept than the availability of simple justice. As the *World Development Report 2005* stresses: "war or other widespread violence spells the end of almost all productive investment, and a reasonable level of political and macroeconomic stability is a threshold requirement for other policy improvements to gain much traction" (World Bank 2005). Part of the maintenance of law and order is to ensure that crimes are controlled. For the rule of law to be effective, people must have trust in the judiciary, law should be cost effective, and lawsuits should end up in firm resolutions.

A strong property rights regime guarantees the resource owners are rewarded for their efforts. The neo-classical foundation asserts that "the better protected these rights, the stronger the link between effort and reward, and thus the greater the incentives to open new businesses, to invest more in existing ones, and simply to work harder" (World Bank 2005). In contrast, unstable property rights creates disincentives for firms to invest and save, as the link between effort and reward is not strong. Economic history is abound with examples of faster economic growth with stronger property rights regimes. A major part of a stronger property rights regime is the need to minimise unnecessary expropriation of property, especially without adequate compensation. Obviously, governments reserve the right to expropriate private property for greater public welfare but those activities need to be transparent and methodical so that private individuals have the confidence in investing in the country. Enforcement of contracts enhances the confidence of businesses to engage in economic activities. Lack of confidence in the judiciary leads to the use of alternative mechanisms, which adds costs to doing businesses and hinders the development of genuine businesses in any country. Political turmoil, terrorism, and state failure appear in almost all the South Asian countries in some form and degree.

The *World Bank Enterprise Survey 2006* shows that the confidence of the private sector in the judiciary is as low as 17 percent in Bangladesh, 37 percent in Pakistan, 68 percent in Sri Lanka and 70 percent in India, compared to 73.6 percent in Organisation for Economic Cooperation and Development (OECD) members and 66 percent in East Asia and the Pacific (Appendix 1). The time taken for dispute resolution in South Asia is comparable to the situation in East Asia and the OECD countries. However, the judiciary takes much longer time to resolve cases of overdue payments in South Asia and over 90 percent of cases filed in courts have ended up without any final resolution.

With regard to property rights, the number of procedures for registering property, time taken and costs incurred are three indicators to gauge the regulatory system of a country. Table 1 shows the average conditions across the main regions of the world and the seven countries in South Asia. New Zealand is included as it recorded the best conditions among the 155 countries that have been included in the survey. Nepal is better placed among South Asian countries with just two procedures to follow with the cost of 6.2 percent of the total value of property. If New Zealand is taken as a benchmark where the cost is just 0.1 percent of the value of property, cost of registering property in South Asia is, on average, substantially higher with the exception of Bhutan.

On enforcement of contracts, Table 2 shows the number of procedures to be followed in collecting overdue debts in South Asia, which varies from 46 in Pakistan and 17 in Sri Lanka. Norway, which recorded the best conditions under this category, had only 14 procedures to complete. The number of procedures itself does not mean that the situation is business-friendly as demonstrated in the case of Sri Lanka, where a person seeking remedy through the judiciary has to spend 440 days and pay 21.3 percent of the total debt. A lender in Norway has to spend only 87 days and 4.2 percent of the total debt to recover. Higher interest rates discourage the development of an efficient credit market.

Table: 1

Indicators of registering property[1]

Region/Economy	Procedures (number)	Time (days)	Cost (% of property value)
East Asia & the Pacific	4.6	62.2	5
Europe & Central Asia	6.5	127.1	3
Latin America & Caribbean	6.7	76.5	4.8
Middle East & North Africa	6.3	52.2	6.8
OECD	4.7	32.2	4.8
South Asia	6.9	124	6.3
Sub-Saharan Africa	7.1	117.8	12.6
New Zealand	2	2	0.1
Bangladesh	11	363	11
Bhutan	5	72	1
India	6	67	7.9
The Maldives	..	..	..
Nepal	2	2	6.2
Pakistan	5	49	3.2
Sri Lanka	8	63	5.1

Source: World Bank and International Finance Corporation. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank.

Note:

1 All procedures necessary when a business purchases land and a building to transfer the property title from the seller to the buyer, including whether it is the responsibility of the seller or the buyer or required to be completed by a third party on their behalf.

3.3 The Regulatory Framework

Government intervention emerges from the perceived need to correct market failures and protect consumers from anti-

Table: 2

Enforcing contracts[1]

Region/Economy	Procedures (number)[2]	Time (days)	Cost (% of debt)[3]
East Asia & the Pacific	29.8	406.8	61.7
Europe & Central Asia	29.8	393	17.4
Latin America & Caribbean	35.4	461.3	23.3
Middle East & North Africa	39.5	432.1	17.7
OECD	19.5	225.7	10.6
South Asia	29.9	385.5	36.7
Sub-Saharan Africa	35.9	438.5	41.6
Norway	14	87	4.2
Bangladesh	29	365	21.3
Bhutan	21	275	113.8
India	40	425	43.1
The Maldives	28	434	8.7
Nepal	28	350	25.8
Pakistan	46	395	35.2
Sri Lanka	17	440	21.3

Source: World Bank and International Finance Corporation. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank.

Notes:
1 Indicators on enforcing contracts measure the efficiency of the judicial (or administrative) system in the collection of overdue debt.
2 All procedures mandated by law or court regulation that demand interaction between the parties or between them and the judge (or administrator) or court officer.
3 The official cost of going through court procedures, including court costs and attorney fees where the use of attorneys is mandatory or common, or the costs of an administrative debt recovery procedure, expressed as a percentage of the debt value.

competitive behaviour (World Bank 2005). Research shows that countries with better regulatory frameworks grow faster (Djankov et. al. 2006). The difference between the economic environment conducive for businesses and one that discourages such activities depends on how governments regulate the market. Prudent and sound regulatory regimes address market failures without inhibiting business activities and reconcile the interests of firms and wider social goals. Countries with heavier regulation of entry have higher corruption and larger unofficial economies but not better quality of public or private goods. Therefore, while implementing a regulatory framework, governments have to balance between the needs of firms and wider social objectives. Often, governments fail to realise the true objectives of imposing regulations. These increase costs of doing businesses, facilitate corruption, create delays, increase uncertainty and risk of investment and thereby inhibit competition. Regulatory regimes sometimes create more damage to local business initiatives when regulatory requirements are eased as far as FDI is concerned. In developing countries, there is scope for reforming the regulatory provisions so that they become clearer, minimise options for interpretations by officials at different times, locations and based on individuals.

As Appendix 1 illustrates, senior management of companies in South Asia spends, on average, 7.2 percent of their time dealing with requirements of regulations, which varies from 12.9 percent in India and 3.5 in Sri Lanka. The OECD average is just under 3 percent and that of East Asia & the Pacific is 7.5 percent. Another measure of bureaucracy is the consistency of officials' interpretation of regulations, which shows that South Asia's officials interpret the regulations in an inconsistent manner than the officials in East Asia and the OECD countries.

The regulatory framework applicable for starting and closing a business in South Asia is comparable to the level of regulations that prevail in other regions, including East Asia and Europe. In South Asia, there are close to eight procedures to complete when one wants to set up a firm; it takes 35 days to complete those procedures; and an entrepreneur has to spend 40.5 percent of per capita national income (Table 3). An East Asian entrepreneur needs to complete 8.2 procedures, spend 52.6 days and spend 42.9 percent of per capita national income. As such, the regulatory framework in

Table: 3

Indicators of starting a business[1]

Region/Economy	Procedures (number)[2]	Duration (days)	Cost (% GNI per capita)	Min. Capital (% GNI per capita)
East Asia & the Pacific	8.2	52.6	42.9	109.2
Europe & Central Asia	9.6	36.4	13.5	49.1
Latin America & Caribbean	11.4	63	56.2	24.1
Middle East & North Africa	10.1	45.4	64.2	859.3
OECD	6.5	19.5	6.8	41
South Asia	7.9	35.3	40.5	0.8
Sub-Saharan Africa	11	63.8	215.3	297.2
Canada	2	3	0.9	0
Bangladesh	8	35	81.4	0
Bhutan	11	62	10.7	0
India	11	71	61.7	0
The Maldives	6	12	12.4	6.6
Nepal	7	21	69.9	0
Pakistan	11	24	24.4	0
Sri Lanka	8	50	10.4	0

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank and International Finance Corporation.

Notes:

1 Refers to a limited liability company with start-up capital of 10 times that of income per capita.

2 These include obtaining all necessary licenses and permits and completing any required notifications, verifications or inscriptions with external parties (government agencies, lawyers, auditors, notaries).

relation to setting up of firms is as comparable to East Asia. There is also very low minimum capital requirement as a percentage of per capita national income. This is very much different to East Asia and the Middle East. The very high minimum capital requirements in East Asia may perhaps be a deliberate attempt to force the firms to be large so that they are capable of withstanding international competition as they can reap the benefits of scale economies. Therefore, the regulatory framework on starting businesses does not seem to explain the apparent slow progress of South Asia in global trade.

Similarly, closing a business is also not too restrictive in South Asia in comparison with East Asia (Table 4). Compared to the benchmark country (Ireland in this case), South Asia needs to improve its performance dramatically. For example, the recovery rate in India is only 12.8 percent whereas the country with the highest recovery rate in South Asia — Pakistan — is only 44.3. The corresponding figure for Ireland is 88 percent. This suggests that investing in South Asia is a risky business. If a company is dissolved for some reason, investors can recovery only a small proportion of their investment. East Asia's situation is similar than the

Table: 4

Closing a business

Region/Economy	Time (years)	Cost (% of estate)	Recovery rate(cents per dollar)[1]
East Asia & the Pacific	3.4	28.8	24
Europe & Central Asia	3.5	14	29.8
Latin America & Caribbean	3.5	17	28.2
Middle East & North Africa	3.8	13.4	28.8
OECD	1.5	7.4	73.8
South Asia	4.2	7.3	19.7
Sub-Saharan Africa	3.3	19.5	16.1
Ireland	0.4	9	88
Bangladesh	4	8	24.3
Bhutan	..	..	0
India	10	9	12.8
The Maldives	6.7	4	18
Nepal	5	9	24
Pakistan	2.8	4	44.3
Sri Lanka	2.2	18	33.9

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank and International Finance Corporation.

Note:

1 The recovery rate measures the efficiency of foreclosure or bankruptcy procedures. It estimates how many cents on the dollar claimants — creditors, tax authorities and employees — recover from an insolvent firm.

conditions in South Asia; one cannot attribute the slow progress and poor supply-side capacity to the poor regulatory framework related to setting up and closing down business enterprises.

Table 5 provides a comparative view of the licensing regime, including all procedures required for a business in the construction industry to build a standardised warehouse in South Asia in the construction industry. Although South Asia has fewer number of procedures to follow, the time and cost of completing these requirements are higher in South Asia, compared to East Asia and the Pacific and OECD countries. The licensing regime in India seems to be quite restrictive on all counts while the Maldives has the least amount of restrictions.

What is the regulatory mechanism governing investment in South Asia? As shown in Table 6, South Asia's regulatory mechanism is not unsatisfactory in relative terms. South Asia's score on the Investment Protection Index (IPI) in 2006 was 5 in a total score of 10. New Zealand, the benchmark case, has scored 9.7 while East Asia and the Pacific scored only 5.3 and OECD, 5.9. This index consists of three other indicators: disclosure index, director liability index and shareholder suits index. South Asia scored 4.1 in the disclosure index, and East Asia and the Pacific has a score of 5.6. The director liability index measures how liable the director of a private limited company is to an investment decision. South Asia's score is marginally higher than that of East Asia and the Pacific. Similarly, South Asia scored higher in the shareholder suits index than East Asia and the Pacific. The values are as close to values for the OECD as well. Both India and Pakistan have scored well in all the indices. Again, the poor export performance is not attributable to the poor regulatory framework as it is commonly believed.

3.4 Macroeconomic Stability

Sound macroeconomic policies are required for sustained economic growth. Macroeconomic stability lowers the risk of doing business by providing a predictable climate for investment and other initiatives. Similarly, regulatory policies that create a better competitive environment and reduce trade transaction costs are also important for sustaining interactions among exporters and importers.

Maintaining prudent fiscal and monetary policies is of particular significance, which ensures price stability where price includes both commodity prices, wages and exchanges rates. Rising commodity prices, wages and depreciation of exchange rates all contribute to lowering competition.[7] Rising domestic prices can also erode export competitiveness through its impact on export price. Absence of adjustments in the foreign exchange rate may result in higher imports and lower exports, leading to trade imbalances. In short, relative prices (domestic in relation to foreign price) affects the terms of trade of a country and its balance of payments. Therefore, prudent management of macroeconomic fundamentals is crucial for improving export competitiveness. Apart from these specific cases, macroeconomic stability helps developing countries to maintain stable prices and hence, competitiveness, in foreign markets.

Budget deficits have also been quite high across almost all the South Asian countries. In Bhutan, the Maldives, India and Sri Lanka; the ratio has shown an increasing trend (RIS 2005). Large budget deficits, however, have not translated into higher inflation. Except for Bhutan, other countries have experienced some deceleration. In the case of Bangladesh and the Maldives, inflation rates have declined drastically while in the case of Sri Lanka; the decline has been slower (RIS 2005). In summary, South Asian countries have been able to maintain macroeconomic stability.

Table: 5

Dealing with licenses[1]

Region/Economy	Procedures (number)	Time (days)	Cost (% of income per capita)
East Asia & the Pacific	18	157.7	137.4
Europe & Central Asia	21.4	251.8	668.9
Latin America & Caribbean	16.3	206.2	381.2
Middle East & North Africa	19.9	216.1	469.7
OECD	14.1	146.9	75.1
South Asia	15.7	195.3	385.9
Sub-Saharan Africa	20.1	251.5	1,597.3
New Zealand	7	65	29.3
Bangladesh	13	185	290.9
Bhutan	26	249	62.5
India	20	270	678.5
The Maldives	9	131	40.3
Nepal	12	147	314.7
Pakistan	12	218	1,170.70
Sri Lanka	18	167	144

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank and International Finance Corporation.

Notes:

1 All procedures required for a business in the construction industry to build a standardised warehouse, which include obtaining all necessary licenses and permits, completing all required notifications and inspections and submitting the relevant documents (for example, building plans and site maps, utility connections, such as electricity, telephone, water and sewerage) to the authorities.

3.5 Institutions and Governance

Institutions are defined as "formal and informal rules of behaviour, ways and means of enforcing these rules, procedures for mediation of conflicts, sanctions in the case of breach of rules, and organisation supporting market transactions" (North 1990 and 1994; World Bank 2002). As institutions exist to reduce transaction costs that arise from incomplete information and uncertainties, the quality of institutions are important for conducting trade. Creating or improving the efficiency of financial, legal, marketing and agricultural extension institutions has been stressed in developing supply-side capacity of developing countries (UNCTAD 1999). The above institutions play a critical role in export promotion and economic development. Institutions also perform a variety of functions, including consultation with stakeholders, policy coordination, review of existing rules and regulations, and information dissemination. The World Bank (2003) shows that countries that regulate the most have the least enforcement capacity, checks and balances to ensure that regulations are properly enforced.

The existence of credible, efficient, transparent and accountable institutions helps the private sector to develop and grow.

Table: 6

Protecting investors

Region/Economy	Disclosure Index[1]	Director Liability Index[2]	Shareholder Suits Index[3]	Investor Protection Index[4]
East Asia & the Pacific	5.6	4.2	6.2	5.3
Europe & Central Asia	4.5	4.3	5.6	4.8
Latin America & Caribbean	4.1	3.8	5.7	4.5
Middle East & North Africa	5.5	4.7	3.5	4.6
OECD	6.1	5.1	6.6	5.9
South Asia	4.1	4.6	6.4	5
Sub-Saharan Africa	5.4	4.6	5	5
New Zealand	10	9	10	9.7
Bangladesh	6	7	7	6.7
Bhutan	6	6	4	5.3
India	7	4	7	6
The Maldives	0	8	8	5.3
Nepal	4	1	9	4.7
Pakistan	6	6	7	6.3
Sri Lanka	4	5	7	5.3

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank and International Finance Corporation.

Notes:

1 The extent of disclosure index measures (i) whether a corporate body can provide legally sufficient approval for the transaction; (ii) whether immediate disclosure of the transaction to the public, the shareholders or both is required; (iii) whether disclosure in the annual report is required; (iv) whether disclosure to the board of directors is required; and (v) whether it is required that an external body, for example, an external auditor, review the transaction before it takes place. The index ranges from 0 to 10, with higher values indicating greater disclosure.

2 This measures seven aspects related to measuring the extent of liability of a director for damages to the company. The index ranges from 0 to 10, with higher values indicating greater powers of shareholders to challenge the transaction. This measures how easy it is for a shareholder to file a lawsuit and collect information from company documents. The index ranges from 0 to 10, with higher values indicating greater powers of shareholders to challenge the transaction.

3 The shareholder suits index measures how easy it is for a shareholder to collect information and directly examine the documents from the company, and the values range from 0 to 10, with 0 indicating the lowest and the 10 the highest.

4 This combines all the three dimensions of investor protection: transparency of transactions (extent of disclosure index), liability for self-dealing (extent of director liability index) and shareholders' ability to sue officers and directors for misconduct. The index ranges from 0 to 10, with higher values indicating better investor protection.

Good governance can be expected only when the institutions have clearly defined roles, operate in a transparent manner, and stakeholders are able to participate in formulating rules and regulations as well as implementing them. In that sense, a properly functioning stakeholder consultation is of great importance. In such environments, business activities tend to flourish.

Sustainability of export ventures require the services of various institutions such as government ministries, statutory authorities, public and private sector institutions, non-governmental organisations (NGOs) and donor agencies. In South Asia, export development boards or promotion agencies perform a variety of functions such as policy and planning, regulatory functions, production, and delivery of support services.[8] Each institution is responsible for certain activities, sometimes with overlapping functions. The coordination of activities to improve efficiency becomes quite difficult when the number of institutions involved in exports is large. Many of these institutions are also under-funded, especially in areas of programme budgets. Often these institutions have been established due to political reasons such as giving favours to a close associate after winning an election. As a result, governments provide funding only to cover recurrent expenditures, preventing them from undertaking serious development work. One of the critical requirements of overcoming capacity constraints in export promotion in South Asia is the rationalisation and harmonisation of functions of myriad of institutions dealing with export promotion.

South Asia has yet to inculcate a 'culture of quality' and 'quality consciousness' from production structures to higher levels of administration and management. There are instances where some exporters deliberately attempt to export low-quality products by using the reputation of the industry. For instance, tea in the case of Sri Lanka and carpets in Nepal's case. It requires only a handful of such consignments to ruin the entire industry. Lack of effective mechanisms and institutions to control such actions is a major lacuna in South Asia. Even when such mechanisms exist, they are highly inefficient and inadequate and some of these institutions are open to 'corruption'.

Although South Asia has a number of excellent research centres, industrial research activities are at an incipient stage (except perhaps in India). Exporters are not aware of new technologies available; if they are, they do not have access to technology. There is also a time lag in obtaining new technology. The level of coordination required for building capacity on international trade is minimal in a number of areas, including training officials and the private sector individuals; undertake regular review of international trade policy developments; and educate the policy makers, exporters and the public.

The existence of credible, efficient, transparent and accountable institutions helps the private sector to develop and grow

A key institution that can gauge the level of efficiency of a country is its tax administration. As shown in Table 7, the number of tax payments in South Asia is 25.8, which varies from one in the Maldives to 59 in India. The time it takes to comply with the tax system – a good measure of the efficiency of the tax administration – is the highest in Bangladesh with the lowest number of payments, while it is the lowest in India with the highest number of payments.[9] Tax rates in Bangladesh, India, Pakistan and Sri Lanka are close to the OECD average of 45.4 percent. Pakistan has the highest rate with 57.4 percent. If other countries in South Asia are excluded, the income tax rates are relatively high in South Asia in comparison to East Asia and the Pacific with an average rate of 31.2 percent. Apart from levying high taxes from the private sector in comparison to the social services that South Asia provides, tax administration is an issue requiring further reforms across the region.

Political stability adds another dimension for conducting business activities. Notwithstanding the argument for democracy as the best mechanism for market economy, 'socialist' China has been able to attract much more FDI than South Asia partly owing to the political stability of the one-party system. A society plagued by anti-social behaviour and political instability can certainly project an image of unreliability for foreign investors.

The need for governance structures arises from the fact that there is tension between the priorities of firms and institutions and social objectives. Preferences of firms and institutions may not necessarily be the social objectives, and therefore, there is a need to devise mechanisms so that an acceptable balance can be achieved between private preferences and social objectives. The governance structure is important as it is the existing mechanism within a country to control rent-seeking behaviour, credibility of public sector institutions, fostering public trust and legitimacy and ensuring that policy responses reflect a good institutional fit. The differences between private interests and social well-being gives rise to rent-seeking behaviour and governments make attempts to restrain this behaviour through various social and other control mechanisms. The problem with corruption, apart from its social implications, is that it increases the costs of doing business.

Table: 7

Paying taxes[1]

Region/Economy	Payments (number)	Time (hours)	Total tax payable (% gross profit)
East Asia & the Pacific	28.2	249.9	31.2
Europe & Central Asia	46.9	431.5	50.2
Latin America & Caribbean	48.2	529.3	52.8
Middle East & North Africa	27.3	241.9	35.1
OECD	16.3	197.2	45.4
South Asia	25.8	331.7	35.3
Sub-Saharan Africa	41.4	394	58.1
Saudi Arabia	13	70	1.4
Bangladesh	17	640	50.4
Bhutan	30	370	23.3
India	59	264	43.2
The Maldives	1	0	5.5
Nepal	23	408	31.8
Pakistan	32	560	57.4
Sri Lanka	42	..	49.4

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank and International Finance Corporation

Notes:

1 Taxes, measured at all levels of government, include corporate income tax, personal income tax withheld by the company, value added tax or sales tax, property taxes, property transfer taxes, dividend tax, capital gains tax, financial transactions tax, waste collection taxes and vehicle and road taxes, payable by a limited liability and taxable company.

Governance structures reflect social norms and practices and determine the kind of investment that firms choose on the basis of competition (price, quality and service). For instance, firms in a highly politically unstable country may not want to invest in sophisticated production activities because the cost of instability can be substantially higher. They may instead opt for production with low-skilled and low technology, resulting in low value addition, low profitability and low competitive edge in the global market. Poor governance structures may also result in firms not adhering to competitive market structures since firms know that no authority will challenge their behaviour even when the firm engage in anti-competitive practices. This results in poor quality of goods, higher prices and low incentives to maintain better quality. Organisational architecture also determine the kind of technology the firm uses, adaptability to changes in the international market conditions, strategies to enter foreign markets and the extent of market diversification. These factors, in turn, affect competitiveness and supply-side capacity of firms.

Is corruption a major problem for conducting businesses in South Asia? Unofficial payments as a percentage of sales in the world and East Asia & the Pacific is

1.81 while that in South Asia is 1.26 percent (Appendix 1).

3.6 General Education and Basic Infrastructure

The next layer of the foundation for building a better supply-side capacity is general education and basic infrastructure, which includes transportation systems, energy and ICT. The two pillars of the supply-side capacity of any country are factors that determine productivity and ways and means of reducing cost of international trade.

Basic education is key to developing an adequately educated and trained work force. Does South Asia have better quality human capital compared to its competitors? Although quantitative indicators hide the true picture of the quality of human capital, they inform us regarding the comparative position of South Asia vis-à-vis other regions. As Table 8 shows, South Asia's position in all three major measures of human development, viz. life expectancy at birth, adult literacy and mean years of schooling is well below that of other countries (with the exception of Sri Lanka). The adult literacy rate varies from 41 percent in Bangladesh to 90 percent in Sri Lanka. The same in India and Pakistan are 61 percent and 49 percent respectively. While primary school enrolment and adult literacy rates have increased, South Asia's average illiteracy rate of 46 percent is still the highest in the world. Moreover, 56 percent of women in South Asia are illiterate. As Table 8 depicts, the mean schooling years are far below the levels in China, Thailand and the United States (with the exception of Sri Lanka). The gender disparity in education is a serious concern across all the countries in South Asia (except Sri Lanka), where the mean years of schooling of females is substantially lower. Special attention needs to be paid to girl education in South Asia.

The data indicate that South Asia has made substantial headway in reproductive and child health. The maternal mortality rate has declined from 87 to 73 per 1,000 live births while mortality rates for children under 5 years have declined from 129 to 99 per 1,000 children. Child malnutrition has declined slightly but remains among the highest in the world with almost 50 percent of children below the standards for weight by age. South Asia also accounts for one third of the world's maternal deaths. Nearly half of the children under 5 years are malnourished.

The poor state of public infrastructure and inefficient public services substantially raise production and transport costs, which is a major constraint in the context of global economic integration. In addition to raising the actual cost of production, dilapidated infrastructure raises the hidden cost of 'lost opportunities' arising from cancellation of orders due to delays in delivery. According to World Bank estimates, transport costs outweigh tariff barriers in many developing countries (World Bank 2001). Furthermore, the share of international shipping costs in the value of trade, defined as 'transport cost incidence for exports', is higher than tariff for many developing countries. The freight costs are also highest among industries producing goods with a low value-to-weight ratio, and shipping costs of agricultural and mining products are higher than for manufactured products. As *World Trade Report* (WTO 2004) states: "the effective rate of protection provided by transport costs is in many cases higher than that provided by tariffs". Transport costs differ across countries owing to a number of factors such as distance from major markets and the nature of commodities (World Bank 2004). Goods with low value-to-weight that most developing countries produce have the highest rates for freight and landlocked countries face, on average, 50 percent higher transport costs than otherwise equivalent coastal economies (Limao and Venables 2001 as cited in WTO 2004). Land transport is generally more expensive than sea transport by a factor of seven, which has adverse implications for landlocked countries. Nepal and Bhutan, owing to their terrain and landlocked status, bear extra

A society plagued by anti-social behaviour and political instability can certainly project an image of unreliability for foreign investors

Nepal and Bhutan, owing to their terrain and landlocked status, bear extra costs for transporting imported consignments into the country

costs for transporting imported consignments into the country. These two LDCs rely entirely on India for transporting their cargo, which makes their transport costs higher than the other countries in the region.

The costs of west bound shipment (from Asia to Europe or the US) have fallen while the same is not true for east bound cargo (from the Pacific to Asia). Sea freight is the highest for cargo loaded in Asia (WTO 2004). The trade imbalances, the product composition of exports, the extent of container use for shipping, the average distance of importing countries, terminal handling charges and port efficiency are some of the reasons for this difference. Port efficiency is a significant factor in export competitiveness of any country. South Asia is well endowed with 250 ports, 25 of which are in operation (RIS 2005). Port efficiency, measured in the speed of handling cargo in South Asia, is still low in comparison to East Asia. Infrastructure in ports – maritime cargo handling, storage facilities, fuelling and watering and repair facilities – needs to be improved.

ICT plays a key role in modern business. International competitiveness requires the use of electronic commerce (e-commerce). As the *World Business Environment Survey 2006* (WBES) highlights, only 28.6 percent businesses use the Internet for conducting commercial business in South Asia while that of East Asia and the Pacific and OECD countries are 27 percent and 80 percent, respectively. Of the four countries where the survey was conducted, 36 percent of firms use the Internet in India, 31 percent in Bangladesh, 29 percent in Sri Lanka and 18 percent in Pakistan.[10] As e-commerce has come to stay as the main vehicle of international commerce, inadequate access to the Internet will become a major obstacle for promoting such trade.

Table: 8

Human capital development

Country/Region	GDP per capita (PPP US) 2004	Life expectancy at birth (years) 2003		Adult literacy rate (% ages 15 and above)	Mean years of schooling	
		Male	Female		Male	Female
Bangladesh	1,980	62	63	41	4.94	2.9
India	3,100	63	64	61	6.5	3.57
Nepal	1,470	60	60	..	3.88	1.22
Pakistan	2,160	63	65	49	5.05	2.02
Sri Lanka	4,000	72	76	90	8.94	9.47
China	5,530	69	73	91	7.22	5.82
Thailand	8,020	67	72	93	7.19	6.62
US	39,710	75	80	..	13.85	13.8
South Asia	2,830	62	64	64	..	..
East Asia & the Pacific	5,070	68	71	85	..	..
High income	30,970	75	81	91	..	..

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank and International Finance Corporation

Notes: (..) indicates non-availability of data.

Access to basic telecommunication facilities is limited in South Asia. Notwithstanding the progress after restructuring of state-owned enterprises and privatisation, enterprises in South Asia still experience long delays in getting telephone and electrical connections. For example, firms spend, on average, 55 days to get an electrical connection and 64 days to get a telephone connection whereas firms in East Asia and the Pacific wait only for 12 and 10 days, respectively (WBES 2006).

The information dimension of supply-side capacity is often neglected but is an equally important factor of production in the current competitive environment. Many SMEs in South Asia lack information on important aspects related to production and exports. Entrepreneurs lack awareness of information in terms of accuracy, quality and specificity as well as its value in the process of decision making. Lack of infrastructure or capacity to access information has compounded the problem. Although business chambers and sector associations play a vital role in providing trade information, these networks are not sufficiently widespread. Exporters face many constraints in accessing reliable and timely information and there is no comprehensive trade information network capable of meeting exporters' requirements. Timely establishment of a system for sharing information within a broad spectrum of producers and consumers with a wide range of subjects and levels is also essential.

Within the broad domain of physical capital lies access to appropriate technology for production, including production and processing technology. The appropriate use of technology depends greatly on the availability of a skilled and educated work force because the use of technology requires countries to "deal with the many issues pertinent to acquisition, utilisation, absorption and generation of technology" (UNCTAD 1999). This report also identifies the factors that have had serious repercussions for the cost competitiveness of firms, with respect to LDCs. These include: poor maintenance, leading to lower volumes and poorer quality of output; under utilised capacity resulting from inappropriate product and process choices; and failures in appropriate choices of technology, design and layouts. Exporters often complain that facilities or competencies for developing designs, testing and mould making for new designs are not available, which hinders progress and capacity to penetrate foreign markets. A major contributing factor of this weakness is poor linkages between the industrial sector, business community, research institutes and universities. India has made some headway in this front but the potential is much greater. The capacity to undertake both fundamental and applied research related to industries and manufacturing processes needs to be substantially upgraded.

South Asia possesses huge reserves of energy sources, such as oil, natural gas, coal, hydro electricity, solar and thermal power, bio-mass and wind power. According to current estimates, South Asia contains 5.7 billion barrels of oil, around 0.5 percent of world reserves and the refining capacity of over 2.5 million barrels per day (bbl/d) (IEA 2005). In January 2004, South Asia's proven natural gas reserves were estimated at 67.5 trillion cubic feet (Tcf), spread over India, Pakistan and Bangladesh, Bhutan and the Maldives. In addition, the South Asian sub continent contains 95.5 billion tons of coal reserves or approximately 9 percent of the world total. 93 billion tons is found in India, which is the world's third largest coal producer after China and the US.

Firms in South Asia spend, on average, 55 days to get an electrical connection and 64 days to get a telephone connection whereas firms in East Asia and the Pacific wait only for 12 and 10 days, respectively

South Asia relies heavily on biomass for residential energy consumption, particularly in rural areas. According to the International Energy Agency (IEA), biomass accounted for about 80 percent of residential energy consumption in 2000 and will account for 70 percent of total residential energy consumption by 2020.

All South Asian countries, except the Maldives, have the potential to generate hydro electricity and these countries have had long established hydro electricity generating capacity. However, only 12.5 percent of the overall South Asia's hydro energy potential has been exploited so far. India has the highest installed capacity, followed by Pakistan. The ratio between the current installed capacity and the potential indicates that Nepal and Bhutan have the highest unutilised hydro electric potential. India and Pakistan also have substantial amount of untapped potential in this sector while Bangladesh and Sri Lanka have exploited 40 and 55 percent of their potentials, respectively. South Asia, with the exception of Bhutan and the Maldives, has biogas promotion schemes and further expansion can be expected given the dominance of agriculture. There is also a potential to use solar energy as solar radiation is quite high in the region compared to northern or southern hemispheres. Southern India, Sri Lanka and the Maldives have the potential to receive solar radiation at a constant rate throughout the year and seasonal changes are common in other parts. India alone is estimated to have 20,000 mega watts (MW) potential of wind power while the installed capacity is 1,167 MW. Sri Lanka has installed 3 MW windmill on an experimental basis. Despite these sources, energy is a major problem for firms. The problem is so acute in some South Asian countries, which are heavily dependent on energy imports.

South Asia relies heavily on biomass for residential energy consumption, particularly in rural areas

3.7 Firm-Specific Resources

The centrality of firms is recognised in determining competitiveness in the global economy. A firm coordinates and combines five types of resources to produce goods and services: human, natural, financial, physical and social. The specific combination that a firm uses in producing a commodity or providing a service depends on the nature of the commodity or the service, where some commodities are resource-intensive while others are human capital-intensive. The three other kinds of resources – financial, physical and social – play supportive roles in producing commodities.

Human capital is an input in the production function in standard economic theory. The need for human resources has become stronger in a knowledge-based economy, where productivity as well as competitiveness are increasingly dependant on the ability of workers to use new technology and knowledge. In endogenous growth theory, labour force embodying human capital is considered to have higher capability in creating, implementing and adopting new technologies, thereby generating growth.[11] The extent of human resources available in a country is a result of several inter-related policy decisions of the government.

Regulations governing the labour market play a critical role in the development of a sustainable export economy. This is particularly true under the present international market environment where competitive edge is determined equally by technological advancements, productivity and labour market conditions. One of the primary concerns of any government is to maintain a balance between worker rights and the need to maintain a disciplined labour force, free of *ad hoc* interference in production activities through union action such as strikes. The business community in South Asia maintains that labour regulations are too rigid and the workers have more rights than the employers. As *Doing Business in 2006* depicts, it is relatively difficult to hire or fire workers in Sri Lanka in comparison to East Asia and other parts of the world.[12] The hiring cost, which includes social security payments (retirement fund; sickness, maternity and health insurance; workplace injury; family allowance; and other obligatory contributions) and payroll taxes is as high as 16.3 percent of salaries in Sri Lanka and 12.3 percent in India in comparison to 8.8 percent in East Asia and the Pacific and 20.7 percent in the OECD (Table 9). The cost of firing a worker is as high as 175.7 weeks of pay in Sri Lanka, with an average of 75 weeks of pay in South Asia, in comparison to 35.1 weeks in the OECD, 44.2 weeks in East Asia and the Pacific and a mere 12.9 weeks in Hong Kong, the benchmark case.

The Maldives has the lowest cost of firing in South Asia with just over 20 weeks of pay.

Entrepreneurs face low labour productivity and the inability to maintain consistent production targets, which affect their competitiveness in international markets. In addition, labour laws are not conducive for sub-contracting, which has emerged as a significant method of production in the vertically structured global production system. South Asian entrepreneurs also experience far too many labour union actions such as strikes and work-to-rule campaigns. The number of actual holidays in South Asia is staggeringly high if one were to add the number of days lost due to strike actions and the already too high number of holidays. According to a British Broadcasting Corporation (BBC) report, Indian industrialists are concerned about the long holidays enjoyed by government workers and holiday entitlement costs the national exchequer nearly US$ 4 billion annually. In a highly competitive global order, they believe the country can ill afford to offer its employees so much time off. The All India Association of Industries (AIAI) estimates that the loss due to a spate of holidays in 2004 is around US$ 620 million.[13] Industrialists have demanded an urgent review of the number of holidays granted by the Indian government. Officially, India has 17 national holidays and 30 restricted holidays for certain religious and regional groups. However, there are as many as 99 other holidays, including weekends. In addition, government employees are also entitled to sick, privileged and casual leave which can add up to almost six months every year. The same is true elsewhere in South Asia. For instance, in Sri Lanka, if the number of holidays officially granted for religious and other reasons (21 in 2005) is added to the number of weekends (105 days in 2004) and the entitlements for medical and casual leave (42 days), a Sri Lankan worker could have stayed home for 168 days in 2005. A spate of strikes or work stoppage conducted for political and labour-related reasons during 2005 aggravated the situation further. Politicisation of the labour market can explain much of the current state of affairs in the labour market in South Asia.

Natural resources can facilitate economic development if they are exploitated in a sustainable manner. Lack of natural resources, however, is not a *prima facie* reason for poor export performance since many countries that have been successful in international trade are those with very poor natural resource endowments (for instance, Japan and Singapore). Having a large natural resource base does not guarantee success in international markets.[14]

South Asia has large natural endowments in terms of surface area, different climatic conditions, coastal access and minerals. The Indian subcontinent supports about 22 percent of the global population and accounts for 2 percent of the world's forests spread over about 3 percent of total land area of the world. The areas of these countries vary from 30,000 sq. km (The Maldives) to 297,319,000 sq. km (India). The subcontinent is a reservoir of great biodiversity and has untapped potential to develop forest products. South Asia is also estimated to have large quantities of mineral deposits such as steel, aluminium, copper, lead and gold. Proper land use is a fundamental requirement for economic development. To achieve this objective, South Asian governments need to adopt a scientific land use policy (e.g., land use zoning, land resource inventory); decentralisation of land management for balanced, sustainable regional development; and the modification of land laws to meet current needs. Best practices of land use management of South Asia needs to be shared and adapted to country conditions for effective implementation.

Finance and financial markets is required for the smooth functioning of the real economy. Divergent categories of products require financial requirements because of time span of investments, the size of investment required and the time it takes from the inception to exporting a commodity or product. Some commodities and services require huge invest-

Entrepreneurs face low labour productivity and the inability to maintain consistent production targets, which affect their competitiveness in international markets

Table: 9

Hiring and firing workers

Region/Economy	Difficulty of Hiring Index[1]	Rigidity of Hours Index[2]	Difficulty of Firing Index[3]	Rigidity of Employ-ment Index[4]	Hiring cost (% of salary)[5]	Firing costs (weeks of wages)[6]
East Asia & the Pacific	26	29.6	23	26.2	8.8	44.2
Europe & Central Asia	34.5	56.9	41.5	44.3	29.6	32.8
Latin America & Caribbean	40.5	50.9	29.5	40.3	15.9	62.9
Middle East & North Africa	30.8	55	35	40.2	15.9	62.4
OECD	30.1	49.6	27.4	35.8	20.7	35.1
South Asia	41.9	35	42.5	39.9	5.1	75
Sub-Saharan Africa	48.1	63.2	47.8	53.1	11.8	53.4
Hong Kong, China	0	0	0	0	5	12.9
Bangladesh	11	40	20	24	0	47
Bhutan	78	60	0	46	0	94
India	56	40	90	62	12.3	79
The Maldives	0	20	0	7	0	20
Nepal	56	20	90	55	0	90
Pakistan	67	40	30	46	12	90
Sri Lanka	0	40	80	40	16.3	175.7

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. World Bank and International Finance Corporation: Washington D.C

Notes:

1 The difficulty of hiring index measures (i) whether term contracts can be used only for temporary tasks; (ii) the maximum duration of term contracts; and (iii) the ratio of the mandated minimum wage (or apprentice wage, if available) to the average value added per worker.

2 The rigidity of hours index has 5 components: (i) whether night work is unrestricted; (ii) whether weekend work is allowed; (iii) whether the workweek can consist of 5.5 days; (iv) whether the workday can extend to 12 hours or more (including overtime); and (v) whether the annual paid vacation days are 21 or fewer.

3 The difficulty of firing index has 8 components: (i) whether redundancy is not considered fair grounds for dismissal; (ii) whether the employer needs to notify the labour union or the labour ministry to fire 1 redundant worker; (iii) whether the employer needs to notify the labour union or the labour ministry for group dismissals; (iv) whether the employer needs approval from the labour union or the labour ministry for firing 1 redundant worker; (v) whether the employer needs approval from the labour union or the labour ministry for group dismissals; (vi) whether the law mandates training or replacement before dismissal; (vii) whether priority rules apply for dismissals; and (viii) whether priority rules apply for reemployment

4 The average of three sub-indices: a difficulty of hiring index, a rigidity of hours index and a difficulty of firing index. All take values between 0 and 100, with higher values indicating more rigid regulation

5 The hiring cost indicator measures all social security payments (including retirement fund; sickness, maternity and health insurance; workplace injury; family allowance; and other obligatory contributions) and payroll taxes associated with hiring an employee.

6 The firing cost indicator measures the cost of advance notice requirements, severance payments and penalties due when dismissing a redundant worker, expressed in weekly wages.

ments while others require little investment but their gestation periods can be very long. For example, an exporter of raw material requires only a limited amount of capital while a production venture aimed at producing motor cars would require highs amounts of investment. The collateral requirements also hinges on the differences in risk ratings and the size of capital. Weak financial institutions undermine and work as a major constraint in developing productive capacity of firms in developing countries.

As Appendix 1 depicts, 56 percent of investment in South Asia is internally financed, with 17 percent comprising of bank finance and 6.6 percent of investment coming from informal finance. The Legal Rights Index, which measures the legal rights of lenders, is not as well developed as in East Asia & the Pacific or the OECD, and much lower in comparison to the benchmark country – the United Kingdom (Table 10). South Asia is at the same level as Latin America and the Caribbean and even below Sub-Saharan Africa. As the Credit Information Index shows, South Asia is doing well in the area of disclosing credit information but very poor in both public registry coverage and the private bureau coverage. This suggests that while the rules and regulations relating to information disclosure are adequate, the development of actual listing of individuals or business firms in either public or private bureaus is not adequate. According to this survey, Bangladesh has the best legal framework as far as credit markets are concerned.

Many South Asian countries implemented structural adjustment programmes with the objective of infusing the financial sector with efficiency and productivity. However, much of the financial sector reforms have not enabled these institutions to achieve the main objective of providing short and long-term business finance, especially to SMEs. Instead, the focus has shifted from financing productive activities like manufacturing – often involving higher risks – to trade finance, which involves almost no financial risk.

South Asia possesses limited export credit and insurance facilities as compared to its neighbours although instruments such as development banks, commercial banks, venture capital companies, merchant banks, leasing companies and export credit instruments exist. Developed countries have specialised banks for providing export credit and financial assistance. In addition, they also provide export credit through foreign aid and government-to-government credit with the condition that the funds be used for a specific purpose, importing goods and services from the donor country or from a designated company.

Financial institutions in South Asia are criticised for being risk-averse: credit depends largely on collateral. Large enterprises obtain credit at cheaper rates while SMEs often find it difficult to secure funds. Financial liberalisation and privatisation initiatives in South Asia have also eroded exporters' access to financial resources as some 'development banks' have become too 'commercially' oriented.[15] There is lack of understanding between exporters and bank officials on new projects and their financial needs. This situation has severely constrained the entry of new exporters and entrepreneurs into export business, which is essential for emerging from lacklustre export performance and entry into new areas of production and niche markets. One of the most critical issues is the high cost of finance in developing countries, of which the main reason is relative underdevelopment of the financial sector and the limited number of financial instruments.

Large enterprises obtain credit at cheaper rates while SMEs often find it difficult to secure funds

Physical resources include capital assets owned by firms as well as public infrastructure. One of the weakest areas of industries in developing countries is low capital intensity, which has far-reaching implications for labour productivity. In addition to poor access to better quality technology, firms in developing countries operate with poor quality public infrastructure.

Social environment includes factors such as compensation mechanisms and sanctions

Table: 10

Obtaining credit

Region/Economy	Legal Rights Index[1]	Credit Information Index[2]	Public registry coverage (% adults)[3]	Private bureau coverage (% of adults)[4]
East Asia & the Pacific	5.3	1.8	1.7	9.6
Europe & Central Asia	5.6	2.5	1.4	6.6
Latin America & Caribbean	3.8	4.5	11.5	31.2
Middle East & North Africa	4.1	2	1.9	1.7
OECD	6.3	5	7.5	59
South Asia	3.8	1.8	0.1	0.6
Sub-Saharan Africa	4.4	1.5	0.8	3.5
United Kingdom	10	6	0	76.2
Bangladesh	7	2	0.4	0
Bhutan	3	0	0	0
India	5	2	0	1.7
The Maldives	4	0	0	0
Nepal	4	3	0	0.1
Pakistan	4	4	0.3	0.9
Sri Lanka	3	3	0	2.2

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington, DC: World Bank and International Finance Corporation

Notes:

1 This measures the degree to which collateral and bankruptcy laws facilitate lending, based on collateral and insolvency laws, supported by the responses to a survey on secured transactions laws. The index ranges from 0 to 10, with higher scores indicating that collateral and bankruptcy laws are better designed to expand access to credit.

2 This index measures rules affecting the scope, accessibility and quality of credit information available through either public or private bureaus. The index ranges from 0 to 6, with higher values indicating that more credit information is available from either a public registry or a private bureau to facilitate lending decisions.

3 The coverage indicator reports the number of individuals and firms listed in the public credit registry with current information on repayment history, unpaid debts or credit outstanding. The number is expressed as a percentage of the adult population. If no public registry operates, the coverage value is 0.

4 The coverage indicator reports the number of individuals or firms listed by the private credit bureau with current information on repayment history, unpaid debts or credit outstanding. The number is expressed as a percentage of the adult population. If no private bureau operates, the coverage value is 0.

for anti-firm or anti-social behaviour, governance structures within and outside the firm, social norms, customs, beliefs and institutions that govern their interactions. This broad contour determines the ability of a firm to function efficiently. Firms aim to minimise transaction costs in production and delivery. Satisfying customer requirements is a fundamental requirement for the successful operation of firms. As many different individuals and institutions hold information regarding preferences, gathering relevant information is both difficult and expensive. However, the actual cost of information gathering depends on the way societies are organised and their cultural and social beliefs.

3.8 Exporter-Importer Interface

An export assignment requires a firm to deal with a number of institutions and follow trade procedures. It needs to transport goods from the factory to the port, complete customs procedures and documentation requirements, ensure that products meet quality requirements and standards, insure consignments, and meet all other requirements under exchange control and financial institutions.

Table 11 shows the comparative position of South Asian countries with regard to export and import procedures. Efficient time management is essential for international competitiveness, particularly for assembling industries and *entrepot* trade. Such business ventures become unprofitable if there are long gestation periods, as in the case of South Asian countries. For example, the time taken for imports for Nepal is 38 days and exports require 44 days. An industry that depends on imported inputs would, therefore, require 82 days, apart from the time it takes to assembling or producing the commodity under consideration. Sri Lanka and the Maldives have the lowest number of days required for imports and exports in South Asia, with just over 50 days in total. The number of days required in East Asia on average is only 54 days. This gives East Asia an advantage for delivering commodities to international markets on time. The same operation would require only 26 days in OECD countries and in Denmark – the benchmark country – 10 days only. Documentation requirements are relatively higher in South Asia in comparison to other regions, except Sub-Saharan Africa.

Customs procedures, which refer to mandatory procedures that an exporter or importer must fulfil in order to export or import a consignment, are required to conduct import and export activities in an orderly manner. These requirements have become increasingly complex and the involvement of the number of institutions has risen sharply. UNCTAD estimates that the average customs transaction involves 20–30 different parties, 40 documents, 200 data elements (30 of which are repeated at least 30 times) and the re-keying of 60–70 percent of all data. Firms also have to meet many documentation requirements that lead to extensive data entry and high probability of data re-entry and duplicity of effort, raising costs further. Specific problems related to customs procedures and documentation requirements include: lack of transparency of methods and procedures, delays in border crossings, high corruption at border crossings, packaging and labelling requirements and differing national standards.

Customs procedures, which refer to mandatory procedures that an exporter or importer must fulfil in order to export or import a consignment, are required to conduct import and export activities in an orderly manner

The institutional capacity for the formation and adoption of standards; laboratory capacities for precision measurement, testing, and complying with international conformity assessment requirements; and ability to improve product quality and productivity play significant roles in maintaining export competitiveness. Apart from India and Pakistan, other South Asian countries do not have the requisite internationally accredited testing facilities or a national scheme for certifying enterprises for the ISO 14000 Environmental Management System (EMS) demanded by importers. Activities related to the management of export quality take place only on a voluntary basis in response to specific demands from buyers, except in few areas where compulsory quality assurance schemes are operated by different regulatory bodies in the world.

Meeting international standards has become difficult for developing country producers. Lack of an institutionalised standard regime in South Asia is a major drawback. Each country needs to establish its own standards related institutions and enact legislation, define standards and procedures and set up laboratories. Although almost all the South Asian countries have enacted legislation and established standard institutions, the level of expertise and laboratory facilities are inadequate to meet international standards. Many exporters are unaware of changes taking place at the international front, and many small-scale entrepreneurs are not capable of investing on new standards. Conformity assessment procedures in South Asia seem to be the weakest link in this area. As a result, some exporters attempt to ignore standards, produce and export low quality products, creating a bad reputation for the industry as a whole. This is an area where public-private partnership must be built in order to build awareness; provide information and training to exporters on quality requirements, changes in international standards, conformity assessment procedures; and to build infrastructure and laboratory facilities.

International competition requires appropriate, innovative and attractive packag-

Table: 11

Trading across borders [1]

Region/Economy	Documents for export (number)	Signatures for export (number)	Time for export (days)	Documents for import (number)	Signatures for import (number)	Time for import (days)
East Asia & the Pacific	7.1	7.2	25.8	10.3	9	28.6
Europe & Central Asia	7.7	10.9	31.6	11.7	15	43
Latin America & Caribbean	7.5	8	30.3	10.6	11	37
Middle East & North Africa	7.3	14.5	33.6	10.6	21.3	41.9
OECD	5.3	3.2	12.6	6.9	3.3	14
South Asia	8.1	12.1	33.7	12.8	24	46.5
Sub-Saharan Africa	8.5	18.9	48.6	12.8	29.9	60.5
Denmark	3	2	5	3	1	5
Bangladesh	7	15	35	16	38	57
Bhutan	10	12	39	14	12	42
India	10	22	36	15	27	43
The Maldives	7	4	24	12	4	29
Nepal	7	12	44	10	24	38
Pakistan	8	10	33	12	15	39
Sri Lanka	8	10	25	13	15	27

Source: World Bank. 2006. *Doing Business in 2006: Creating Jobs*. Washington,DC: World Bank and International Finance Corporation

Note:

1 Procedural requirements for exporting and importing a standardised cargo of goods of a company with more than 100 employees

ing. This makes it essential for the packaging of products to go through the same strict procedures as in actual production of a commodity, including reliability monitoring and certifications. Exporters face a number of difficulties in the area of packaging, which include high cost; lack of knowledge and resources on process control, material approval and quality assurance; difficulties in procuring new designs; low quality and reliability of packaging forms; inconsistent supply of packaging materials; and lack of facilities. As far as smaller countries in South Asia are concerned, the packaging market is dominated by a very few firms exercising monopoly power. Trade in industrial goods, in particular, requires a country to have institutional capacity for the formation and adoption of standards; laboratory capacities for precision measurement, testing, and complying with international conformity assessment requirements; and abilities to improve product quality and productivity. Smaller countries find it difficult to meet these strict international standards due to poor quality of laboratory services and non-recognition of services rendered by smaller laboratories. But South Asia as a region can face the challenge through regional cooperation. One strategy would be to establish a specialised laboratory in each country and offer the services to other countries.

It is not enough for a firm to be able to produce goods to meet the quality and international standards. They must also certify that their products indeed meet such requirements by producing laboratory certificates and other proofs required by importers. Some standardised products can claim the certificates issued by national standard institutions but specific products require laboratory certificates from recognised institutions and organisations.

3.9 Global Market Environment

Technological advances, bilateral and regional trade agreements, global financial markets and institutions; all influence the way firms and governments do business. These factors affect supply-side capacities of firms in developing countries. South Asia cannot isolate itself in the global market but needs to implement a policy framework for integrating with the rest of the world while addressing its own capacity and competitiveness. The policy framework will have to recognise the changing international environment. In this respect, it is important to recognise that the global business environment is characterised by four main elements: rapid change in consumer behaviour, increased role of multinationals in exports from developing countries, change in the system of production and delivery, and increased role of bilateral and regional trade agreements.

Consumers are no longer constrained by geography and location, making them much more quality conscious. Markets are also horizontally integrated. Therefore, producers must be able to meet the changing requirements of various market segments in order to be competitive in the global marketplace. Quality of goods and competitive prices are the two key determinants in this environment. Moreover, it is important for South Asia to recognise the need to adapt to changes much faster than at present. Market intelligence also plays a major role in this situation.

The global business environment is characterised by four main elements: rapid change in consumer behaviour, increased role of multinationals in exports from developing countries, change in the system of production and delivery, and increased role of bilateral and regional trade agreements

The new global economic order is characterised by rapid advancement of ICT and production and processing technologies, together with the change of management techniques. Since much of the technological advances happen within multinational firms located mostly in industrialised countries and technology transfer is taking place at a very slow speed, export companies from developing countries are in a disadvantaged position vis-à-vis MNCs. South Asia needs to foster its own MNCs and develop capacity to innovate and adapt technological advances. The response to MNCs will determine how successful South Asia will be in the next few years. They play an increasingly critical role in exports from developing countries in production of goods and services, research and development, design technology, sourcing materials, transporting, marketing, or wholesale and retail trade. South Asian economies, in particular LDCs, cannot afford to remain behind. They need to recognise this reality and devise effective techniques in response to this situation. Selective promotion of FDI that allows some space for local SMEs to grow seems to be one such strategy. South Asia needs to promote its own brand of MNCs while attracting the investment that seeks efficiency improvements and can help the transfer of technology, or investments seeking foreign markets vis-à-vis bilateral and regional trade agreements.

The global division of labour is characterised by 'slicing up' of production processes and the location of each 'slice' in a country where the best conditions exist

The global division of labour is characterised by 'slicing up' of production processes and the location of each 'slice' in a country where the best conditions exist. South Asia needs to identify the products and services and their components that the region as a whole, and countries separately, are competitive in producing within the global production chain. In this endeavour, bilateral and regional trade agreements can play a pivotal role. In order to overcome supply-side constraints, South Asia needs to forge close cooperation in all economic activities and utilise the full potential of such arrangements.

Many small and medium producers are unable to sustain their presence in overseas markets for their products due to inadequate export quantities, poor quality and standards, and inadequate funding for overseas marketing. In order to develop a suitable structural framework to optimise exports of SMEs, small producers should be encouraged as a source of supply to large exporters and 'trading houses' This measure would also mitigate the problem of inadequate supply of many products, particularly in agriculture. The establishment of industrial clusters can also be an effective instrument as they have distinct advantages in a number of areas such as better coordination, optimal use of labour resources, ability to 'bundle up' many services and better sub-contracting opportunities. The East Asian experience suggests that subcontracting among large firms and SMEs is an effective strategy in gaining competitive edge in the global market because such arrangements are efficient in terms of adaptability, technology absorption, opportunities for specialisation and the development of expertise in a narrow set of products.

Issues for discussion

- What are the five most critical supply-side constraints for each South Asian country?
- What would be the level of export expansion of each country if their respective governments were to solve the five most critical supply-side constraints?
- It is often argued that trade liberalisation needs to be implemented in a sequential manner. Should the South Asian governments address supply-side concerns before introducing further trade liberalisation or should they be implemented simultaneously?

Chapter 4

Conclusions and Recommendations

4.1 Conclusions

Three main forces have shaped the current trade liberalisation regime in South Asia. These are: internal pressure to reduce trade barriers and achieve economies of scale and efficiency that led to unilateral liberalisation; the need to integrate into the global economy; and the need to obtain development aid while maintaining access to structural adjustment funding through the Bretton Woods institutions.

Tariff reductions have enabled firms to improve market access and market reforms have enabled countries to attract FDI, facilitating improvements in market linkages, and integration into global production networks and value chains. The benefits of trade liberalisation are not commensurate with the extent of reforms in comparison to other countries that introduced similar reform measures, particularly those in South East Asia. The reasons for this apparent failure are debatable. This paper argues that one of the critical factors that have not adequately kept pace with the reform process is the supply-side capacity, without which South Asia cannot maintain its competitiveness and take advantage of market access.

The paper has identified some factors constraining supply-side capacity in South Asia. The region has to improve its conditions if one were to look at the best performing nations under each of these categories. The factors that the discussion paper identified as not restrictive in determining the supply-side capacity in South Asia in comparison to other regions but could improve compared to the best performing nations include:

- Bureaucracy and interpretation of rules and regulations.
- Time taken to resolve cases under court of law.
- Regulatory procedures in starting and closing business.
- Rules and regulations governing credit markets.

Table: 12

Critical supply-side constraints in South Asia

Factor	Importance
Political instability	¤ ¤ ¤ ¤ ¤
Inability to enforce the rule of law	¤ ¤ ¤ ¤ ¤
Poor general education, particularly gender bias	¤ ¤ ¤ ¤ ¤
Poor management of human resources	¤ ¤ ¤ ¤ ¤
Poor quality of public infrastructure (roads, energy, ICT)	¤ ¤ ¤ ¤ ¤
Quality and productivity	¤ ¤ ¤ ¤
Institutional structures	¤ ¤ ¤ ¤
Tax administration and rates	¤ ¤ ¤ ¤
Enforcement of regulations relating to credit markets	¤ ¤ ¤ ¤
Confidence in the judiciary	¤ ¤ ¤
Enforcement of property rights	¤ ¤ ¤
Enforcement of contracts	¤ ¤ ¤
Licensing procedures and regulations	¤ ¤ ¤
Institutional mechanism for enforcing credit market rules and regulations	¤ ¤ ¤
Inadequacy of research institutions	¤ ¤ ¤
Health conditions	¤ ¤ ¤
Access to technology	¤ ¤ ¤
Export import procedures	¤ ¤ ¤
Institutional capacity to form standards	¤ ¤
Export credit and insurance facilities	¤ ¤

- Regulatory regime governing investments and investor protection.
- Corruption and rent-seeking behaviour.
- Macroeconomic stability.
- Availability of natural resources.

The discussion paper identified the above factors constraining South Asia's supply-side capacity. In Table 12, the frequency of stars indicates the seriousness of their influence in relation to other factors:

4.2 Recommendations

Since there are many issues that need to be tackled, each country in South Asia has to prioritise its actions, design an intervention strategy in those key areas and sustain the efforts. There are common issues that constrain the supply-side capacity across all the seven countries in South Asia, which include: establishment of systems of governance that ensures political stability; enforcement of rule of law; address basic education with particular emphasis on girl education; introduce better human resources management through better labour regulations and enforcement; and improve public infrastructure including roads, energy supply and ICT. South Asia also needs to develop a system of governance that ensures political stability if it is to become globally competitive.

Issues for discussion

- What would be the appropriate forum in South Asia to address common supply-side constraints?
- What would be the implications of the failure to correct supply-side constraints in South Asia under the current international geopolitical and economic scenarios?

APPENDIX: 1

Some supply-side indicators of South Asia

Bureaucracy	Bangla-desh	India	Pakistan	Sri Lanka	South Asia	East Asia & Pacific	Europe & Central Asia	Latin America & Caribbean	Middle East & North Africa	OECD: High income	Sub-Saharan Africa	All countries
Senior management time spent dealing with requirements of regulations (%)	3.71	12.91	8.69	3.54	7.21	7.52	4.53	9.9	8.93	2.97	9.29	6.4
Consistency of officials' interpretations of regulations	78.64	64.11	35.17	71.11	62.26	54.22	46.94	34.52	59.6	57.52	53.42	49.31
Corruption												
Unofficial payments for firms to get things done (% of sales)	2.1	..	1.61	0.14	1.28	1.81	0.78	2.06	5.02	0.13	1.72	1.33
Firms expected to give gifts in meetings with tax inspectors (%)	85.8	..	..	2.74	44.27	33.59	43.35	6.92	27.74	28.26	15.89	31.85
Value of gift expected to secure government contract (% of contract)	4.05	..	..	0.03	2.04	1.52	1.56	5.34	0.84	0.55	3.59	2.29
Courts												
Confidence in the judiciary system (%)	17.02	70.63	37.41	68.83	48.47	66.32	56.03	49.7	78.77	73.6	59.35	58.96
Dispute resolution time (weeks)	16.3	..	..	7.13	11.71	8.66	11.59	7.35	37.21	14.82	11.02	12.46
No resolutions in courts for overdue payments (%)	92.05	..	..	91.23	91.64	66.07	61.84	79.33	77.49	60.49	84.51	69.02
Crime								4.89	0.25	0.82	1.19	1.39
Security costs (% of sales)	0.51	..	1.09	0.82	0.81	3.12	0.81	3.26	0.28	0.21	1.11	0.82
Losses due to crime (% of sales)	0.41	..	0.08	0.54	0.34	0.49	0.3					
Finance												
Internal finance for investment (%)	59.85	..	58.12	50.02	56	30.79	69.75	48.38	72.38	60.26	66.54	61.87
Bank finance for investment (%)	29.71	..	6.49	15.3	17.17	23.18	13.45	23.63	13.07	20.03	19.77	17.4
Informal finance for investment (%)	4.61	..	13.61	1.74	6.65	12.91	3.61	4.76	4.3	1.47	2.5	4.38
Supplier credit financing (%)	4.17	..	4.63	10.04	6.28	6.71	5.41	15.14	6.03	8.69	6.72	7.3
Collateral needed for a loan (% of loan)	92.5	94	69.48	104.68	90.16	106.7	153.73	138.37	166.34	127.38	142.11	141.66
Loans requiring collateral (%)	69.85	86.27	67.12	89.45	78.17	75.86	84.96	77.5	84.01	67.91	82.73	80.86
Informality												
Sales amount reported by a typical firm for tax purposes (%)	..	..	..	93.7	93.7	70.54	90.16	75.7	75.13	93.55	79.43	84.08
Infrastructure												
Delay in obtaining an electrical connection (days)	66.29	67.67	32.91	54.05	55.23	12.89	12.3	23.28	48.6	8.32	49.95	25.13

Bureaucracy	Bangla-desh	India	Pakistan	Sri Lanka	South Asia	East Asia & Pacific	Europe & Central Asia	Latin America & Caribbean	Middle East & North Africa	OECD: High income	Sub-Saharan Africa	All countries
Electrical outages (days)	248.96	..	11.47	..	130.22	5.01	12.28	10.6	15.41	1.14	49.3	20.75
Value lost to electrical outages (% of sales)	2.76	8.14	4.93	..	5.28	2.59	3	2.91	4.46	2.25	4.51	3.42
Water supply failures (days)	17.59	..	3.64	7.64	9.62	1.65	4.41	11.71	15.39	0.18	30.84	10.19
Delay in obtaining a telephone connection (days)	125.97	63.25	22.32	48.38	64.98	10.3	13.84	57.35	61.49	7.91	69.68	34.49
Firms using the Web to interact with clients/suppliers (%)	31.12	35.9	18.34	29.33	28.67	27.13	62.46	43.38	27.5	80.2	29.77	46.7
ISO certification ownership (%)	..	..	17.01	..	17.01	26.51	12.2	10.37	8.88	14.53	11.97	13.4
Spending on R&D (% sales)	0.21	0.35	0.57	0.04	0.29	1.26	0.3	0.86	0.62	0.17	0.64	0.5
Firms offering formal training (%)	27.15	17.81	11.09	32.55	22.15	46.32	43.01	56.33	21.05	41.85	38.89	41.2
Permanent skilled workers receiving training (%)	32.56	..	36.02	..	34.29	40.86	24.58	27.5	29.38	30.1	22.23	26.96
Employment growth over the last 3 years (%)	..	5.84	..	10.25	8.05	11.43	19.18	9.74	11.31	7.22	16.24	14.92
Time spent in meetings with tax officials (days)	2.83	..	3.1	4.2	3.37	4.55	2.82	3.73	3.35	1.65	5.01	3.4
Average time to clear direct exports through customs (days)	8.27	4.75	8.88	3.11	6.25	3.75	3.26	3.48	4.88	4.63	4.4	3.95
Longest time to clear direct exports through customs (days)	12.78	7.21	16.6	5.39	10.49	5.99	6.1	6.68	8.29	8.33	8.43	7.19
Average time to claim imports from customs (days)	10.56	6.56	17.12	3.6	9.46	5.39	3.85	8.14	10.78	5.28	8.22	6.21
Longest time to claim imports from customs (days)	21.39	9.32	31.14	7.26	17.28	9.81	7.82	16.64	22.24	9.4	16.46	12.25
Firms that export directly (%)	38.07	18.41	17.02	42.44	28.99	32.32	24.16	36.32	24.96	20.01	31.32	27.55

Source: The World Bank. 2006. *World Business Environment Survey 2006*. Washington, DC: The World Bank and the International Finance Corporation

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Endnotes

1 In the case of India, the average tariff rate was approximately 22 percent in 2004 (IMF, 2004).

2 The share of industrial goods in Sri Lanka's exports was 78 percent in 2005, of which textiles and garments accounted for 46 percent and tea accounted for an additional 13 percent. Thus, two commodities were responsible for almost 60 percent of export earnings in Sri Lanka (Central Bank of Sri Lanka, 2005). A similar situation can be observed in Bangladesh where almost 72 percent of export earnings came from textiles in 2004 (ADB, 2005). This obviously increases the vulnerability of the economy to external shocks.

3 In the case of Sri Lanka, the exchange rate regime prior to 1977 was characterised by a dual exchange rate regime, which included two set of exchange rates for imports and exports. Imports were classified into two categories (essential and luxury commodities) and applied a lower exchange rate for essential commodities and the higher rate for luxury commodities. Similarly, exports were classified into traditional and non-traditional exports, and the lower rate was applicable for traditional exports (e.g., tea and rubber) while the higher rate was applicable for non-traditional exports.

4 See *South Asia Development and Cooperation Report* for a detailed description of trade and other policy reforms (RIS, 2004).

5 The contribution of textiles and garments explains the structural shift from primary to manufactured products as textiles are classified as manufactured products, particularly in Bangladesh and Sri Lanka. This opens these countries to many other problems with the phasing out of the quota system. While large countries like India and countries that could adopt in the changing environment could tackle the fall out from the quota-free regime, other countries are likely to face severe adjustment problems.

6 For a detailed discussion on this issue, see RIS (2004).

7 Depreciation of the exchange rate can affect competitiveness if a large proportion of imported inputs are used in production of the exportable commodity.

8 A clearly documented case is Sri Lanka with several ministries and institutions with overlapping jurisdictions, which has undermined the institutional capacity for promoting exports. See SLEDB (2004).

9 The Maldives has been excluded from this comparison as data do not seem to represent the true situation.

10 The World Business Environment Survey (WBES) is an initiative of the World Bank which, in partnership with other institutions, seeks to assess the state of the enabling environment for private enterprise in a large number of countries, surveying at least 100 firms per country. The survey seeks to evaluate the conduciveness of the business environment to private investment and business development, the priorities for reform, and their relative standing in their region or globally.

11 UNCTAD (1999) provides a brief overview of education and human resources development in East Asia, especially Japan, South Korea, Taiwan, and China.

13 This is equivalent to Indian Rs. 26 billion at the exchange rate of Rs. 40/US$ 1.

14 India's situation is changing rapidly with trade and investment liberalisation.

15 For example, it is claimed that the Development Finance Corporation of Ceylon has abandoned its original intention of providing development finance and has become another 'commercial' bank after the divesture.