Celebrating Reform 2008

DOING BUSINESS REFORM CASE STUDIES

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Doing Business Case Studies

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Preface

Reforming business regulation takes leadership—more than many other reforms. Committed leaders provide vision, energy and direction to improve business climates, often in the face of daunting challenges.

The U.S. Agency for International Development and the World Bank Group are fortunate to work with many leaders around the world, some of whom are recognized in the accompanying case studies of reform. It has been a privilege to support their efforts and to see their results. We have also been pleased to partner together in many areas of this work.

We hope the case studies will inspire others to reform business regulations. They feature reforms in many of the areas covered in the *Doing Business* report. The case studies span the globe—from Rwanda to Singapore, from Peru to Vietnam—and provide lessons on both the substance and the process of reform efforts. It is through such efforts that governments can encourage businesses to invest, grow and create the jobs that lift people out of poverty.

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Introduction

Penelope J. Brook and Sabine Hertveldt

On June 4, 2008, *Doing Business* organized the second annual awards for outstanding reformers of business regulation (details available at www.reformersclub.org). Some of the global top 10 reformers from *Doing Business 2008,* including Bulgaria, Croatia, Colombia, Egypt, FYR Macedonia, Georgia and Saudi Arabia showcased their reforms to an international investor audience and global business media. Reform leaders were publicly acknowledged for their achievements and became members of the Doing Business Reformers' Club.

But reform is harder than it looks. For any reform to happen, there must first be agreement that there is indeed a problem, and about what exactly the problem is. There must also be agreement that the problem is a priority for people to spend time, money and political capital doing something about it.

And there needs to be a credible solution to the problem. The technical substance of the solution may be complex, but in many cases the solution is relatively simple in essence. The technical challenge, more often, is in tailoring the solution to local circumstances, and figuring out how best, in those local circumstances, to implement it.

Not all "obvious", high-priority problems with credible technical solutions get translated into reforms. While the whole motivation of reform is to produce long-term benefits that exceed costs, all reforms do have costs in the short term. The costs are usually felt—and voiced—sooner than the benefits, which generally take a while to show up, and are often quite dispersed.

Getting a reform done in the first place requires convincing enough people that the benefits will come to exceed the costs, and a willingness to address the concerns of those who may lose. Maintaining support for the reform—and living to reform another day—requires demonstrable benefits, ideally within the electoral cycle.

Doing Business is part of a wider World Bank Group effort to support governments in designing and implementing reforms that create a sound and efficient regulatory environment for businesses. The particular contribution of *Doing Business* is the provision of indicators on business regulations and their enforcement across 178 countries, from Afghanistan to Zimbabwe. Using a time-and-motion approach to analyze government regulations that enhance business activity and those that constrain it, the reports rank countries on their ease of doing business.

The annual publication of the *Doing Business* indicators supports the identification and diagnosis of problems. Why should it take 7 days and 5.3 % of per capita income to register a business in one developing country, and 155 days and five times per capita income in another? Or why are 3 documents and 9 days needed to process an export in a third developing country, and 9 documents and 52 days in another?

The *Doing Business* rankings have been highly effective in opening up conversations about reform. But they also help identify role models for would-be reformers and offer the opportunity to pick and choose. A reformer may look to the best performing country on an individual indicator for guidance. But she may also scan the rankings to identify other countries in the same region, or with similar histories and cultural and legal traditions. Thus Mauritius, the highest ranking African country, has become a magnet for would-be reformers from across Sub-Saharan Africa. The increasingly popular sub-national *Doing Business* reports generate often intense reform conversations between states and provinces in countries like Mexico, Colombia and India.

Annual publication of the *Doing Business* indicators makes possible measurement of the impact of reforms on the time and cost burdens of business regulation—an early indication of success for reformers. Of course, a reduction in the regulatory burden on firms is a means, not the desired end. Reformers want to know: if business registration got easier, did the rate of business registration increase—and was an increase sustained? If business registration increased, did this translate into higher rates of private investment and job creation in the formal sector? While *Doing Business* itself doesn't measure these outcomes, it is enabling a rich program of research on regulatory burdens and regulatory reforms. Data from the "starting a business" indicator alone have been used in 112 published academic papers—and counting. *Doing Business* has inspired close to 200 reforms over the past 5 years, 55 of them related to "starting a business".

In addition to publishing indicators and rankings, *Doing Business* identifies the most active reformers—countries that are active in reforming across a number of the *Doing Business* indicators, and achieving substantial improvements in their rankings. One reason for doing this is simply to recognize reform effort. But another is to help would-be reformers identify others who have worked through the procedural and political challenges of reform. We can read the laws and regulations of a high-ranking country to see why it ranks highly. This provides insight on the technical question of "what to do to reform". But it is reforming countries that are the richest source of insights on how to reform and what pitfalls to avoid.

This is where *Celebrating Reforms 2008* comes in. The stories told here range across continents, income levels and legal systems, and most of the *Doing Business* indicators. They talk about not only what a country did to improve the regulatory environment, but why and how they did it. Some of these reform efforts predate *Doing Business;* others were directly informed by it. Some are now sufficiently well established that we can begin to talk about their impact. Some reforms such as the property reform in Egypt and the business registration reform in Saudi Arabia have been celebrated at the June 4, 2008 Reformers Club. Others are still in process, with lessons from early steps informing an ongoing debate and discussion about what and how to reform.

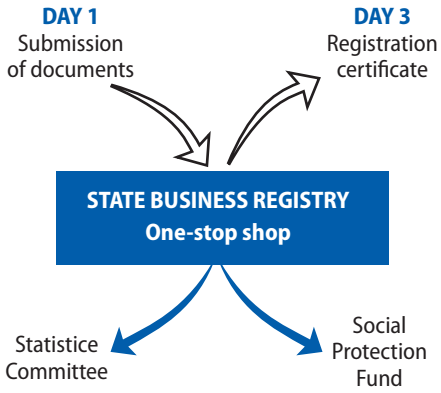
Learning from other reforms is useful. But waiting for the perfect conditions before starting the reform risks postponing it forever. From the start, reformers must set ambitious goals. As Michelangelo once said, "The greatest danger for most of us is not that our aim is too high and we miss it, but that it is too low and we reach it."

How to reform in 3 months… Azerbaijan registers businesses faster by setting-up a one-stop shop

Svetlana Bagaudinova, Dahlia Khalifa, and Givi Petriashvili

Before 2008 entrepreneurs looking to start a business in Azerbaijan had to register at 5 different agencies, complete 15 procedures, and file 33 documents. It took more than 2 months. But in 2008 Azerbaijan launched a new company registration system—and the reform went through in just 3 months. As of 1 January 2008 an entrepreneur can be ready to do business much faster—by submitting 7 documents and completing 6 procedures at the new, one-stop shop State Business Registry. Since January 2008, 3,465 limited liability companies have been registered at 14 different State Business Registries across the country. The electronic registry is linked to one-stop shop secondary agencies, including the State Social Protection Fund and the State Statistics Committee.

FIGURE 1
Streamlined procedures with the new one-stop shop



The challenge—diversify away from oil

Today Azerbaijan is one of the world's fastest growing economies. Thanks to rich hydrocarbon resources and the government's oil and gas strategy, Azerbaijan almost doubled its GDP during last 3 years. Now the goal is to diversify beyond petroleum and to develop sound growth opportunities in the nonoil economy. With 84% of GDP produced by the private sector, reaching that goal required continuously improving the business environment to create favorable conditions for businesses to grow and flourish. Azerbaijan's leadership went for it.

Azerbaijan ranked 96 in *Doing Business 2008,* in part because of the burdensome administrative barriers to doing nonpetroleum business—say, taking an average of 207 days to obtain a construction permit and up to 3 years to close down business.

In 2006 President Ilham Aliyev reviewed *Doing Business 2007.* His reaction: "unacceptable." "Azerbaijan's position," said the president, "is not high enough to fulfill our ambition to create a modern economy and to maintain a role of

FIGURE 2
Timeline of business registration reform in Azerbaijan

Source: Doing Business database.

regional leader. All necessary measures have to be taken to improve the business environment, to enable economic diversification and job creation."

On 30 April 2007 Presidential Decree 567 went into force, detailing instructions to the relevant state authorities. A key goal was to improve the business registration system and to reduce the number of procedures required for registration.

Mobilizing for reform

After receiving directions from the president, the government immediately mobilized for upcoming countrywide reforms. The Ministry of Economic Development was appointed to lead in shaping strategic guidelines. "Our priorities are clear: diversification and sustainability. Reforms should result in immediate impact to encourage businesses to invest, grow, and employ," says Heydar Babayev, minister of economic development, who coordinated the government's activities. A working group was established, composed of the Ministry of Economic Development, Ministry of Taxes, Ministry of Justice, Ministry of Labor and Social Protection of Population, the Social Protection Fund, and the Statistics Committee. At the helm was Prime Minister Arthur Rasi-zadeh. As a starting point, the working group set short- and long-term goals for improvements in the business environment.

The short-term goals target improvements over 2 years in business registration, licensing and permits, tax filing and property registration, access to credit, labor and investor protection. The long-term, 3–5 year goals include improving cross-border trade, contract enforcement, and procedures for closing a business.

The government then sought feedback. At the initial stage, the Ministry of Economic Development conducted interviews with entrepreneurs, discussed regulatory roles with government agencies, studied international experience, and assessed recommendations from the World Bank and the International Finance Corporation. The working group, with help from the International Finance Corporation experts, proposed creating a one-stop shop for business registration by introducing a unified coding system. Analysis showed the great potential for improving the business registration system—and the steps to make it happen.

Looking for best practices

From that starting point, the working group searched for best practices to guide it. According to Samir Nuriyev, Head of the Entrepreneurship Development Department in the Ministry of Economic Development, the working group reviewed "almost every one-stop shop registration system deemed successful." According to Zaur Fati-zadeh, head of the State Registration of Commercial Legal Entities and Economic Analysis in the Ministry of Taxes, the reformers "looked everywhere, from Europe to Asia and the Commonwealth of Independent States." Representatives also visited Latvia and Georgia, the top-ranked reformers at the time, to get a closer view of their registration processes.

Thinking hard about institutional architecture

The next step was to think carefully about institutional architecture, best practices, legislation, information technology solutions, and human resource requirements.

Before the reform, registering an enterprise required 5 government agencies: the Ministry of Taxes, the Ministry of Justice, the Ministry of Labor and Social Protection of Population, the Social Protection Fund, and the Statistics Committee. One would become the primary agency for the new one-stop shop, with the others moving into a secondary role without further direct contact with the registrant. The question was which one.

Organizing the single window required a delicate, reasoned approach. One should keep in mind that the burdens are not always eliminated but are shifted from business to the government. Robust coordination system capacity would be needed, putting 2 candidates under the spotlight: the Ministry of Taxes and the Ministry of Justice.

On 1 January 2006 the Ministry of Taxes had established a consolidated, state-of–the-art taxpayer database system. The system provided online tax filing, taxpayer information, compliance guidelines, filing forms, and more. With some adjustments, that system could easily become a unified business registry. Robust coordination system capacity would be needed, putting the candidate under the spotlight: the Ministry of Taxes.

On 25 October 2007 a presidential decree appointed the Ministry of Taxes as a State Registration Authority. The Minister of Taxes, Fazil Mammadov, identified the stakes:

Introducing a one-stop shop in Azerbaijan will become a starting point for building e-government. The glass of this single window must be so transparent as to leave no doubt.

According to a cross-ministerial agreement, the Ministry of Taxes receives the unified registration form, covering all information required by the State Statistics Committee and Social Protection Fund. The agreement specified which information should be forwarded to the other institutions through an electronic message, with the taxpayer identification number used to identify the registering entities. The registration certificates previously issued by the State Statistics Committee are to be eliminated.

No additional fees and less time to register

Before January 2008 most companies engaged lawyers for pre-registration, submission, and follow-up with the registration agencies. Most registrants also needed to pay additional fees to speed the cumbersome process—an unnecessary burden on business and unacceptable for modern, good governance. To make matters worse, the registration requirements were regulated in 13 pieces of legislation.

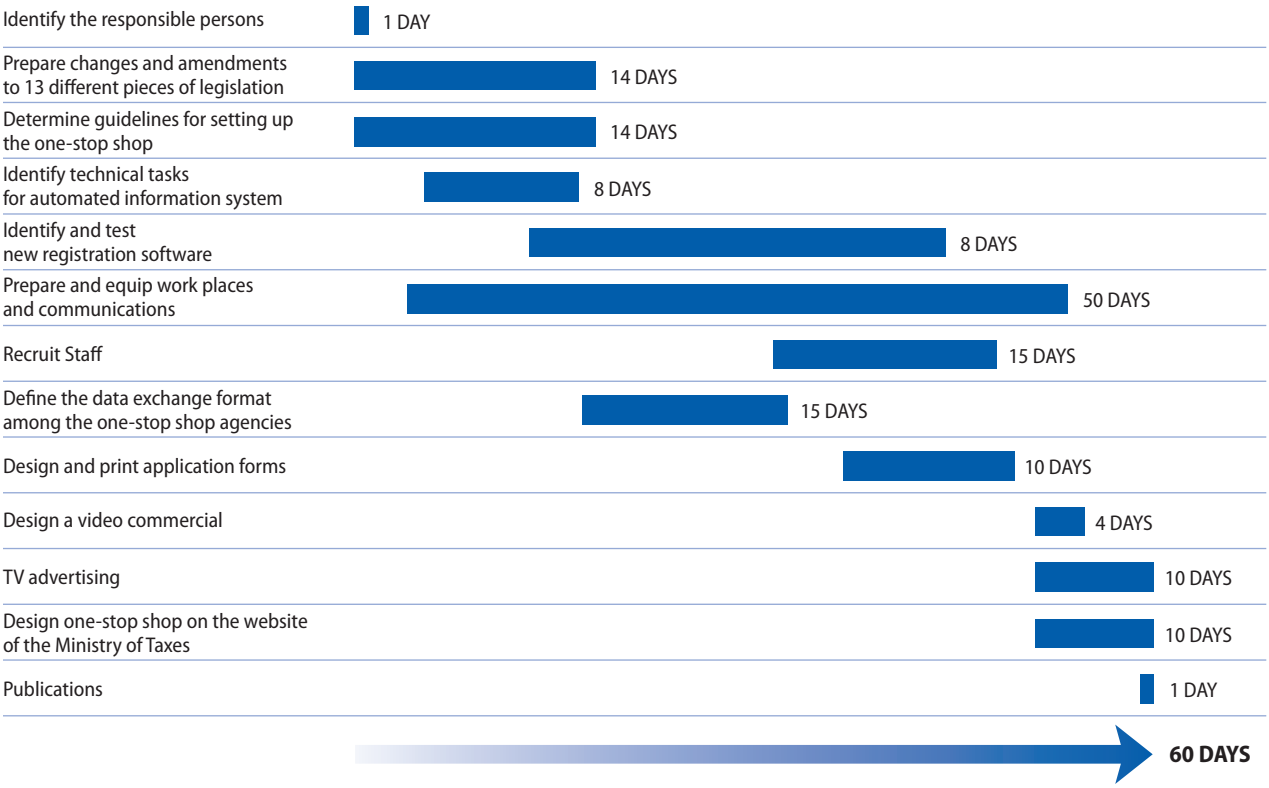
Thankfully, all that is now in the past. The simplicity and directness of the new registration system make additional assistance from professionals unnecessary. The process is regulated by only 2 pieces of legislation. and The minimum charter capital to establish a company is just 10 manats.

Giving customers what they want—information and ease of use

To guide registrants through the streamlined registration process, the government produced a standardized, 2-page corporate charter guide, obtainable without charge from the State Business Registry, in hard and electronic copies. The most popular application form is for limited liability companies. "There is no need to re-invent the wheel," says Nuriyev.

A consolidated application form was designed to enable an effective single-window service, addressing all information required for registration with the Ministry of Taxes, the Social Protection Fund, and the State Statistics Committee. The new form is the only form needed to register a new legal entity, or to amend or update previously registered information. All mandatory information for the specific type of entity is noted in the application to register a new legal entity. Only the fields being revised need to be completed when the application is to amend information on an existing entity. To further boost efficiency, the taxpayer number is used as a unique identification number for all commercial legal entities.

FIGURE 3
Azerbaijan creates a one-stop shop in 60 days



Within 3 days of concluding the registration process, the register provides the applicant with an abstract from the State Register. The applicant then has 3 weeks to inform the registrar of any discrepancies or corrections needed.

The Ministry of Taxes set up 14 regional offices, including in Nakhchivan, connected to the central system and database established at the state level by the Ministry of Taxes. The system communicates with the Social Protection Fund, and the State Statistics Committee, and other public institutions for the information exchange. For registration, the system also had to communicate with the actual offices of the Ministry of Taxes. So, lowering the burden on businesses can take lots of work from the government.

A Help Desk was created at each registration station to guide registrants through the new process, providing advice about necessary documents, filling out the application forms, and providing standardized corporate charters—any assistance needed through the whole process. The staff answers questions and e-mail inquiries, providing pre-reviews and comments from the registration officer before submission, for example. Each regional office provides the service.

Human resources

The Training Department of the Ministry of Taxes tailored a training program for new and existing registration staff to prepare them before the launch. It took 15 days to recruit and train the staff.

Cutting the Ribbon

On 29 December 2007 the president cut the ribbon on the new one-stop shop, commenting "I want to assure all the entrepreneurs that the government will render all possible assistance to the development of entrepreneurship. Their investments will be under reliable protection in all parts of the country."

Public reaction was swift and positive. After the announcement of the new one-stop shop, the country's leading economists, government representatives, businessmen, entrepreneurs, unions, and others spoke in the media, hailing the progressiveness of the new system and its stimulating impact on developing business in the country. Within the first 6 working days, 572 businesses registered.

Spurred by the President's directive, the government spared no effort to reform. The 5 agencies once required for registering a new business all worked together to bring the one-stop shop to fruition. Azerbaijan proved that reform is about cooperation rather than competition—and about learning from the experience of others.

One-stop shopping in Portugal

Camille Ramos

In 2005 it took 11 procedures and 78 days to start a business in Portugal—slower than in the Democratic Republic of Congo. An entrepreneur needed 20 forms and documents, more than in any other European Union country, and the cost came to almost €2,000. The planning for reform began as soon as new Prime Minister Jose Socrates took office in March 2005. And in 4 months On the Spot Firm, the one-stop shop for creating a company, was fully operational. Portugal is now one of the easiest countries to start a business, taking only 7 procedures, 7 days, and €600.

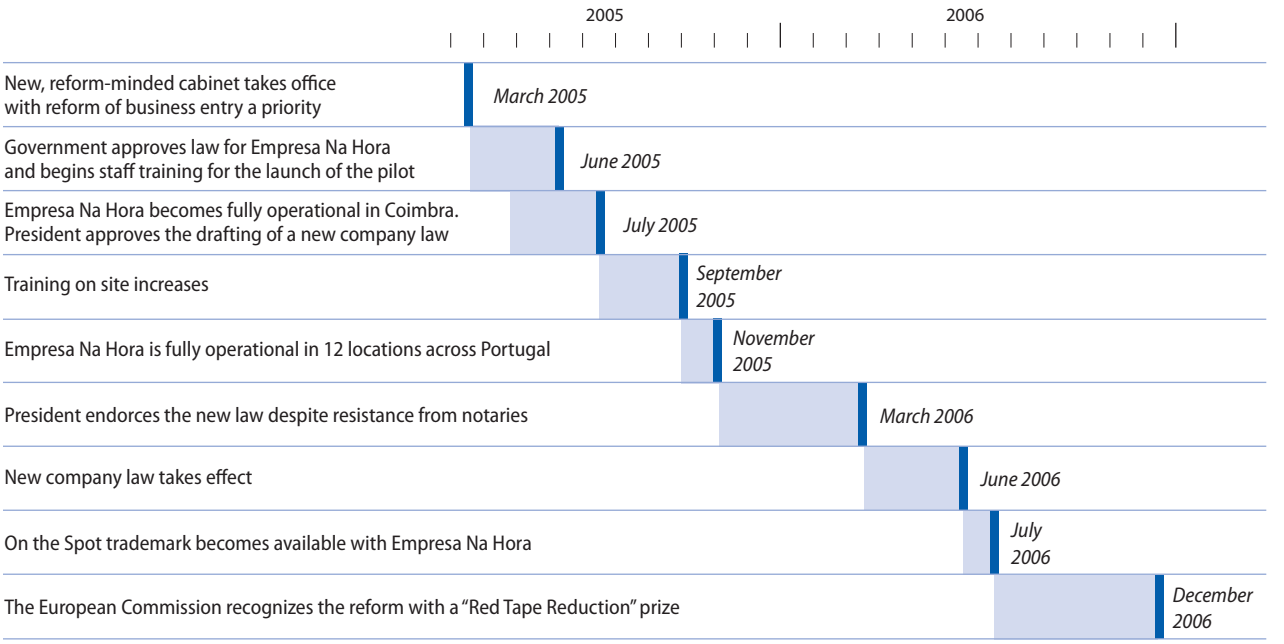
Well begun means half done

Times were tough for the Portuguese government at the end of 2004. The previous Parliament had been dissolved in November 2004, and government scandals spurred early elections. The economy it was no better—Portugal had Western Europe's lowest gross domestic product per capita. In February 2005 the Socialist party won its largest victory ever, and Jose Socrates was sworn in as prime minister.

Building on the momentum, the new government committed to cutting the bureaucracy and modernizing and simplifying public services. To jump-start

FIGURE 1
Timeline of business start-up reform in Portugal

Source: Doing Business database.



the reform process, the government chose 2 initiatives likely to be quick wins. The plan was to achieve these quick reforms and then to incorporate them in a larger process.

Just after the May 2005 elections the government set up the Unit for Coordination of Administrative Modernization (UCMA), a cross-departmental a task force of 7 people to oversee the program for modernizing public services. A platform for cooperation across many departments, the UCMA was integrated into the Presidency of the Council of Ministers and under the direct authority of the minister of state and internal affairs, Antonio Costa, who was in charge of the government's program on administrative modernization.

As head of the UCMA, Maria Manuel Leitão Marques was responsible for bringing together the Ministries of Justice, Finance, Economy, and Labor and Social Security—all involved in starting a business—to make reform a reality. Each ministry also had working groups in charge of modernization. These worked closely with the UCMA team. UCMA's job was to aggregate and coordinate measures proposed by the different ministries and public services, supervise implementation, and assess the results.

Targeting past failures

Among the government's first targets was simplifying starting a business. But the UCMA decided to inspire the government by showing that quick reform was possible in another area—targeting earlier failed attempts to reform car registration. Paulo Henriques, an advisor to the UCMA, remembers that "for 10 years, a reform to create a single document to register a car was in the pipeline, and parties could never come to an agreement over how the fees were to be split." Within 3 months UCMA had settled the issue—there would be one document and the fee would be equally split among the Road Traffic Agency and the Public Registrar —and a single car registration became possible.

The idea was to develop a pilot that could be implemented as quickly as possible—reforms that are too broad or too drawn out can mean delays, resistance, and failure. Building on the success of the car registration reform, in less than 2 months the new government drafted a law simplifying business startup. And in 4 months the reform was fully operational.

The goal for On the Spot Firm was to create a one-stop shop that would allow an entrepreneur to register a company in an hour. On the Spot Firm was to bring all agencies under a single roof, getting them to collaborate so that promoters did not have to visit every office to get the required documents. In the one-stop shop the corporate taxpayer number, the social security number, commercial registra-

tion, and the declaration of beginning activity could all be taken care of the same day. Allowing companies to use standardized articles of association, making notaries optional in evaluating the company deeds, and choosing company names from a pre-approved list eliminated major bottlenecks.

The keys to success were central coordination and the support of the prime minister. Cutting across ministries, the UCMA was able to work closely with all involved—and thus knew what to prioritize. The ministries all had priorities with the reform, so having an intermediary designate a work schedule was important. The UCMA was in charge of making sure departments and ministries complied with its hard deadlines.

To ensure that the reform would be delivered when promised (in 2 months, from May to July 2005), representatives of each ministry met frequently to confirm that everything was going well. UCMA kept a close watch, to identify potential setbacks. Some ministries did not always cooperate and lagged behind. But the prime minister stayed informed, addressing the issues during the next cabinet meetings. Attaining early buy-in at the highest levels locked in political allies, reducing the risk of reversal.

You can't please everyone

Not everybody was happy with the reform. The Association of Notaries very clearly disapproved. The notaries estimated that eliminating them from starting a company would cost at least $3.7 million and about 65,000 deeds. "Its not that we are against debureaucratization," claims Joaquim Lopes , the president of the association, "but the state violated its duty of good faith and the principle of judicial safety." The state's privatization of notary services, undertaken in the previous government, created an expectation of continuity. Notaries had invested in modernizing their services to enter a more competitive market. But the prices at On the Spot Firm were lower than the notary fees, which the government had also fixed.

At the end of 2007 the notaries threatened to take their complaints to court, claiming that the government created a monopoly and was price dumping. They argued that On the Spot Firm violated the rules of competition. "In these cases, the state annihilates the competition that it itself created and legitimated," argues Joaquim Gomes Canotilho, a law professor.

Explaining the new system helped the government counter the notaries' resistance. The benefits of change were a powerful communication tool. On the Spot Firm reduced the total waiting time by 230,000 days in a year. This generated 19,500 new jobs and more than €93 million in investment.

What gets measured gets done

Public servants were wholly responsible for On the Spot Firm. No external consultants were involved—a source of great pride. The UCMA boasts that the only external consulting they received was on the logo. Marques' advisers felt that it was important to involve mid-level public officials in the reform. If they believed in the reform, they would drive it from one day to the next. To ensure that everything went smoothly, the personnel underwent rigorous training.

On the Spot Firm launched its pilot in Coimbra, and once things were running smoothly there, staff from other cities came for training on site. The program swiftly expanded to 12 locations across the country, and today it is present in 93. Training occurred onsite and offsite, and initially the oversight was weekly or biweekly. But as the delivery date approached, control checks came up to twice a day.

Progress as a constant

The 2006 reform became part of a larger package for administrative and legislative simplification, called SIMPLEX, targeting both companies and individual citizens. The idea was to build collaboration and information sharing between the different public agencies and, above all, to increase Portugal's global competitiveness.

The SIMPLEX measures focused on transparency and accountability—with a public delivery date. On the Spot Firm wanted to foster a culture of reform, and Marques emphasized that public performance measurements ensured accountability. Progress would be the constant—and the measurements would be rigorous. The UCMA's model was the private sector. Every month an online report published the number of companies registered and how much time it took.

Who suggests reforms? Everyone

But the most important judge was the customer—citizens and businesses. More than 70% now use the new system. Complaints or suggestions are welcomed any time—in person, by mail, or electronically. Henriques comments, "We take the suggestions seriously, as they are usually valuable concerns. We have incorporated suggestions such as diminishing the number of documents that have to be presented, or incorporating different clauses into the standardized articles of association—all public suggestions." Every year the reform program for the coming year is published online, open for comments for 2 months. For the 2007 SIMPLEX program 86 of the 256 new initiatives came directly from the public.

Even after these successful reforms, Portugal faced pressure to continue reform. In January 2007 the European Committee launched the Action Program for Reducing Administrative Burdens in the European Union, whose goal was to reduce by 25% the administrative burdens on companies by 2012. Portugal responded by developing an action plan aligned with SIMPLEX.

Some reforms also had input from the private sector. A private sector committee under the Office of the Secretary of State for Justice, the Committee for Cutting Red Tape Initiatives, met once a month to informally discuss concerns, barriers, and suggestions for improvements based on committee members' experiences. Marques remembers, "We were always brainstorming on how to improve. That's where the reformers got the idea to eliminate the outdated requirement for entrepreneurs to register and legalize their financial accounting books, which was recognized in *Doing Business in 2008*. Companies would purchase the accounting books only to satisfy legal requirements to start a business, but would not use them. Not only was there political will to change this, but there also was the desire to climb in the *Doing Business* rankings."

Still seeking a budget solution

Although the reform was centrally coordinated, the budget was fragmented. This meant that the main budget for each reform came from a specific ministry (for On the Spot Firm, from the Department of Justice). But because each reform involved other ministries, ministries had to pay for different aspects of the reform. And it was the UCMA's job to enforce the system. The decisions sometimes created friction between the UCMA and the ministries. Marques comments, "in a system in which departments were not used to working together, coordination was especially difficult when it came to the budget."

If the budget had been allocated to individual projects instead of coming from ministry budgets, the process would have been much smoother. In future reforms the government plans to create a budget for each project. How?

The Ministry of Finance, investigating ways to improve the situation, has created a working group to discuss different possibilities. The ministry wants to assign a budget for each project, but the transition to the new system must be done carefully. So, the ministry is looking at how other Organisation for Economic Cooperation and Development countries have solved their budgeting issues and how these solutions might be adapted for Portugal. Its goal is to have a plan by 2009.

What's next?

With the success of On the Spot Firm and the SIMPLEX program, Portugal hopes to make more services accessible to the public online. It wants to be at the forefront in the electronic era, offering the public easy access to information and services. For some services, the country is developing a multichannel approach that combines online services with other channels (say, call-center and in-person services).

On the Spot Firm has succeed, and the reform team is proud that more than 50,000 entrepreneurs have used the services since 2005. Its success has inspired other countries. Angola and Cape Verde have requested legal and technical assistance based on the Portuguese model. Cape Verde will soon be ready to follow through with the reform. Other countries such Slovenia, Hungary, Egypt, Mozambique, Angola, São Tomé and Principe, Chile, Finland, Bosnia-Herzegovina, Romania, China, Brazil, Turkey, Sweden, and Andorra have visited the On the Spot Firm service.

Competitiveness from innovation, not inheritance

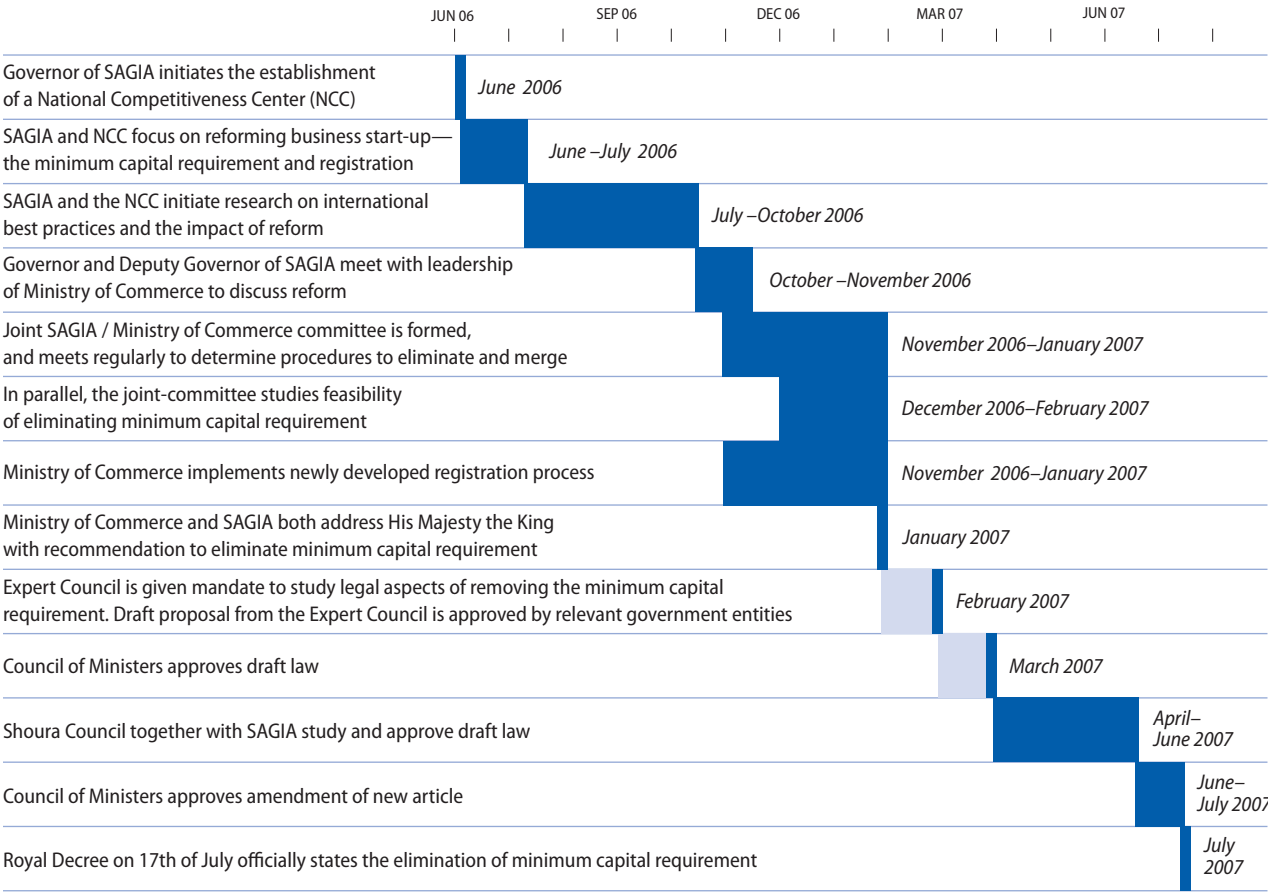
Karim Ouled Belayachi and Jamal Ibrahim Haidar

Starting a business in Saudi Arabia used to be limited to those who could afford one of the highest minimum capital requirements in the world—$125,000 for limited liability companies. In July 2007 Saudi Arabia slashed the minimum capital requirement and simplified business startup procedures. What once required 13 procedures now takes only 7. The time to start a business fell from 39 days in 2006 to only 15 in 2007. According to *Doing Business*, the country's ease of starting a business ranking soared from 159 in 2007 to 36 in 2008.

The need to transform the Saudi economy was clear—from one based on inherited wealth to one based on innovation. The oil sector makes up more than half the gross domestic product (GDP) but employs only 2% of the workforce. Even if oil maintained its high price, the sector would not generate the new jobs

FIGURE 1
Timeline of business start-up reform in Saudi Arabia

Source: Doing Business database.



to satisfy the growing workforce. The country's population is young, with 49% younger than 20, and a large share will soon enter the labor market. That could fan unemployment.

How to reform fast? Political commitment

After seeing that the country was not the best in the Middle East and North Africa region and compared poorly with the rest of the world, King Abdullah of Saudi Arabia said in 2006, "I want Saudi Arabia to be among the top 10 countries in *Doing Business* in 2010. No Middle Eastern country should have a better investment climate by 2007." This drove the creation of the 10 by 10 Initiative, with a goal to place Saudi Arabia among the 10 most competitive economies by 2010. The political structure of Saudi Arabia made it possible to start the reform right away.

Saudi Arabia's reforms began in 2003, spurred by a desire to join the World Trade Organization. The agency responsible, the Saudi Arabia Government Investment Authority (SAGIA), improved Saudi Arabia's investor rights and protections in 2003 and enhanced its competitiveness with accession to the World Trade Organization in 2005. But the $125,000 minimum paid-in capital requirement put Saudi Arabia among the lowest 20 countries in *Doing Business*'s starting a business indicator in 2006. After the success in 2003–05 SAGIA executives got direct responsibility for reforming the business entry process to encourage domestic investment.

First, they realigned their agency's mission statement to become "to position Saudi Arabia among the top 10 most competitive economies in the world by 2010 through the creation of a pro-business environment, a knowledge-based society, and by developing world-class economic cities to enhance economic development across the country." Public advertisements seek to include every citizen in that mission.

To analyze performance and promote improvements, the National Competitiveness Center created benchmarks aimed at remodeling the business entry process and rubbing out its rough bureaucratic edges. It used *Doing Business*'s "starting a business" methodology to measure results.

Collaboration, teamwork, and leadership were key to the reform's success. SAGIA's governor, Amr Dabbagh, and deputy governor, Awwad Al-Awwad, spearheaded the reform program because of their backgrounds. Dabbagh brought extensive private sector experience—he was a former chief executive of the Dabbagh Group, with previous work in telecommunications, media and technology, energy, and other major industries. Al-Awwad brought public sector experience,

as an official across several government entities. Together, they proved invaluable in lobbying private and public stakeholders to support change.

An outside agency, SAGIA was not directly responsible for business registration. Its board of directors included representatives from each ministry and 2 members from the private sector nominated by SAGIA's governor. Their diagnosis: entrepreneurial activity in Saudi Arabia was limited, mainly because the process to start a business was long, costly, and required a high minimum capital. The complex business entry process stifled entrepreneurship and innovation. Unlike in other rich countries, small and medium-size businesses did not contribute much to GDP.

Facing opposition

The main arguments for keeping a minimum capital were protecting creditors and protecting companies against insolvency. The argument was not based on specific events, but on a larger view of what would be best for the country.

From November 2006 through January 2007 SAGIA tailored business cases to address these arguments. Their point: a minimum capital requirement made little sense because capital structure depends on a firm's operations and because creditors are protected by the mark-up in asset values.

The reformers challenged their detractors: If a high minimum capital requirement is good, why don't the rich countries require such large amounts? Why does economic informality spread in parallel with the required minimum capital? Why would a company that designs software have the same capital as a highly leveraged company that transports radioactive waste? If capital requirements reflect creditor risks, shouldn't they differ across sectors? SAGIA also benefited from internal *Doing Business* research that showed that minimum paid-in capital does not prevent bankruptcy.

What gets measured gets done

After the announcement of the 10-by-10 Initiative, SAGIA set up a system of key benchmarks, with targets for each year based on an aggressive goal to be among the top 10 countries by 2010. The goal was not only to improve, but to improve compared with others. So, international benchmarks were the targets. The end-of-year bonuses of SAGIA's executive staff depended on achieving or surpassing an overall *Doing Business* rank below 40 in 2006, 30 in 2007, 25 in 2008, 15 in 2009, and 10 in 2010.

SAGIA reported its progress directly to King Abdullah, every quarter. The king wanted briefings on successful collaborations with other ministries—and on the obstacles SAGIA encountered. The system made everyone accountable to the highest levels of government, creating an urgency and sense of responsibility. In 2006 the team missed the annual target, so it faced significant political pressure to make sturdy progress the next year.

The reforms encompassed many agencies and departments outside SAGIA. So, for every significant step forward, SAGIA used a media campaign to thank the relevant ministries or departments, with television spots, newspaper announcements, and awards ceremonies. "It is important to let people know that everyone is part of the 10-by-10 Initiative and that everyone is a winner," says Al-Awwad.

Quick wins to create momentum

Major legal changes do not happen quickly. To re-engineer business registration, SAGIA created momentum by advocating for smaller, simpler reforms. Eliminating the minimum capital would have to wait for later. The reformers identified quick reforms—procedures with little function that could be easily eliminated without objection from the entity that administered them.

An example was the procedure that required the Chamber of Commerce to stamp the company books. The procedure served no real purpose, and the Chamber of Commerce agreed to eliminate it. Also reformed were steps that could be merged together.

In the old registration process the company name and a summary of the articles of association were submitted separately for publication in the Official Gazette. No rationale other than historical protocol justified the separate submissions. The Ministry of Commerce was thus open to a single submission. Technocrats from SAGIA and the Ministry of Commerce implemented the reforms. These quick reforms brought momentum that made it easier for SAGIA to advocate more challenging reforms, such as reducing costs for business registration. The General Organization of Social Insurance's plans computerize its registration procedure and go online further streamlined and simplified business startup.

Meetings at the ministerial or deputy levels became the basis for memorandums of understanding between the organizations—to formalize the agreed reforms. These became a reference point to create pressure and ensure commitment.

Piggybacking? Only if it works

Navigating government agencies was a challenge, but it built understanding of how to promote reforms. Legislative reforms required much more creativity. Discovering that the Ministry of Commerce had already drafted a new Companies Law, SAGIA "piggy-backed" on the new law and received the ministry's support to add Article 164, eliminating the minimum capital requirement.

From January to May 2007 the Ministry of Commerce and the governor of SAGIA lobbied the Supreme Economic Council, the Council of Ministers, and the Shura Council to pass the new law. But the process began to slow. Making use of the new law had originally accelerated matters, but questions arose about articles unrelated to the minimum capital requirement. SAGIA and the Ministry of Commerce agreed that Article 164 could still be fast-tracked if stripped from the new law. The legislative creativity worked. Within a month Article 164 won passage through all legislative bodies and the king's signature. Reflecting on the experience, the deputy governor Al-Awwad of SAGIA says, "it is sometimes important not to wait until you have the whole perfect picture. Instead focus on what works."

Leveraging international experience

Early in the implementation phase, the king sent a memo instructing SAGIA to hold workshops with every related agency in Saudi Arabia on how to improve its ease of *Doing Business*. At these workshops SAGIA and others elaborated clear responsibilities, timetables, action points, and benchmarks.

To benefit from international experience, in June 2006 reformers contracted with consultants from Monitor Group—a global strategic consulting firm that specializes in national economic development—to learn more about best practices for business entry around the world. Monitor Group brought analytical expertise and strategy assistance. And it was a useful outside player to assess current conditions and future requirements. In collaboration with the Ministry of Commerce, it developed a performance measurement system for ministry staff, highlighting the importance of results.

Since its formation, the Ministry of Commerce has been keen to foster the domestic private sector. SAGIA benefited, spotlighting how the ministry's strategic vision aligned with its own. Within a few months the ministry became a partner in championing the reform.

Making the reforms sustainable and responsive to the private sector was imperative because stakeholder views change over time. So, the National Competitiveness Center established a second level of work at the cluster level—a platform for members of the private and public sectors to meet, discuss, and resolve issues, with the National Competitiveness Center just a facilitator.

More outreach needed

Dabbagh and SAGIA have tried to communicate the reforms broadly, but much more can be done. In this country—of more than 27 million inhabitants, where small and medium-size enterprises contribute only 28% of GDP—a stronger media campaign is needed to motivate would-be entrepreneurs to create their businesses and to join the formal sector. The team is reaching out to those people to trumpet the opportunities.

A senior Saudi official who was directly engaged in the reform says, "We are not just content to rest on the accomplishments. We know there is a great deal more work to be done to achieve our 10-by-10 objective, but we like to look at our goal as Michelangelo did when he said, 'The greatest danger for most of us is not that our aim is too high and we miss it, but that it is too low and we reach it.'"

Harnessing the Internet to streamline procedures

K. Latha

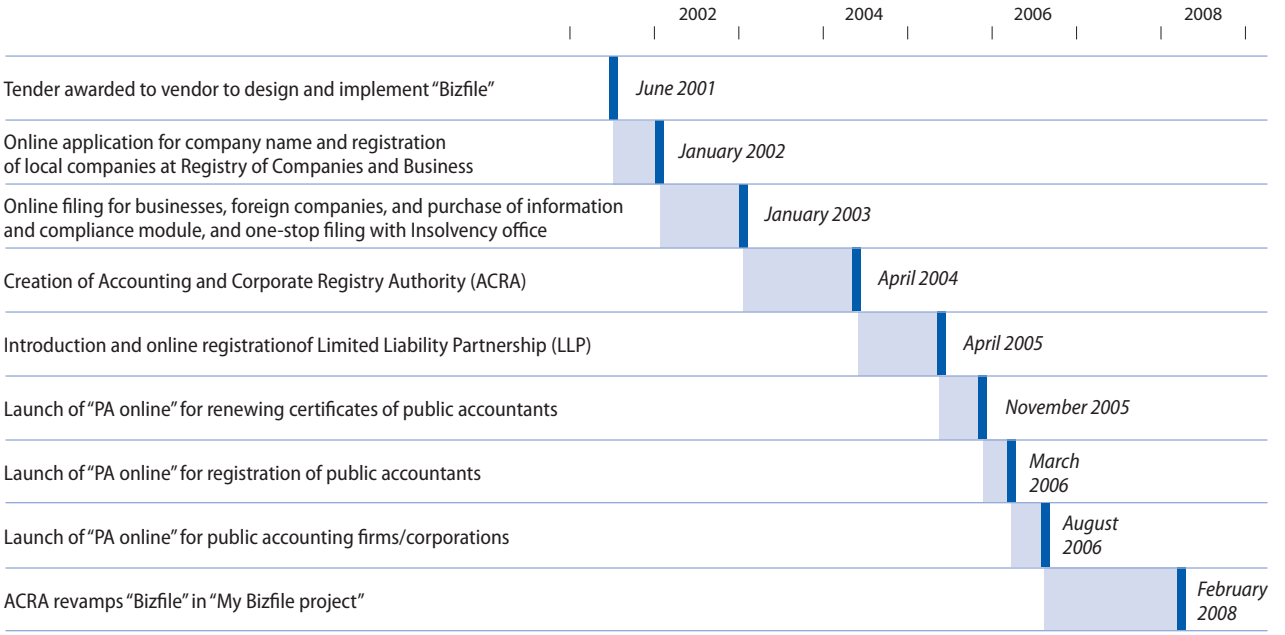
Singapore's Accounting and Corporate Regulatory Authority (ACRA) is entrepreneurs' first stop to start a business. Thousands of businesses and companies are formed every year—and the number keeps on growing. But before 2003 the process was long, tedious, and too dependent on clerical staff entering data by hand, leading to dissatisfaction and delays.

To make operations more efficient and to improve service delivery, the organization embarked on Bizfile, an Internet-based online registration, filing, and information retrieval system. This initiative was part of the government's plan to become a world-class user of information technology, bringing as many public services online as possible, thereby improving customers' experiences.

With Bizfile up and running, information is now updated within half an hour of a successful filing—down from 14–21 days before reform. The time to register a new business has fallen from 24 hours to 15 minutes, and the time to incorporate a company from 5 days to just 15 minutes. Costs are down too—and businesses benefit through lower registration fees.

FIGURE 1
Timeline of business registration reform in Singapore

Source: Doing Business database.



Form 6? Form 7? Or both?

Before 2003 an entrepreneur had to go to the registry, fill out multiple forms, and wait in line to submit an application. The waiting time at the counters could be long, leading to frustration. And customers could file the documents only during the fixed hours when the registry was open. On top of that, the law prescribed a sometimes bewildering variety of company forms—Form 1 to Form 94, and the like—used in different combinations depending on the purpose.

The complex process often forced entrepreneurs to run to their lawyers or accountants, adding their fees to the cost of starting a business. Clerks manually entered information into a central repository, taking between 14 to 21 days to finish. Manual updating inevitably meant human errors—and more time and effort spent correcting them. Data accuracy and integrity became uncertain.

Another problem was processing time for applications. It took 5 days to approve a company name and another 5 to incorporate a new company. Registering a new business took 24 hours—longer if approvals were required from other government agencies. For these cases, the registry had to send, via mail or fax, copies of the application forms to the agency concerned, and the agencies had to reply using the same methods.

An ambitious plan—put everything online

The Registrar of Companies and Businesses, Ms Juthika Ramanathan, saw an online filing system as a way to tackle the problems in the manual registration system and offer better service to customers. Support came from an e-government encouraging public agencies to offer their services online. So, the registry won strong backing from Ministry of Finance for its plan to become one of the first regulatory agencies in the world to offer all its services online. It was a big step, involving far more than just putting manual forms online. Instead, the registry painstakingly reengineered all its forms and offered all its other services online.

Bringing the Internet to business registration

Bizfile was designed to provide a user-friendly online filing system for all the forms and documents needed for new and current businesses. To enable faster processing, the registry reviewed and re-engineered work procedures and removed or reduced labor-intensive elements. Bizfile also implemented a compliance management system to track entities' compliance with statutory requirements and to penalize defaulters—another part of the registry's responsibilities. Bizfile also made up-to-date information quickly available to the public.

Work on Bizfile commenced in 2001, with completion targeted for 2003. A local information technology company, SCS Computer Systems Limited, was awarded the contract.

Bizfile was fully implemented on 13 January 2003. It resides on the government's standardized eService platform, the Public Service Infrastructure. To access Bizfile, customers do not need any special software and hardware—just a personal computer with broadband Internet connectivity.

Today, Bizfile offers 284 electronic services: registration and closure of companies, businesses, limited liability partnerships, and public accounting firms; filing of statutory documents; registration of company charges; purchase of information and extracts of documents lodged; payment of fines; and other services. The system also includes an intranet module to help officers process complex cases requiring human input. For cases requiring approval from other government agencies, Bizfile sends an email notifying the agencies of a pending application. The agency then logs on to Bizfile to retrieve the online application and provide its comments, saving time and effort.

The system made it easier for business owners, company officers, and professionals to file documents. The registry also reached out to private service providers, promoting service bureaus for people who required assistance in filing but could not afford to engage a professional. The initiative thus created another channel to handle filings where assistance is required. The first service bureau opened next door to the registry, around the same time as Bizfile's launch. In the early days of Bizfile the registry worked with the service bureau to monitor performance and solicit feedback.

To prepare users and smooth the transition to online filing, the registry implemented Bizfile in 2 phases. Name reservation and incorporation of local companies became active on 15 January 2002. Business registration and other processes came on line on 13 January 2003.

There was some resistance from customers and staff. But the registry overcame it through change management initiatives—constant communication, extra help for customers during the initial stages, and a strong message that counter staff should perform value-added functions such as approving online applications and having greater involvement in ACRA's strategic projects.

A fresh look at work processes

A major change was doing away with the confusing forms and form numbers and instead classifying transactions according to what the customer wants to do. Consider incorporating a limited company. In the manual system some required documents would have to be prepared and affirmed by a lawyer or other professional. With the online system, all customers have to do is look for the transaction under the header "Application for Incorporation of a Company" and incorporate the company on their own. There is no need for a professional firm.

To simplify the process, Bizfile pre-populates forms with information already available in the database. The customer doesn't need to reenter the information but can make changes if needed.

To ensure accuracy and integrity, Bizfile validates and verifies the data entered. This could mean checking the addresses against a register provided by a local authority, calling on algorithms provided by the national registration body that issues identity cards, or verifying information with a building register to confirm whether a road, street, or house exists at the address declared by the customer.

The registry also reviewed what documents needed to be filed, questioning longstanding rules and removing obsolete or unnecessary requirements. Statutory declarations, formerly required to be made before commissioners of oaths or notaries public, were replaced with online declarations carrying the same punishment for false or misleading statements. Affidavits to support applications to correct court records are no longer required, with the records now obtained from the courts only if the need for inspection arises.

Taking full advantage of widespread access to the Internet, email, and Portable Document Format (PDF) files, the registry replaced hard copy certifications with electronic notifications. When an entity successfully registers, the registry sends an e-mail confirmation that can be printed for records. Signed hard copies can be purchased if the filer requires them—say, to register in a foreign jurisdiction. Amendments to the laws validated the changes.

The requirement to sign forms for authentication was also removed. All filers are now authenticated through their unique identification card number and SingPass. The identification card number is issued by the National Registration Office; SingPass, by the Central Provident Fund Board, a statutory body that administers the compulsory savings fund. All employed people can get a SingPass. Those who cannot get a SingPass can hire a professional firm to file on their behalf. To enable professional firms to file on clients' behalf, the registry issues a professional identification number.

Where possible, Bizfile integrated decision making rules into the system, allowing it to process applications without human intervention. Certain names, for example, are prohibited. Bizfile processes the name based on these rules and informs the customer of the outcome almost instantaneously. Selecting a company name now takes only a few minutes, down from 5 days before the reform.

Information technology advances also enabled online payments using credit cards, internet banking facilities, or cashcards.[1] Professional firms that do regular filings can open a deposit account with the registry, drawing on it to pay filing fees.

The registry's reviews also revealed that some common forms used in insolvency cases were lodged with both the registry and the Insolvency Office. So, the registry created a one-stop filing process so that the form needs be filed only once, using Bizfile. Bizfile then transmits a PDF version of the electronic form to the Insolvency Office.

Still striving to improve

The government continued pushing forward to improve Bizfile after its initial implementation. On 1 April 2004 the registry was merged with the Public Accountants Board to form the Accounting and Corporate Regulatory Authority (ACRA). Established to be the national regulator of businesses and public accountants, ACRA now regulates more than 340,000 business entities and more than 800 public accountants.

In April 2005 ACRA added online filing for limited liability partnerships to Bizfile. Just a few months later, it added a new module, PA Online, which provides online registration and renewals for public accountants' licenses, cutting the time for renewals from 2 months to 30 minutes. Registration time fell from an average of 3 months to less than 21 days.

Bizfile garnered many accolades, locally and worldwide. Most important, customers continue to express satisfaction with Bizfile's e-services. And improvements are still ongoing. For example, the first phase of MyBizfile was launched in February 2008, with the second phase slated for later in 2008. MyBizfile is a project to make transactions via Bizfile easier. Other enhancements include streamlining current services and including a step-by-step guide, a search facility for specific services and customized information search.

BizFile's effects—already impressive

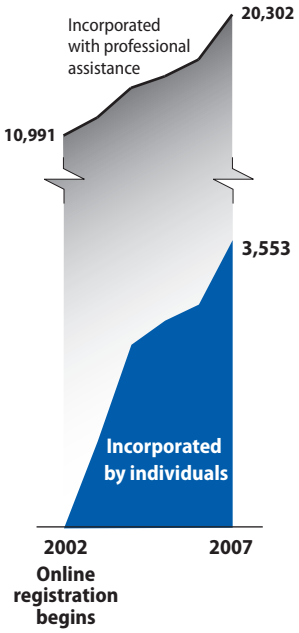
With the simplified rules, individuals can now register their business entities on their own—without the need to seek professional assistance. This saves money for business owners.

Bizfile is available 24 hours a day, 7 days a week, including Sundays and holidays. It also has a Helpdesk facility accessible from 8am to 7pm on weekdays and 8am to 1pm on Saturdays. Filings are now based on transactions, not forms. And the Bizfile menu was arranged in logical sequence, based on the life of a business entity, to make filing easier.

After a successful filing, information is updated within half an hour—down from 14–21 days before reform. It is then available for purchase as well. The time to register a new business has fallen from 24 hours to 15 minutes; that to incorporate a company, from 5 days to just 15 minutes. Bizfile has saved manpower costs as well, with the savings passed to the businesses through lower registration fees. The fees to register a new business dropped from S$100 to S$50; those to incorporate a new company, from S$1,200–$35,000 to a flat rate of S$300. Bizfile cut the annual fee to renew a business registration from S$25 to S$20.

With the mundane, labor-intensive work trimmed away, officers can be retrained and redeployed to do higher value-added work—say, approving charge registrations and name appeals. This boosts their job satisfaction and career prospects.

FIGURE 2
Bizfile enables individuals to register businesses on their own



Source: Doing Business database.

Notes

1. A cashcard is issued jointly by the participating banks, which are jointly liable to the cardholder for the deposit and stored value. These cards can be topped up at the teller machines of the participating banks and can be used for making electronic payments.

The author is the Head of the Business Facilitation Division, Accounting and Corporate Regulatory Authority (ACRA), Singapore.

Creating a new profession from scratch

Carolin Geginat and Jana Malinska

With the Czech construction market booming, public building offices were swamped. Projects were becoming bigger and more complex by the day, and the building officers who had to approve them often felt that they lacked the experience to do so.

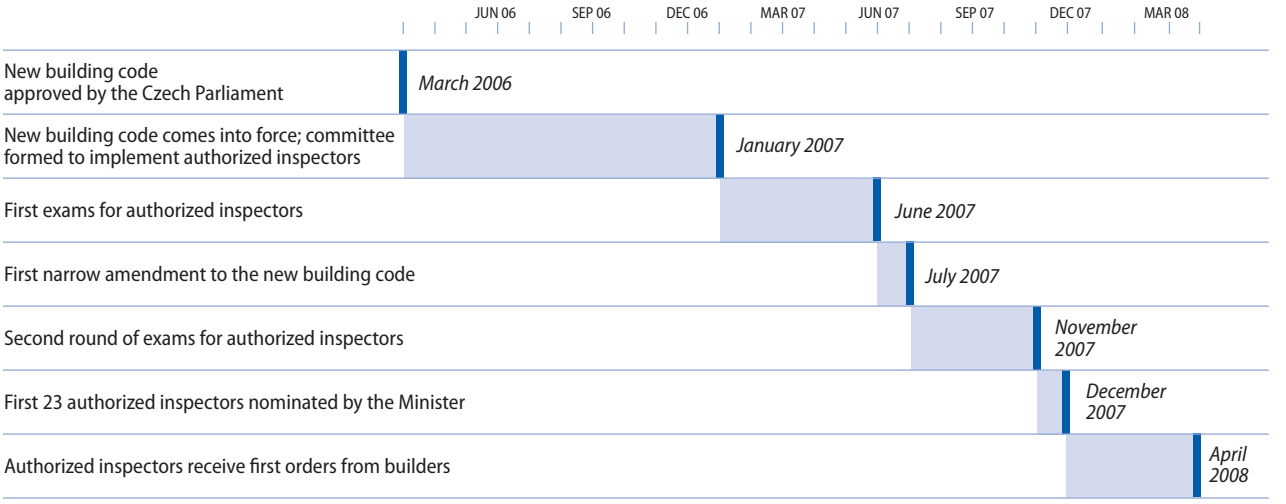
The officers got a moment to breathe only when, say, the applicant forgot a stamp or a document in the application. The officer interrupted the process, notified the applicant, and put the project back at the bottom of the pile until the application was resubmitted. The result was that builders faced long waits for approval, and building officers were frustrated because the pile of applications in front of them never seemed to shrink.

As of 2007, it took 36 procedures, 251 days, and costs equivalent to 18.5 percent of the per capita gross national income to obtain all the approvals to build a simple new warehouse and connect it to utilities in Prague.

The 2007 building code sought to turn things around. At its center was an entirely new profession for the Czech Republic: the authorized inspector. Did it work? It's too soon to tell. Important decisions have to be made on the role of inspectors in the building permitting process and implementation of the new profession is still on-going.

FIGURE 1
Timeline of building permits reform in the Czech Republic

Source: Doing Business database.



The legacy of a planned economy

Until 1 January 2007 all construction permits in the Czech Republic were governed by a 1976 law. As in many other Eastern European countries, land allocation and construction were, for half a century, based mostly on administrative decisions and a planned economy—not supply and demand. A private property and real estate market for businesses did not exist, and new developments in the construction industry were few.

To address the needs of the free market after 1989—and more recently, to implement European Union regulations—amendments to the 1976 Territorial Planning and Building Code introduced a new regime of town and country planning and construction permitting. In 1990 work officially started on a new code to replace the 1976 one.

The task proved complex—at the same time 51 other laws and regulations needed amending. The new building code concerned many players. And all wanted their voices heard, from the builders and construction firms, to the neighborhood associations, to lawyers, environmental activists, and local government officials. After long preparations and broad consultations, the new law was finally approved by the Czech Parliament in March 2006 and became effective in January 2007.

Initial opinions on the new code are varied, with the final impact as yet unclear. Instead of marking the end of a long reform process, the new law seems merely to have kicked off a second round of scrutiny. Parliament had already passed a first, narrow amendment to the new code in March 2008,[1] and a more far-reaching amendment is scheduled for 2009 to correct for any problems evident in the first 2 years.

A new player—the authorized inspector

A main innovation of the 2007 building code was the introduction of a new independent profession, the authorized inspector, along with the related shortened building control proceeding. These were introduced to privatize parts of the building control procedures—and to speed the licensing process.

The new law stipulates that developers may ask the public building office to handle the entire permitting process or may contract a private inspector. That inspector goes through the project's documentation to assess if it accords with the territorial plan and the relevant building regulations. Cutting the lengthy back and forth between builders and building offices, the authorized inspector can help builders address discrepancies between the design plans and the required standards right away. Reformers hope that wait times will fall as a result.

At the end of the process the authorized inspector issues a certificate that the designed structure can be built. Although the certificate and the relevant documentation still have to be sent to the public building office, the builder can start construction immediately. Authorized inspectors can also issue the basic approval document at the end of construction, allowing builders to put the building into use. Inspections during construction are still carried out by the building offices, but they follow a schedule established by the inspector during the initial assessment.

Creating a new profession from scratch

In January 2007 implementing the new profession fell to the 2 professional chambers: the Czech Chamber of Architects and the Czech Chamber of Authorized Construction Engineers and Technicians. A Coordination Committee, charged with overseeing implementation, engaged in dialogues with professional peers from England, Sweden, and Bavaria to design a workable solution for the Czech Republic. Early in the discussions it became clear that Sweden's privatization model went beyond what the reformers wanted. The most important inspiration came from England (where private inspectors can replace public buildings proceedings) and Bavaria (where private inspections complement public building proceedings).

For a reformer who must deal with politics, an advantage of having only some private elements (like in Bavaria) is that building offices do not have to cede their ultimate decisionmaking power. That means less resistance from the building offices to be overcome during the reform.[2] But where private inspectors compete directly with public building offices, the offices might have more incentives to streamline their processes—as in England, where approved inspectors can work anywhere in the country, making them particularly interesting for big construction firms. In response, some local public building offices started partnering with building offices elsewhere in the country to offer similar services.

Implementation in the Czech Republic remains ongoing. The two chambers established an expert exam commission and set the terms and conditions for exams, with the first exams held in June 2007. In December 2007 the first group of 23 successful candidates were appointed authorized inspectors by the minister of regional development.[3] As of April 2008, another 34 had been appointed and the new inspectors have received their first orders.

The new system reflects choices about how best to manage the respective roles of the public and private sector players, including their responsibilities, accountabilities and liabilities.

Offer the same services or split responsibilities?

The Czech system is closer to the English than to the Bavarian. As in England, the Czech authorized inspector is an alternative to the public building process, not a complementary service as in Bavaria. The inspector chaperons the builder from the beginning of the proceedings to the end, ensuring that all the documentation for approval is in order and offering advice, if needed, on how to address discrepancies.

But unlike in England the Czech inspector does not carry out the technical controls during construction. The building offices remain responsible for inspections during construction, following the schedule of the authorized inspector. That's the reverse of the approach in Bavaria, where the permit is issued by the public building office and inspections are delegated to the private inspector. In the Czech Republic the authorized inspector issues the permit and "tasks" the public building office with the inspections.

Who tasks the authorized inspector?

As in England, the authorized inspectors are tasked and paid for by the builder, not by the building office. But this can create adverse incentives because authorized inspectors are not accountable to public building offices. So, they might be tempted to enforce less stringent standards with important clients.

To counter the incentive problem, the Czech law obliges the inspector to provide expert cooperation to the public building office if required to do so. And the minister for regional development has the right to revoke the certification of an authorized inspector for repeated or material breaches.[4]

But the building offices' ability to intervene, where necessary, in cases handled by authorized inspectors depends on their retaining staff with qualifications equivalent to those of the authorized inspectors. An incentive problem looms because of the expected salary differentials between authorized inspectors and public building office staff. The average gross monthly salary for a building office employee is about $1,000. Meanwhile, authorized inspectors expect their salary to be around $50 an hour. With an authorized inspector able to earn in just 20 hours as much as colleagues at the building office earn in a month, qualified staff will likely migrate from the public sector to the private.

A first indication that this might occur is that, according to the chairman, building offices are already considering outsourcing the inspection part of the process to the authorized inspectors using a loophole in the law. If this were to happen, the Czech Republic might end up with an entirely privatized system after all.

Who carries legal liability?

Whether the structural safety controls are carried out by the building offices or the authorized inspectors, Czech authorized inspectors hold the liability for damages resulting from substandard building—because they draw up the schedule of needed inspections.[5] Consistent with that liability arrangement, the new building code foresees that authorized inspectors have to ensure adequate insurance coverage. The details of the insurance coverage, however, have yet to be worked out. Today, unlike in England and Germany, there is no minimum coverage required. Instead, the law simply stipulates that the insurance is based on an agreement with the builder contracting the authorized inspector.

Based on experiences abroad, it might take awhile for insurance companies to adequately price the risks associated with the new profession. In England it was 12 years before the central government approved the insurance schemes and the insurance cover became readily available. In Bavaria the insurance market was better prepared because "approving engineers" already existed, introduced in 1942 because wartime scarcities forced policymakers to look for alternatives to support understaffed public building offices.

Conclusion

Over the last decade, building control systems in Europe have undergone significant changes. More and more countries have introduced private elements in their building control process. Some countries have gone further than others. Countries like the Czech Republic who have come late into the game can profit from the experiences of other countries like England or Germany. This case study highlighted some of the choices that the Czech Government had to make when trying to privatize building control activities. The newly appointed authorized inspectors have received their first orders recently. Practice will show if the authorized inspectors will really make a difference in the life of Czech builders.

Notes

1. The main changes contained in the amendment concern the approval of simple constructions such as garages. The amendment clarifies that if the garage forms a complex together with a house; only one building permit has to be obtained (jointly for the garage and for the house). As of April 2008, the first amendment is still awaiting the approval by the President of the Czech Republic.
2. In Bavaria, building offices in fact had to cede power as a consequence of the building code reform of 1994 and its subsequent versions. However, their loss of power was more attributable to the introduction of "approval free" building categories than the utilization of private party assessments for structural and fire safety.
3. Additional candidates have passed the exam but are still awaiting their appointment.

4. Article no. 144 section 2 of the Building Code. Other reasons to revoke the certification are if the Authorized Inspectors ceases to be a person without a criminal record or if he has been inactive in his function as an Authorized Inspector for longer than 3 years
5. The builder remains responsible for the building as a whole and the project designer assumes responsibility for accuracy of plans and most of the design and technical aspects of the building. The authorized inspector is materially responsible for his work and carries the legal liability for the building together with them. In the case of a construction failure, an examination will have to take place to establish if the documents approved by the Authorized Inspector were right and if the designer, constructor or the Authorized Inspector is responsible for the failure.

How to raise revenues by lowering fees

Jamal Ibrahim Haidar

Over the last decade Egypt's economy grew rapidly. But its property market remained far below its economic potential—for government revenues and as an investment vehicle for citizens. In July 2006 the government collected just EGP 6.1 million in registration fees, less than the price of an apartment in "The First Residence," a luxury building in an affluent Cairo neighborhood. Old property registration laws from 1964, high fees, and inefficient government agencies hindered the formalization of real estate.

A 2004 World Bank study found that 60% of Egyptian domestic firms identified tax administration as a major constraint, 53% identified corruption as a major constraint, and 26% expected to pay informal payments to get things done. Firms not able to pay were excluded from regular business. Ranked 147 of 175 countries on the *Doing Business* registering property indicator, Egypt was behind all but 2 countries in the Middle East and North Africa. But reform in 2006 helped Egypt cut registration fees from 5.9% to 1% of property value. And meanwhile state revenues rose—along with the country's *Doing Business* ranking.

A fortune in unregistered property

Of Egypt's estimated 25 million urban properties, only 7% were formally registered. According to Hernando De Soto, unregistered property in Egypt is worth $241 billion—55 times the foreign direct investment the country received over the last 200 years, including the Suez Canal and the Aswan Dam, or 30 times the value of the Cairo stock exchange.

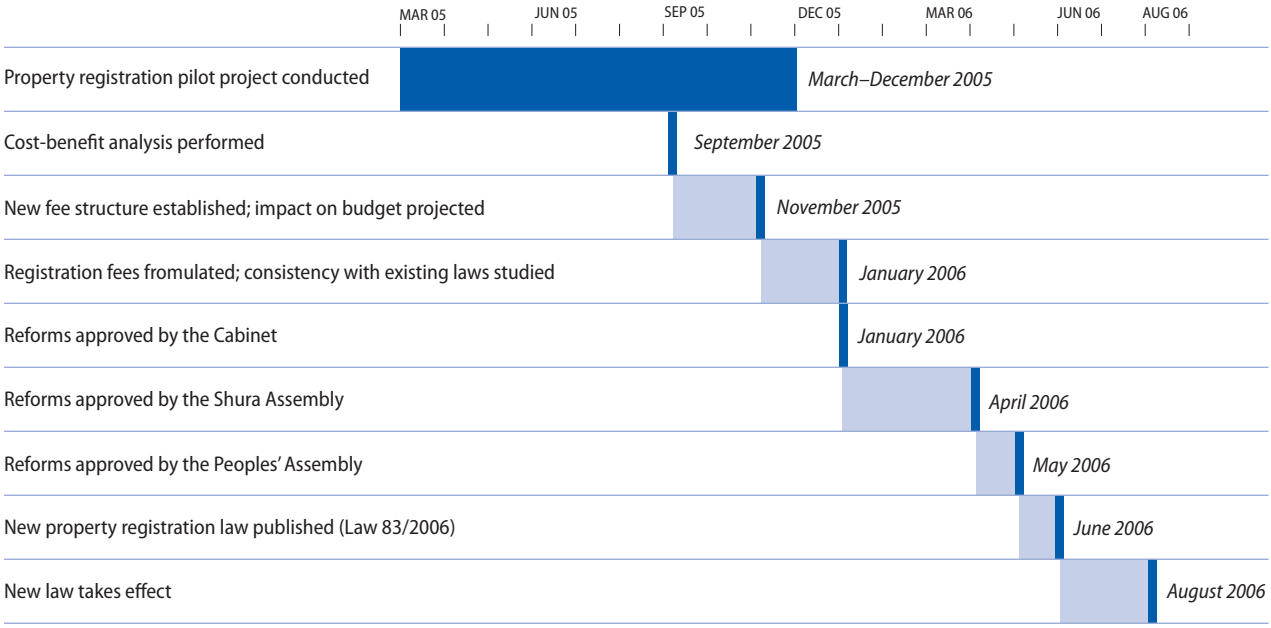
In 2005, 90% of properties were either unregistered or registered at underestimated values.[1] Transferring a property between domestic companies cost 5.9% of property value. Compare that with less than 0.5% in New York. Egypt's fee based on a percentage of the property value encouraged undervaluation, complicated property registration, and required more regulation to secure tax revenues. It also created opportunities for corruption.

Empowering winners

The government identified 2 problem areas: high costs and cumbersome procedures. According to Emad Hassan, director of National Database Program of the Ministry of State for Administrative Development, the goal was to bring informal property into the official national framework by formalizing it. How? By reducing property registration fees, simplifying the property registration

FIGURE 1
Timeline of property reform in Egypt

Source: Doing Business database.



process, and encouraging citizens and companies to obtain titles. An inspiration was Peru's 2003 nationwide titling program, which quickly converted informal property into securely delineated holdings.

Reducing registration fees was not a new idea in Egypt. But before 2004 the program focused on cutting the fees to 3% of property value. From March 2005 a new vision emerged, based on the assumption that the property registration is a public service, so fees should just equal the real cost to the government. The new model for reform recommended changing the fees structure from one based on percentages to one based on fixed fees.

The focus was on empowering the winners from reform and engaging stakeholders. To determine who could affect the success of the reform, the Ministry of State for Administrative Development conducted stakeholder mapping. First, staff created a comprehensive stakeholders list. Second, they brainstormed about how each person or group could make a tangible contribution to the reform—they did not want relevant people to sit on the sidelines because they were not given a role and asked to participate. Third, they identified steps to mitigate potential resistance.

Cooperating with the Ministries of Justice and the Property Tax Authority, the Ministry of State for Administrative Development led a pilot project between March and December 2005 to study property registration. Representatives of the

government departments met 6 times, once a month. In 3 meetings they also invited bankers, technical experts from the World Bank and the International Finance Corporation, and members of the Lawyers' Syndicate to present their opinions.

The reformers understood the importance of involving the stakeholders in face-to-face meetings, forming a stakeholder working group in April 2005. It comprised the Ministry of Investment, with its 2 arms, the General Authority for Investment and the Mortgage Finance Authority; the Ministry of State for Administrative Development; the Ministry of Justice; the Public Notary Authority of the Ministry of Justice; the Ministry of Housing; the Real Estate Taxation Authority of the Ministry of Finance; the Egyptian Surveying Authority of the Ministry of Water Resources and Irrigation; and governorates and municipalities under the Ministry of State for Local Development.

In November 2005 the working group delivered its final report. Its conclusion: if only half the informal properties became registered after the reform, the revenues would be EGP 5.5 billion, more than half of that net profits.

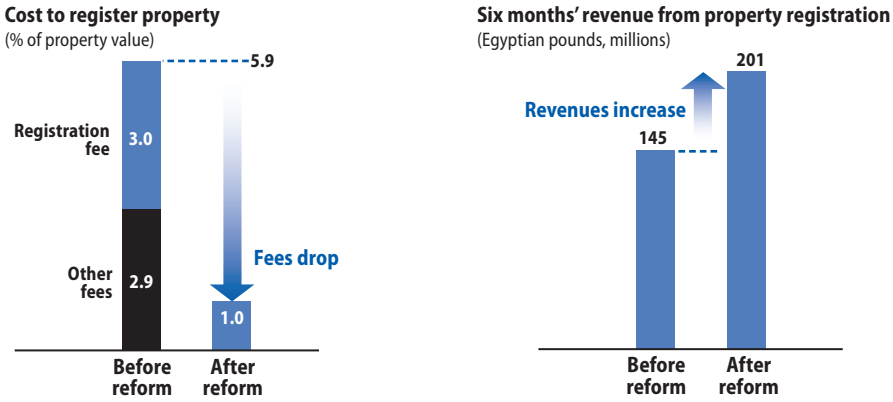
The Ministry of State for Administrative Development used a cost-benefit model to identify the real cost of registering property: EGP 23 for drafting a title, EGP 40 for surveying and measurements services, and EGP 37 for registration services—for a total of EGP 100.

Capping fees

In December 2005 the highest ministerial committee of the Council of Ministers approved the study. The council instructed Mamdouh Marei, minister of justice to make the necessary legislative adjustments. A draft law was prepared in January 2006, along with a study to measure the draft law's effects on other laws. The aim was to make property registration fees comparable to those in other emerging economies—less than 2% of property value in Georgia, Russia, and Chile. The new cost structure would lower or eliminate excessive fees for inspections and requesting registration.

The Shura Council approved the amendment of Law No. 70 of 1964 concerning notarization and registration fees and the land register system law in April 2006, only months after the Ministry of Justice formulated the new registration fees schedule in January. The Peoples' Assembly approved Law 83 in May 2006, and it was issued in June 2006 and enforced in August 2006. The premise was simple: the larger the area, the higher the fee, because people with more can afford higher fees.[2] Other key provisions:

FIGURE 2
Cutting fees increased revenue in Egypt



Source: Doing Business database, Egyptian Ministry of State for Administrative Development.

- The fees for document registration, initiatory pleadings, and related works are capped at EGP 2,000 ($350).
- The notarization and registration fees are capped at EGP 30 ($5.21).
- 14 other registration fees are now merely symbolic, each less than $6.
- Fees for inspections and requesting registration are now gone.

The total property registration fees decreased from 5.9% of property value to 1%. Revenues from title registrations rose 39% between the 6 months before the reform and the 6 months after.

Overcoming opposition with a shared vision

"The aim was not to reach consensus but to facilitate acceptance of the reform idea among relevant agencies. In addition to identifying the reform and its impact, we had to build a common understanding of the case across the relevant public and private agencies," says Hassan, director of National Database Program. The initial focus was on the ministers of investment, justice, and finance, then on key stakeholders in the economy as a whole. The Ministry of State for Administrative Development held specialized conferences and workshops tackling the housing industry, mortgage finance, and property registration, and the Lawyers' Syndicate, major taxpayers, and banking industry provided positive feedback.

The Egyptian opposition was initially skeptical about who would benefit from the reform. "If we reduce the cost of registering property, what would be the impact on the property capital and credit market? How would the poor benefit?"

asked an opposition parliamentarian. To address those challenges, Mahmoud Mohieldin, minister of investment, developed a shared vision. He ensured that the new cost structure would cut excessive fees and make the cost of registering property affordable without affecting government revenues. In a January 2006 speech at the Peoples' Assembly, he emphasized that the reform would benefit the most people possible.

India was his example. In July 2004 the state of Maharashtra cut stamp duties from 10% to 5%—and boosted total stamp duty revenues by 20%, about 80% of that from property transfers. Now more properties are registered, and the registry holds better information on property values and on who owns what. That supports the collection of capital gains and property taxes as well.

Ambitious goals

Introducing a higher flat fee for larger properties helped overcome the initial criticism that poor people would not benefit. The People's Assembly demanded a broad target group for the reform. The minister of Investment understood this and backed up the reform with the right legislation. Osamah Saleh, Chairman of Mortgage Finance Authority, says "We were aiming to reduce property registration fees so that every property holder will have the chance to receive a formal title. The poor especially would benefit because they would have the chance to use their properties as collateral, start *Doing Business*, and achieve their dreams."

As a reform leader, Professor Ahmad Mahmoud Othman Darwish, minister of state for administrative development, ensured that the work plan was robust, the milestones were achievable, and the appropriate resources were committed to do the work. He set clear expectations up front on the time individuals and teams would have to commit to the effort. He also determined how individual and team performance would become part of the regular appraisal process. Departments rewarded contributions to the success of the transformation formally (by public recognition) and professionally (by promotions).

The Egyptian property registration reform aims to formalize 1 million properties during 2007/08, 2 million during 2008/09, 4 million during 2009/10, and 6 million a year during 2010–10. Citizens and businesses in both rural and urban areas got encouragement to register their properties. Within a year of the law's passage, revenues from title deeds jumped from EGP 100,000 to EGP 2 million, and total registration revenues from EGP 6.3 million to EGP 41.5 million.

The message—a new era for property registration

The Ministry of Finance's successful media campaign about its tax reforms in January 2006 ushered in a new era for communicating legal reform to the public. The Ministry of Investment used the same approach to communicate the property registration reform, conveying news, key milestones, and the benefits to the public. It distributed the approved law to the private sector and nongovernmental organizations and held roundtables with the Lawyers' Syndicate, major taxpayers, and the banking industry. It also convinced banks to market new mortgage offerings to attract more property into the Egyptian formal economy.

Long time still a problem

A remaining challenge for Egypt is to reduce the time it takes to register property. Today, it still takes an entrepreneur more than 6 months to register a property transfer in Cairo.

Hani, who sells newspapers in the streets of Cairo, sums up the dilemma: "My house is mine and not mine. It is mine because I inherited it from my father. It is not mine because it is not registered in my name. I cannot spend 6 months without work in order to go through the property registration process. My mother works at home. I often worry that people will seize my house when I'm away."

Simplifying and combining procedures, keeping registry records updated, continuing to digitize records, and introducing fast-track procedures could be next steps to help Hani and others like him.

Notes

1. OPIC, Office of Economic Development, Issue Paper 1:2005, July 2005.
2. If the property area is less than or equal to 100 square meters, registration fees are EGP 500 (less than 100). If the property area is more than 100 but less than or equal to 200 square meters, registration fees are EGP 1000 (less than $200). If the property area is more than 200 but less than or equal to 300 square meters, registration fees are EGP 1500 (less than $300). If the property area is more than 300 square meters, registration fees are EGP 2000 (less than $400).

When enough is enough

Cemile Hacibeyoglu

Since independence the citizens of Ghana have dealt with a dysfunctional land administration system with 2 overlapping systems: the inefficient state land bureaucracy and customary tenure. Long and expensive procedures taking up to 5 years and involving 6 different agencies discouraged many from going through state institutions to register their land. Many preferred to avoid the headache, keeping their land issues within clans or tribes—unrecorded, but simpler, cheaper, and aligned with traditional practices. The government was aware of the problem but could do little about it. The turning point was the Lands, Forestry, and Mines Ministry's Land Administration Program, which cut the time to register property to 34 days.

Achieving this was not easy. The government struggled more than 5 decades to address its weak land administration system. The bumpy road involved interagency competition, deteriorating land tenure security, and many mistakes along the way—all within a complex environment where most people are used to abiding by customary law.

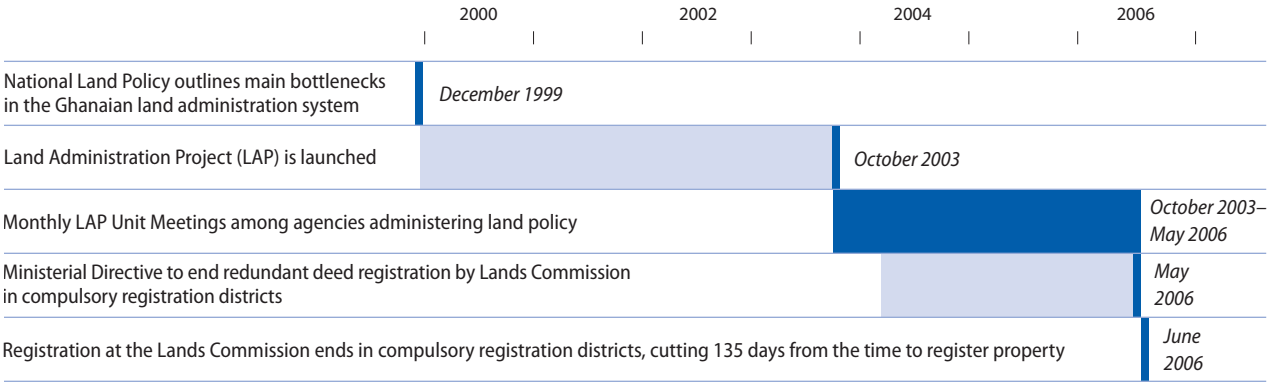
Tangled land administration

In Ghana land issues are administered in a plural environment, with customary laws and norms operating alongside state law. About 80% of land is held by the customary owners: tribes and their leaders, clans and families, and tendamba—the "owners" of the land and groves, typically the first settlers in communities. The remainder belongs to the state. During colonial times data on land ownership were not comprehensively recorded. According to custom, most transactions happened without documentation, and boundaries were not defined by surveyed maps but by such physical landmarks as hills, streams, and trees.[1] Because landmarks are not a reliable way of delimiting land, litigation over ownership and boundaries was a constant.

Shortly after independence the government introduced the 1962 Land Registry Act (Act 122), which disallowed the registration of the oral transactions and made it compulsory to register all instruments affecting land. This was to be administered through the deeds registration system which has been in practice in the country since the 19th century. The system based on documents proving a person or an entity's right to transfer the property. But while a deed was an evidence that an isolated transaction took place, it did not prove that the party registering the land actually owned it.

FIGURE 1
Timeline of reforming property registration in Ghana

Source: Doing Business database.



To complicate the situation, registrars did not have the power to investigate and reject documents of questionable validity. So, anyone with a deed could claim the land and sell it to someone else. Without a thorough search, there was no way to find the actual owner. To ensure that the seller had a legal right to sell the property, the buyer had to trace the deed back to a title. That search had to be repeated for each deal on the land. Time consuming and expensive, the process could not always turn up all the restrictions and obligations that may have been filed against a parcel of land or owner.[2]

The deeds registration system therefore failed to ensure title security. Its flaws: inaccurate maps, multiple sales of the same parcel, use of unapproved development schemes, haphazard developments, conflicting land uses, and time consuming land litigation, among others.[3] And then there was customary land tenure, under which tribe members transferred properties through oral transactions. Because these transactions were undocumented, the same piece of land was sometimes allocated to multiple owners. The result was that the public lacked confidence in the state's ability to secure tenures. Some citizens even had to hire illegal private security—"land guards."[4]

Early reform attempts—too little outreach

The weak land registration system finally prompted the government to replace the deeds system with something more secure and transparent. The government enacted the Land Title Registration Law (PNDC Law 152) in 1986, introducing title registration as the official system for recording property in 2 districts: greater Accra and the city of Kumasi. These were "compulsory registration districts" where deed registration was to cease. The purpose of the new system was to promote title security by registering the title rather than just the transaction.

Under title registration the registrar and the state guaranteed the title and its authenticity and there would no longer be any need to trace ownership back to the root title. The new law also promoted accurate parcel or cadastral maps to reduce fraud and multiple registrations of the same parcel.

The implementation of the law began in 1988 with the creation of the Land Title Registry, which replaced the Lands Commission in the compulsory registration districts. But implementation proved slow. By some accounts, less than 5% of land in these districts had been registered 15 years later.[5] And many Ghanaians complained that the procedures were slow and costly. A 1996 study reported an average turnaround time of 5 years to secure concurrence to a private land transaction.[6] According to that study, only 10% of land buyers in the north ever approached the Lands Commission for official, formal documentation proving their landholding.[7] Customary practices remained widespread, and most people continued to ignore the law.

The reasons for the failure were many. It takes trained and skilled administrators, lawyers, and supporting staff to address title uncertainty. And it takes equipment for accurate and fast surveying, production of maps and plans, and information storage. "Unfortunately," says Kasim Kassanga, former minister of lands, forestry, and mines, "the reform was inadequately funded and resourced and has suffered from personnel and logistical problems."[8]

According to Odame Larbi, head of the Land Administration Program at the Ministry of Lands, Forestry, and Mines, the problem was duplicated efforts and too little coordination among land administration agencies.[9] Without cooperating with the Title Registry, the Lands Commission continued accepting and processing documents on private and family lands before the documents went to the Title Registry. "The 1986 law clearly called family and individual owners in compulsory registration districts to apply to the Land Title Registry to register their land. In spite of these clear instructions, the deeds registration system continued operating in these areas," notes Larbi.

This duplication confused the public, leaving lengthy and redundant procedures. It also aggravated fundamental problems in Ghana's land administration system. Two different people, someone with a title from the Title Registry and someone else with a deed from the Lands Commission, could be allocated the same land. After more than 15 years, the law had failed to eliminate multiple sales, excessive litigation, and the use of land guards.[10]

"This confusion was partly the result of lack of public outreach," says Larbi. Many experts and authorities agree that the Land Title Registration Law was not publicized widely enough and that the public remained largely unaware of the change in legislation. Public education was conducted mainly through the distribution of flyers and brochures, and a few public lectures.[11] With only 60% of the population literate and an affluence of local languages, such efforts were inadequate.

"A more intensive and extensive public education program in major languages should have been applied in targeted districts," says Rebecca Sittie, the chief registrar of the Land Title Registry.[12] Applicants continued going to both agencies because they thought it was necessary to get approval from both. The Lands Commission, for its part, continued providing the service because demand meant revenue—and extra cash is hard to turn down.

The Land Administration Project

The confusion and duplication of efforts continued. The government began to realize that it was failing in its goal to secure land tenure in the country. Problems were particularly acute in the urban and peri-urban areas, where the growing population and rapid urbanization increased the social and economic demand for land. "Our chiefs are supposed to be the custodians of our land. But instead of safeguarding my land, my chief sold it to a commercial company," says Kofi, a farmer in peri-urban Kumasi, adding "I didn't have a proof that the land was mine, so it was taken from me. Now instead of making profit of rising land values, my family and I have to live with our relatives." Similar cases were common. The resulting homelessness, poverty, and violence showed that land tenure security was a problem not just of economic development but of basic rights.[13]

This was the backdrop to the introduction of the Ministry of Lands, Forestry, and Mines' National Land Policy. Published in June 1999, the policy was the country's first formal land policy—and the cornerstone of national development policy. The policy outlined the bottlenecks to efficient and effective land administration, stressing such problems as indeterminate boundaries, weak and fragmented land administration, and inadequate tenure security.[14] The new government implemented the policy with enthusiasm and designed the Land Administration Program as a tool to implement it. The program, supported by international donors, is to last 15–20 years and consists of 5-year phases. The first phase, known as the Land Administration Project, began in 2003.

The Land Administration Project lays the foundation for reforming land administration. "The goal," says Larbi, director of the project, "is to create a sustainable and well functioning land administration system that is fair, efficient, cost effective, decentralized, and good for land tenure security." The implementation of the project in 2003 created awareness of land management problems throughout the country. "Special emphasis went to education," says Abossey Allotey, deputy director at the Survey Department, adding that public outreach through media had been extensive. "I attended a television program where I talked about problems of the country's land management system and possible solutions. The interest was definitely there. That's something one wouldn't have imagined 5–10 years before." Public figures became involved, including the president. "Every single occasion was used to stress that it was in people's own interest to document their properties," adds Allotey.[15]

Saying enough is enough

That awareness prompted the Ministry of Lands, Forestry, and Mines to start looking at ways to resolve the disagreements and lack of coordination among the 6 agencies involved in land administration. "Before, there wasn't much cooperation among the agencies," says Sittie, "But since 2004 heads of departments of each agency would meet once a month to discuss their issues. These meetings, also known as "LAP Unit Meetings, were an excellent way for us to find common ground to solve our issues."

On 16 May 2006 Dominic Fobih, the minister of lands, forestry, and mines, issued a directive calling on the Lands Commission to stop registering deeds belonging to family and individual owners in the compulsory registration districts. "This procedure is not backed by any law, is duplication, causes delays, and confuses the public, who tend to believe that plotting is synonymous with registration," the directive warned.

The directive introduced little new. It just called on "all institutions involved in the implementation of the Land Administration Project to pursue the objectives of the project." But it voiced an important message: enough is enough. It was time for all relevant stakeholders to start abiding by the long-ignored law.

The results were impressive: the 135 unnecessary days it took the Lands Commission to plot a document suddenly disappeared from a landowner's to-do list. Queues at the Lands Commission disappeared, and within 34 days anyone could complete a property transaction in a compulsory district.

According to Larbi, interagency competition and lack of coordination were the main obstacles preventing the full implementation of the 1986 law. "Some of the agencies that have traditionally been a part of land management process in the country saw the law as a threat to take over their traditional role. They claimed they couldn't stop providing title registration services because they did not want to turn down the people who came to them." In fact, the staff were manipulating people's lack of knowledge of the law.

"Before the directive, everybody was doing what they wanted," agrees Sittie, "There was little cooperation between the agencies. There was even competition. Everybody was stepping on each other's foot." When the minister demanded that everyone abide by the law and address the problems, people finally realized that the game was up and there was no choice but to start abiding by the law.. Sittie believes that this move was long overdue.

The directive, which went into effect on 1 June 2006, dramatically increased the workload of the Land Title Registry. To keep up with the demand, the registry recruited new staff and is planning to computerize its databases in 2008. Information technology will help the agency deal with the heavy workload brought on by the change and further reduce the time required to search for a title. Ghanaian officials will then be able to keep accurate records of registered properties.

The Ministry of Lands, Forestry, and Mines is working to sustain its progress within the framework of Land Administration Program and plans to expand the registry's operations to the rest of the country which remains under the operations of Act 122 and the deeds registration system. The Ministry has already established 6 land registries under the Land Administration project, 1 in each regional capital in addition to the 2 already in Accra and Kumasi. Encouraged by LAP's initial success, the Ministry is determined to continue its quest to make land management in Ghana less cumbersome and more secure.

Lessons

First, the failure to widely publicize the 1986 law demonstrates the importance of well-designed public outreach. The government had to deal with confused applicants and cumbersome transactions for 2 decades before it could enforce a directive—this time, better publicized—compelling stakeholders to comply with its previous decisions. With only 60% of the population literate and many local languages, the government knew that it needed an extensive public outreach program in targeted areas, using mass media.

Second, identifying bottlenecks and conducting negotiations is important. But when this doesn't lead to results, the determination to say "enough is enough"

is a must. When the Ministry of Lands, Forestry, and Mines realized that duplicated efforts and lack of coordination among agencies created deadlock, it took action by issuing a directive compelling all the agencies to abide by the law.

Third, it is crucial to build the capacity to implement reforms. After publishing the directive in May 2006, the Ministry of Lands, Forestry, and Mines had to make sure that the Land Title Registry had the capacity to process all the applications formerly handled by Lands Commission. Recruiting new staff and computerizing databases helped the registry deal with the higher workload, smoothing the transition for Ghana's landowners.

Notes

1. Kotey Kasanga, "Current Land Policy Issues in Ghana," Land Reform, Land Settlement and Cooperatives, Food and Agriculture Organization of the United Nations, 2003.
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3. Andrew Adjei-Yeboah, Ghana's Deputy Minister responsible for forestry at the Ministry of Lands; a key note address at a training session on transparency in land administration organized by the Global Land Tool Network in Ghana on January 22-24 2008.
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5. Joseph Blocher, Building on Custom: Land Tenure Policy and Economic Development in Ghana.
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15. Interview with Mr. Abossey Allotey in April 2008.

Slashing the time to register property from 18 months to 15 days

Roger Coma-Cunill and Marie Delion

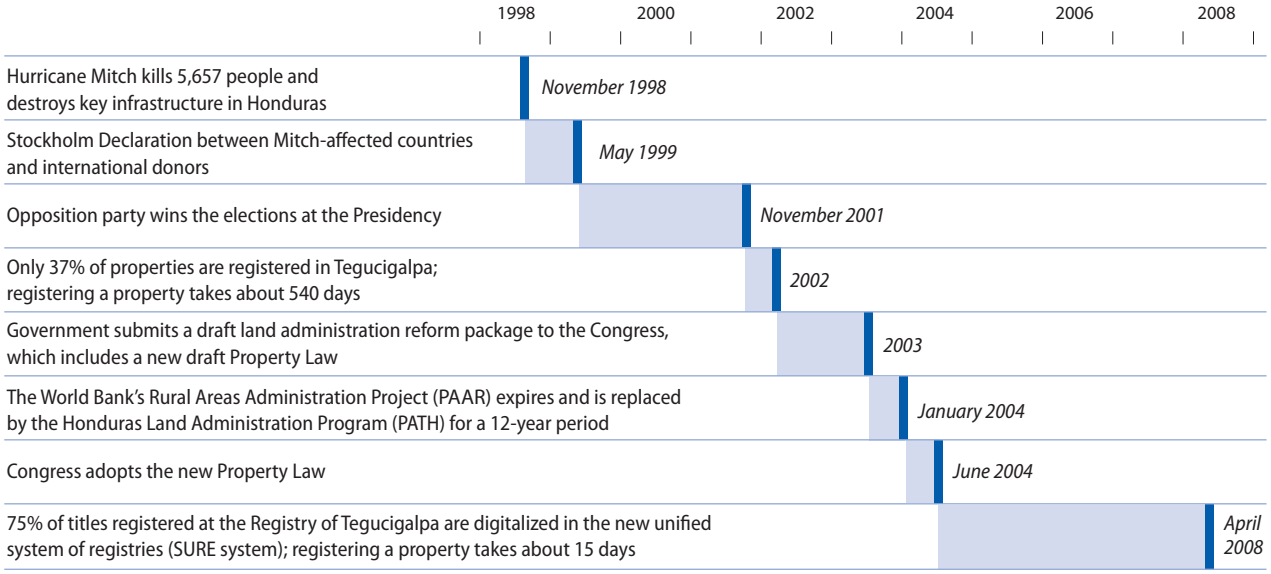
Honduras's property registry system was obsolete. Its 24 national registries were in dire need of staff and technology. Registration was done by hand in books. The "personal folio" system recorded the name of the owner and a brief description of the property but did not link the owner to the location. A citizen could know whether a neighbor sold his property 2 days before but could not be sure which of his 2 properties he sold. Was it the one next door or the one in back of the house?

This system created instability in the real estate market. The same property could be registered 2 or more times by different owners, leading to painful litigation. Citizens distrusted the registry because of its inefficiency—registering immovable property took 1–2 years. In 2002 only 37% of properties in the capital city, Tegucigalpa, were registered. The system was ripe for reform.

Today, land administration reform and, especially, a new property registration system have increased confidence, bringing higher standards for efficiency and security. The modernization slashed the time to register a property transfer from an average of 18 months to 15 days

FIGURE 1
Timeline of property reform in Honduras

Source: Doing Business database.



The reform team—rich in political experience

There was broad consensus about the need for reform. The question was how to do it.

On 30 November 2001 Ricardo Maduro became the 2nd president from the National Party to be elected since the reestablishment of democracy in 1982. Luis Cosenza was named as his vice-president, and Jorge Ramón Hernández Alcerro, as the minister of homeland security and justice. The government envisioned modernizing the real estate registry not as a standalone reform but as part of a larger initiative: the land administration reform.

Someone with a strong political background was needed to spearhead the reform. Henry Merriam, former mayor of Tegucigalpa (1976–80), had the experience to act with a lower profile and strike consensus across political parties to obtain Congress's support.

He was appointed to head a special unit inside the government that would implement the reform, the Project Coordination Unit. He would have direct access to the President and manage funds from international donors. Immediately after the appointment, Merriam staffed the Project Coordination Unit with a small team of lawyers and land specialists and started working on a new land administration reform law. That work was instrumental in drafting the new property law.

The most innovative property law in Latin America

In 2003 the government submitted to Congress a draft land administration reform package composed of 5 draft laws: Framework law of water and sanitation, Law of territorial planning, Property law, Forestry law, and the General Law on water.

The new property law had 2 interlinked objectives. One was to create the institutional and legal framework for a more efficient system of property rights that would reduce transaction costs and activate capital markets. Another was to regularize the situation of properties under dispute and help regularize the land claims of indigenous people. International experts considered it "the most innovative property law in Latin America"—for 2 reasons.

First, the draft law transferred responsibility for the property registry from the judiciary, where it traditionally resided in Latin America, to the executive. The law created a decentralized government agency, the Property Institute, to manage a new computerized system on property data, accessible to the public. It would also be responsible for the regular operations of the registries of immovable property.

Second, the law introduced a new registration system, the "real folio" technique, to make property registration easier, cheaper, and safer. The starting point of the reorganized system would be the location of the property and its cadastral record. The idea was to connect the registry records with geo-referenced cadastral information in a central electronic database. Parties involved in a sale and purchase would then be able to verify the ownership and encumbrances of the property online. That would make the registration process more convenient—and more secure.

The technical challenges ahead were significant. Tegucigalpa had a registry but not a cadastre, so all the maps and measurements from the properties had to be done from scratch. But in 2003 the most pressing challenges were political.

Opposition from notaries, lawyers, and civil society

In 2003 the government submitted the 5 draft laws to the Congress for debate. The first 2, on water and sanitation and territorial planning passed with widespread support. The private sector supported the land reform package, especially the chambers of commerce of the bankers and the real estate brokers. It was a golden opportunity to expand their business. But the property law stalled.

Notaries enjoyed their monopoly over the whole registration process. The old law required that notaries personally submit all the registration documents at the registry. The new law eliminated this requirement, restricting the role of notaries to certifying the identity of the parties in a transaction. Notaries feared that citizens would rather pay a lower fee to the registry by doing the paperwork themselves than pay a higher fee to the notary. That would cost them business. So, notaries organized an intense campaign against the new law, targeting members of Congress. And lawyers supported the notaries' claims because they feared that taking the system outside the judiciary would cost them career opportunities and political clout.

Various civil society organizations considered that some legal provisions of the draft law were against the interests of their communities. They argued that the law violated ILO convention no. 169 concerning indigenous and tribal peoples in independent countries. The organizations also felt that their communities had not been adequately consulted in the drafting of the property law. In August 2003, the government of Honduras supported, through a World Bank-financed project, a wide consultation process of the law.

In parallel to the opposition from the notaries and the Garífuna community, was a grassroots movement led by the charismatic priest, José Andrés Tamayo. This movement did not directly oppose the new property law, but opposed the draft

forestry law, the 4th of the 5 laws in the land reform package. Tamayo's claims placed ecological issues and land regularization at the center of the national debate. Since both laws addressed similar issues, the opposition to the forestry law could easily hinder the adoption of the property law.

Building consensus for reform

Henry Merriam focused his efforts to build consensus on 2 key stakeholders: congressmen and civil society leaders.

Merriam organized meetings for congressmen in Tegucigalpa. Senior congressmen from the 2 major political parties and other minority parties gathered in an informal group—"the good guys," as they called themselves. They spent several nights discussing the 5 draft laws, far from media attention and political pressures. They came to a general consensus on the draft property law, reconciling their positions on such controversial issues as transferring the registry from the judiciary to the executive.

Merriam worried that the popularity of Tamayo's movement would hinder the property draft law. So, he sponsored another grassroots movement to balance the messages from priest Tamayo. This movement used a family-oriented message to convey the benefits of the new property law for future generations. Influencing the public opinion proved effective, especially in Tegucigalpa. Thousands of citizens picked up the message, overcoming their initial skepticism about the new draft law. This paved the way for Congress to adopt the new property law on 29 June 2004.

While this approach proved effective to obtain Congress approval, several indigenous organizations continue to oppose the law, and further consensus is needed on several provisions. The implementing rules of the law have not yet been prepared, and many ambiguities created by the law need to be resolved.

Financing reform—with help from the World Bank

The reform got a financial boost from an ongoing project on land reform financed by the World Bank. The Honduras Land Administration Program was launched in early 2004, with the Project Coordination Unit managing the World Bank's funding at national level.

The Honduras Land Administration Program is a 3-phase, $139 million project divided into 4-year parts. The first phase, funded with $39 million and set to run through 2009 was restructured to support the goals of the 2004 property law. First, it establishes a national electronic property rights system—the National System

for Property Administration. Fully integrated and decentralized, this system will bring together geographic data from the cadastre and alphanumeric data from the registry under the real folio registration method. Second, it aims to incorporate into the system about a third of the country's real estate in 7 departments.

The reform after 4 years

The new property registration system has increased confidence, bringing higher standards for efficiency and security. Citizens are more willing to register their property. The registry in Tegucigalpa received 65% more registration applications between July and December 2007 than in the same period in 2006. And the modernization slashed the time to register a property transfer from an average of 18 months to 15 days

It is expected that the Property Institute will progressively take over the management of the unified registry system from the Honduras Land Administration Program. Until now, political factors and insufficient resources hindered the Property Institute's capacity. Even so, the accomplishments are impressive.

A new institutional framework for property registration Immovable, movable, and intellectual property registries are being modernized, with central coordination from the Property Institute.

A unified computerized system of registries Of the 24 registries throughout the country, 7 are interconnected through a central server in Tegucigalpa, managed by staff from the Honduras Land Administration Program, soon to be transferred to the Property Institute. The 7 registries—for Tegucigalpa, Comayagua, Siguatepeque, San Pedro Sula, Puerto Cortés, Roatán, and Trujillo—account for around 85% of real estate transactions. The unified electronic system of registries is 1 of the 4 subsystems of the National System for Property Administration.

Digitalized registry books The registries for Comayagua and Siguatepeque have their books fully digitalized. The registry in Tegucigalpa, however, is only 75% digitalized because of its many books to scan—around 10,000—and the limited resources available.

Integration of geographic and legal property information—the real folio system This integration is the most innovative and complex part of the reform. Digitalizing the registry books is a big step in the right direction, but the digitalized data are still not linked with the geographic data from the cadastre. This is the goal of phase 1 of the Honduras Land Administration Program. Comayagua, 80 kilometers northwest of Tegucigalpa, is the only city that has

achieved a completely digital real folio system. There were 3 reasons for the early success: Comayagua was part of a pilot project started 12 years ago, it is the only municipality among Honduras's 298 that had a complete digital cartographic database, and it had a visionary mayor who quickly realized the advantages of an integrated online system for property registration—for example, better tax collection.

Tegucigalpa, however, did not have a cadastre. Instead, teams from the Honduras Land Administration Program had to organize regular onsite visits, undertaking laborious property measurement and cross-checking with the existing registry information. The geographic data obtained from these field operations, known as tables of cadastral-registry validation, had to pass a strict quality controls before being introduced into the unified registry system together with the existing legal information. With staff and resources in short supply, only 1% of the properties in Tegucigalpa have yet been measured.

Lower transaction costs to register property The digitalized registry information in Tegucigalpa, though not a perfect real folio system, has cut the time and cost to register a property dramatically. The 15 days it takes to register property today is a long way from the 1–2 years under the old system. And the process is transparent, traceable online through the unified registry system.

The new procedure for buying and selling land is simple: the buyer presents the copy of the notarized title deed and other necessary documents at the Property Institute's office. The buyer receives a receipt. Experts from the Property Institute evaluate the documents. The buyer tracks the steps at home online—scanning, verification of title problems, and the like—until the final registration is granted. The buyer then goes to the Property Institute to pick up the documents, stamped to prove that they have been registered.

Lessons learned

Modernizing the property registry is a technical process—at least at first glance. But a related goal, the highly political titling process to regularize disputed properties, took over the political attention and funding for the whole reform. Honduras' institutions are highly sensitive to the political cycle every 4 years, paralyzing the reform during most of 2005 and 2006. Several years after the reform, 4 lessons are clear.

First, separate the technical from the political. The politicization of the property registry modernization could have derailed the reform. Political interference brought frequent changes in management at the Property Institute, affecting the daily work of its staff.

Second, create a modern career path for civil servants. Reforms cannot be sustained if staff, from the secretary to the manager, changes every time a new government comes to power. Honduras should consider establishing a modern career path for the public sector based on merit, so that qualified and well-paid personnel guarantee the stability needed for reforms to succeed. Staff from the Property Institute and the registries nationwide would benefit from this measure, which in turn would improve outcomes.

Third, grant financial autonomy to the registries. The Ministry of Finance currently collects registration fees ($5 million in 2007) and redistributes them across ministries through the national budget. Meanwhile, the 24 national registries are underfunded. They could become financially autonomous if they collected the registration fees directly, allowing them to buy more computers and hire more support personnel. This would eliminate some bottlenecks in the registration process and further reduce the transaction costs to register property.

Fourth communicate the benefits to citizens. The team squads of the Honduras Land Administration Program have had trouble measuring private properties in Tegucigalpa because citizens are reluctant to collaborate. Some fear, without basis, that the authorities are planning to raise taxes. The real folio system cannot be established without their participation, so the government must be sure to communicate the benefits.

Although citizens can already verify a property's ownership from their home computer, they cannot verify its location in the same digital document, except in Comayagua. The digitalized registry is certainly an improvement on the old system, but a complete digital real folio system in Tegucigalpa remains far away. Political and economic problems must still be overcome.

Bringing more credit to the private sector

Valerie Marechal and Rachel (Raha) Shahid-Saless

Most entrepreneurs wanting a loan go to the bank. But in countries with inadequate collateral laws banks are less willing to lend—as in Peru before the 2006 reform of its secured transactions law. In 2001 the minister of economy and finance acknowledged the problem: "Although Peruvian banks grant 90% of the financing for businesses, [the funds] that they input in the financial system represent only 26% of the GDP. This percentage is very low compared with the 70% in Chile or the 150% in the United States and Canada."

To address these inadequacies—and motivated by the Inter-American Development Bank's insistence on reform as part of a loan package—the government implemented a new law in June 2006. The new law was a positive step forward. Some inefficiencies remain, which if left unresolved, might hamper the new system's effectiveness.

20 types of security interests, 17 registries

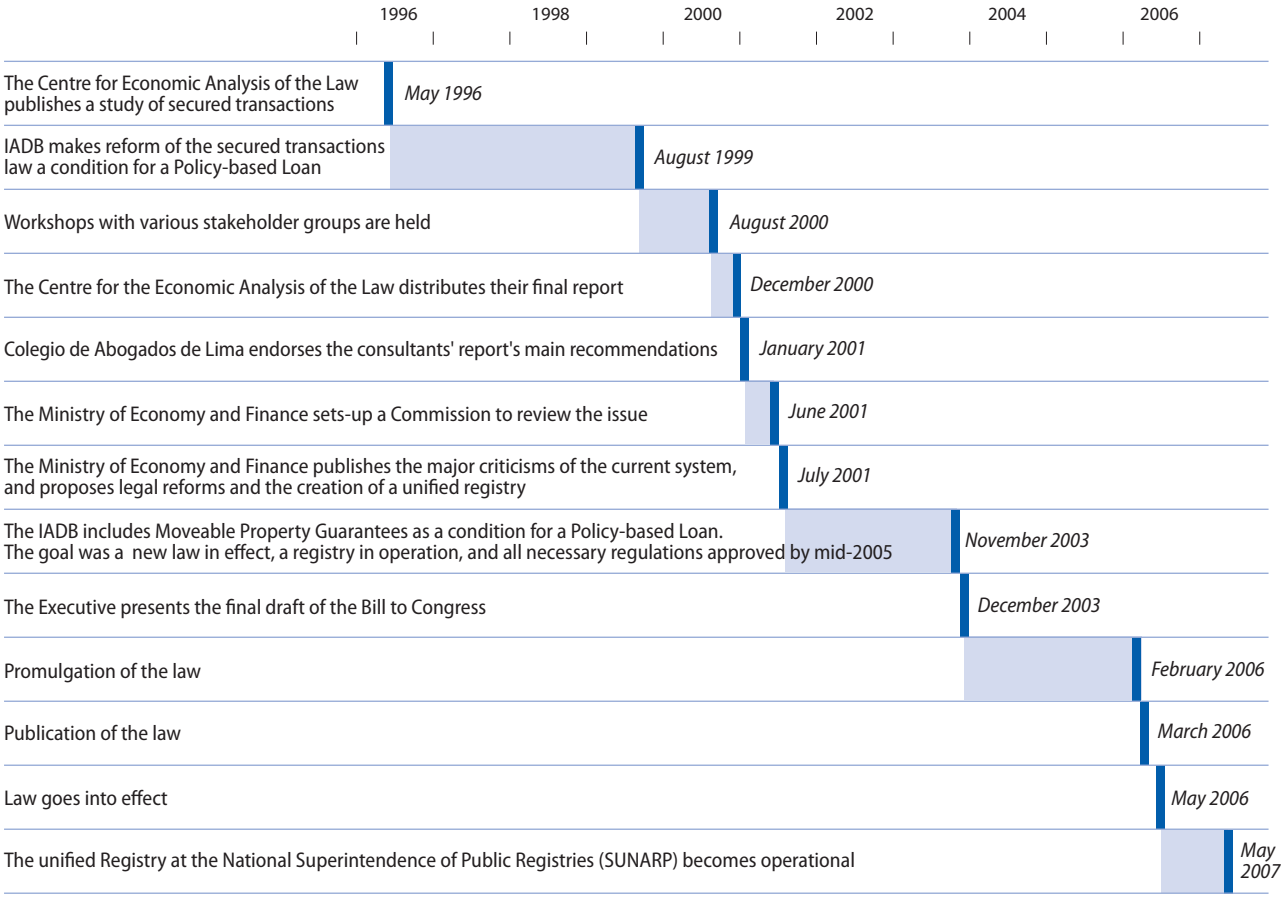
Before the reform it was difficult to create, register, and execute security interests in Peru. According to the Ministry of Finance and the Economy, moveable property accounted for about two-thirds of capital in manufacturing. But the law did not allow most types of moveable property to be used as collateral, including future assets and changing pools of assets. This left the lion's share of small and medium-size businesses' assets as "dead capital." Further muddying the situation were Peru's more than 20 types of security interests, varying from a commercial pledge to an agricultural or industrial pledge. According to a 2006 World Bank study: "Transaction costs rise when much time and effort must be devoted to determining whether the law permits taking a security interest in a particular item."[1]

Other inefficiencies also plagued the process. To start, parties had to describe with specificity the movable assets used as collateral—say, by providing the serial numbers. This requirement circumscribed the use as collateral of key classes of business assets—such as inventory or accounts receivable.

For recording security interests, Peru had 17 registries for different kinds of assets, each with its own regulations and requirements. This system was a recipe for confusion and uncertainty. "Should a pledge on a commercial fishing boat be registered in the boat registry, the company registry, or the registry of inventory? If multiple pledges were filed in more than 1 place, which would have priority?" asks the World Bank study.[2] Consulting separate registries also increased transaction costs for the banks.

FIGURE 1
Timeline of secured transactions reform in Peru

Source: Doing Business database.



When a debtor defaulted, the procedure for a creditor to seize and sell the collateral was slow and onerous. Professor Mario Castillo Freyre from the College of Notaries of Lima highlights: "often the execution of the security interest would take longer than the economic life of most moveable goods, so depreciation would reduce the value to nothing by the time the secured creditor could collect." According to the Ministry of Economics and Finance, the judicial execution of a security interest in Peru took between 18 and 24 months in 2001. By then, creditors lost a substantial portion of their investment. "If the creditor could recuperate the money within 3 months from the date of noncompliance, rather than 18 months, the applicable interest rate could come down up to 3 percentage points", highlights the Ministry of Economics and Finance.

5 years to reform

In a study published in 1996, the Center for the Economic Analysis of the Law showed how the shortcomings of the secured transactions laws limited access to credit in Peru. This motivated the Inter-American Development Bank (IADB) to link certain provisions of its loans to Peru's secured transactions reform. The main challenge, according to the IADB, was that the banking community and some in the Ministry of Economics and Finance were still not fully convinced of the need to have a reform.

The government held workshops in August 2000 on the draft report prepared by the consultants with the Center for the Economic Analysis of the Law. Business groups responded positively, identifying how moveable property guarantees could benefit them.

Following these workshops, the consultants from the Center for the Economic Analysis of the Law distributed their final report, which a local university published in December, 2001. A turning point came in January 2001, when the Lima Bar Association endorsed the main recommendations. The Ministry of Economics and Finance formed a commission to review the issue in June 2001, and the cabinet of advisors released a white paper in July. The white paper proposed changing the law and creating a unified collateral registry. The Ministry of Economics and Finance then set up a commission to draft the Bill on Guarantees Based on Moveable Property. External consultants and the National Forum on Competitiveness provided comments and modifications to the text, which the executive branch presented to Congress on 19 December 2003.

After more negotiations—including agreements with the notaries who wanted to maintain an active part in the new system, and with interest groups reluctant to subordinate wage claims to the claims of secured creditors—Congress approved the law on 10 February 2006. The President promulgated it 2 weeks later, and it was published on 1 March. The new law entered into force on 30 May 2006 after almost 5 years of discussion.

The reform included reorganizing the security registration system. Two options were on the table: to create an entirely new registry or to unify the multiplicity of registries electronically. According to projections, the first solution would cost $5 million, and the second $2.9 million. The reformers chose the second. The new unified database became operational on 30 May 2007, a year after the new law entered into force. The final cost of the reform is not yet known.

More flexible rules on collateral

The Bill on Guarantees Based on Moveable Property (Law 28677) redesigned Peru's rules on collateral. Almost any type of moveable asset, tangible or intangible, present or future, can now secure a loan. The more than 20 different pledges were aligned under a single system: guarantee based on moveable property. The new law abandoned the requirement to describe assets specifically. Pledges on movable property are now recorded in two registries: one for movable property that consolidates the 17 old registries and a new registry for contracts. Finally, the law allows parties to agree to sell the asset without court intervention if the debtor defaults.

Thanks to the changes, Peru's ranking in the *Doing Business* Legal Rights Index jumped from 164 to 93 of 178 economies. But the law did not remedy all the system's shortcomings.

Criticisms of the new system

Although the reform was a positive step forward, it suffered from weaknesses at the drafting stage. Some of these flaws were the result of political compromises being made. For example, recognizing the importance of notaries in Peru's legal system, the new law maintained their role. However, it took no steps to make their services more affordable and readily available across the country.

The Chamber of Commerce of Peru had been the new law's most vocal critic after its implementation, arguing that the law should have been suspended until the registry was fully operational. Its complaint: "the lack of technological interconnection at a national level between the various registries guarantees neither compliance with the law nor the judicial security of the transactions." Scholars and few members of Parliament have also asked whether allowing out-of-court enforcement and thus allowing debtors to renounce a trial is constitutional in a civil law system.

Other criticism came from experts who believed that the final text of the law did not include certain recommendations they considered essential for increasing the law's effectiveness. According to experts from the Center for the Economic Analysis of the Law, "the new law…will not permit the divisibility of the collateral to allow for the maximum possible use of capital for credit with more than 1 lender. It effectively raises the cost to the borrower of seeking other lenders. The new law does not void clauses that require payment of the entire loan if a second priority security interest is created, defeating most of the potential benefits of broadening access to credit."

In addition, the law remains unclear in some areas. For example, the law does not specify whether once a floating loan is paid back, the registration on that loan will terminate or not. This is critical as having to re-register a loan every time the loan is paid off will mean that the creditor may lose its priority in the re-registration process on the same collateral. Repeating the registration process on the same asset would add to transaction costs and be superfluous.

Finally, the law stated that, should the parties not agree on the terms of the contract, upon non-compliance, the creditor, through a notary, can send a notice of non-compliance to the debtor. If the debtor fails to perform, three days later, the creditor can proceed with an extra-judicial sale through a third-party. As many critics, including the Lima Chamber of Commerce have pointed out, the three day deadline for the payment is very short, creating the possibility for abuse.

The unified registry—implementation problems

The main problem with implementing the new law stems from the registration system. The law gave the National Superintendent of Public Registries 60 days to develop the regulatory, logistical, and technological infrastructure to merge all registries on movables and centralize them nationally. After 6 months, the necessary system was still not in place.

The unified registration system suffers from many of the former system's shortcomings. Security agreements cannot be registered directly and still require the involvement of notaries, whose fees are not competitive, nor are they readily available in all areas. In addition, much time can pass between when the security agreement is submitted to the registry and when it appears online. As a result, information about a collateral agreement does not immediately become available to the public. During that lag, a debtor could secure several loans from different creditors with the same asset.

Another issue is the higher registration costs of the new system. According to Professor Castillo Freyre, registering a leasing contract for 20 automobiles costs $6,000. Before the reform, it was not necessary to register this type of contract. High costs may handicap the new system's ability to increase the amount of private credit in Peru.

Insufficient training and knowledge

A major obstacle in implementing the law has been that the key actors—lenders, borrowers, and lawyers—lack knowledge and training regarding the new system.

Post-reform training for users was limited to only a few ad hoc seminars. Insufficient knowledge can have serious consequences, especially for less educated entrepreneurs and businesses in rural areas. Professor Ronald Cardenas Krenz, director of the Legal Department at the Universidad Femenina del Sagrado Corazon, notes that while out-of-court enforcement facilitates the execution of security interests and encourages lending, debtors may not fully understand that they are relinquishing the right to have a court adjudicate a dispute over default.

The law's impact

In the aftermath of enacting the law, there has been a steady growth in registering new collateral agreements on moveable property. In June, 2006, immediately after the law came in force, the rate of registrations was low, with only 103 registrations for the month of June. This was the result of uncertainties associated with the workability of new system. After June 2006, the rate of registration gradually and steadily increased. It reached the level of over 5,000 registrations in November, 2006 alone.

However, comparing the number of registrations on movable property prior to June, 2006 and post June 2006 does not tell the entire story. This is because prior to the reform in June 2006, the number of registrations on "movable property" was not counted as one category. Even post-reform, the number of registrations in this category is not routinely measured. Moreover, delays in implementing the new registry often held up the effective use of the system.

Nevertheless, lenders have demonstrated optimism. Representatives of commercial banks have repeatedly echoed that the possibility for lenders to use extrajudicial remedies should reduce the risk of not recovering loans. With faster and more reliable recovery instruments, lenders will no longer transfer the risk to debtors by charging a higher interest rate.

The lessons

Other countries can learn from the positive aspects of Peru's reform. Peru moved ambitiously to unify its registration system, simplify the enforcement of collateral agreements, and expand the pool of assets usable as collateral.

Based on Peru's experience, countries may want to consider 4 elements when reforming their secured transactions laws:

Recognize the importance of the support and involvement of local stakeholders (in this case, the Lima Bar Association) as an important and necessary impetus for a successful reform.

Synchronize the start of the new registry's activity with the law coming into force. This will guarantee that the technical and administrative regulations to implement the new system are in place.

Set registration costs at reasonable rates, because excessive costs discourage financing.

Develop, before implementing the law, a strategy for dissemination and training, aimed not only at the financial and legal industry but also at non-institutional users of the system—say, small businesses and borrowers in rural areas.

Notes

1. Heywood Fleisig, Mehnaz Safavian, Nuria de la Peña, Reforming Collateral Laws to Expand Access to Finance, The World Bank, Washington D.C., August 2006
2. Ibid

Protecting minority shareholders to boost investment

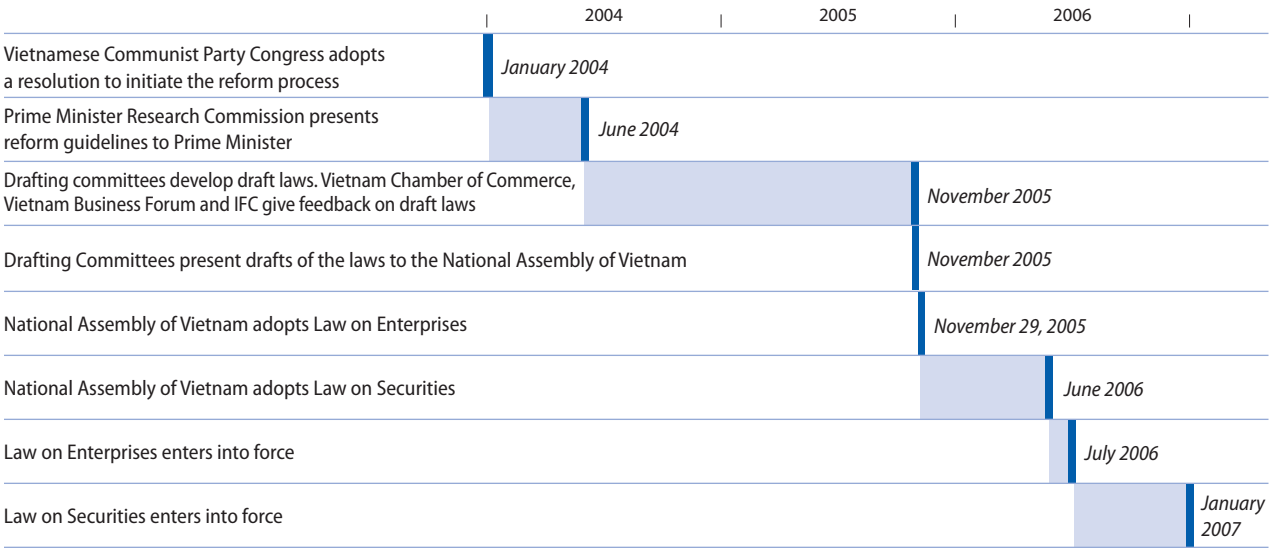
Jean Michel Lobet

Investors used to be afraid to put their money in Vietnam. Why? Fear that company management would misuse the funds for personal benefit. The previous laws lacked clear rules for transparency and directors' obligations. And the regulatory system governing companies was fragmented and opaque: there was a law for domestic companies (Law on Enterprises 2000), a law for state-owned enterprises (Law on State Owned Enterprises 2003), a law for foreign-owned companies (Law on Foreign Investment 2000), and a law for agricultural companies (Law on Cooperatives 2003).

Vietnam also lacked clear legislation regulating the securities market, with the result that the informal stock exchange was much bigger than the Ho Chi Min Stock Exchange. Several state-owned companies were partially privatized by issuing shares to employees, managers, and the public. They in turn sold them through the Internet and in private deals with family, friends, and acquaintances.[1] An estimated 60–100 trades with VND 15–25 million ($10,000–16,000) took place every day in the unregulated stock market in 2005. While legal, this gray stock market could not protect investors or ensure orderly, fair, and efficient market mechanisms.

FIGURE 1
Timeline of investors' protection reform in Vietnam

Source: Doing Business database.



These shortcomings spurred reform—a new law on securities and an updated law on enterprises. The reform improved Vietnam's *Doing Business* protecting investors indicator ranking from 170 to 165 and its overall ease of *Doing Business* ranking from 104 to 91. But implementation remains a challenge.

Building on earlier reforms

The first reform, the Law on Enterprises of 2000, was an important step in developing the country's private sector. Thanks to that reform, business registrations boomed, creating almost a million jobs.[2] But the law was weak in regulating such fundamental issues as protecting minority investors. The government knew that the first reform effort was not sufficient and that they needed to go farther in the reform process. "Vietnam needed to show to the world that it was ready to offer higher standards and protections for investors," says a government official.

Ambitious targets—a spur to reform

To meet the targeted 2006–2010 gross domestic product (GDP) growth rate of 7.5–8% a year, the government recognized that it had to integrate its economy internationally, making unfettered access to world markets a government priority.

Vietnam also needed to create jobs since half of its population was under 40. The government had to accommodate 1.5 million young people entering the work force annually.

Vietnam's application to join the World Trade Organization was another key driver for legal reform. The accession process required that Vietnam's laws and legal institutions be transparent, rule-based, and neutral in their application to domestic and foreign business. The gaps in investor protections were large.

Vietnam's domestic private sector has also repeatedly called for a transparent, predictable, stable business environment with clear laws that do not discriminate on the basis of size or status—domestic or foreign, state or private. A government official explains, "The goals were defined; now, the challenge was to start the reform process."

Everyone lends a hand

The reform process had to be quick—the deadlines to fulfill the World Trade Organization accession requirements were tight. In about 20 months Vietnam's policymakers developed 2 big pieces of legislation: the Law on Enterprises and the Law on Securities.

The process started in early 2004 after the Communist Party Congress approved a resolution about developing the private sector. To lead the reform process, the government set up the Prime Minister Research Commission—a think tank responsible for designing economic, social, and administrative reforms, the first in Vietnam's history.

The commission presented its first report in June 2004, outlining the reform project to the Prime Minister. Regulatory drafting committees were then established by the Ministry of Planning and Investment. The committees prepared more than 20 drafts before submitting them to the National Assembly.

Many groups—the Chamber of Commerce, international donors, and international law firms—participated in drafting the legislation. "We received high qualified technical support from the private and public sector," explains a member of the commission.

The Vietnam Chamber of Commerce and Industry was the primary facilitator for business-oriented reforms. Through its website, it invited private and foreign investors to provide feedback on the proposals discussed at the National Assembly, facilitating private sector involvement. During the drafting process the chamber ran conferences that attracted nearly a million participants from the private and public sectors.

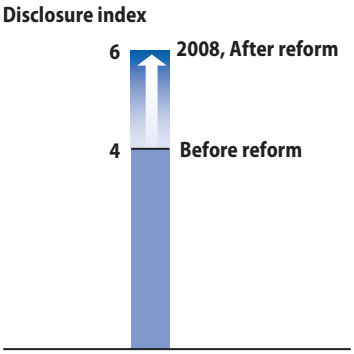
The Vietnam Business Forum—an association founded by international donors in conjunction with the Ministry of Planning and Investment—facilitated dialogue among donors, the private business community, and government leaders. The dialogues gave business representatives privileged, direct access to the Prime Minister and key policymakers before they presented the drafts to the Assembly. The Vietnam Business Forum also published position papers on drafts to commentary and debate.

Many international law firms also provided technical advice to the government. "Their input was fundamental," explains a reformer, "since they represented two different positions at the same time: first, as practitioners, and second, as representatives of the private sector."

The donor community, including the U.S. Agency for International Development, the World Bank and the International Finance Corporation, participated in the reform as well. Donors offered technical assistance and assigned several thousand dollars to the reform process—$100,000 from the International Finance Corporation alone.

On 29 November 2005 the National Assembly adopted the Law on Enterprises, which came into force on 1 July 2006. In June 2006 the National Assembly passed the Law on Securities, which came into force on 1 January 2007.

FIGURE 2
More disclosure after reform



Source: Doing Business database.

Unified and strong laws on corporate governance

The Law on Enterprises unifies the regulatory system for different corporate structures. A single law now regulates all companies regardless of ownership or corporate form. To protect minority investors against directors' misuse of corporate assets, the law mandates special approval processes and transparency requirements for transactions between interested parties.

The law also increases shareholders' participation in approving important company decisions. Shareholders must approve transactions exceeding 35% of the assets of the company. And directors are required to manage companies more transparently, making publicly available relevant information about important transactions.

For the first time the law introduces director duties—rights and obligations that directors must fulfill during their appointment. But no mechanism for enforcing these duties has yet been adopted. And there is no way to sue directors if they do not fulfill their duties because commercial tribunals lack jurisdiction over these cases.

Shareholders or groups of shareholders holding 10% of the total shares now have the right to review corporate records and financial reports, to request that the board of directors examine management and operational problems, and to convene shareholder meetings if management violates shareholder rights or directors' duties, or makes decisions beyond its power.

When additional ordinary shares are issued, the law also provides pre-emptive rights to ordinary shareholders—the right to maintain their fractional ownership by buying a proportional number of shares of the future issue.

The new Law on Securities promotes transparency in day-to-day management, detailing reporting and disclosure obligations for public companies, listed institutions, securities firms, fund management companies, the Securities Trading Center, and the Securities Exchange. Companies must inform the shareholders and stakeholders of fundamental decisions through mass media, institutional and corporate publications, the State Securities Commission, the Securities Exchange, and the Securities Trading Center.

Finally, the law establishes the Securities Exchange and the Securities Trading Center as the 2 main trading venues. The Securities Exchange is a central securities trading market, and the Securities Trading Center is an over-the-counter market (to counter the gray market) for companies that do not meet Securities Exchange listing requirements.

Overcoming internal opposition

Among provincial governments, big opposition grew to the one-stop process for incorporating a company. The new law radically reduced provincial authorities' involvement—and thus their control.

The reform law also created apprehension in the management of state-owned companies. A key goal was to unify the legislation regulating domestic companies, state-owned companies, and foreign-owned companies. Managers of state-owned companies feared losing their privileged status. And directors of state-owned companies and private companies were reluctant about disclosure, transparency, and liability for mismanagement.

How were these difficulties overcome? First, "Vietnam did not have much of a choice," says a government official. The reforms were among the several requirements for gaining access to the World Trade Organization and a bilateral trade agreement with the United States. Second, reformers showed that the 2000 reform of the enterprise law prompted a boom in business. In just a few years about 60,000 new businesses had been registered, creating about a million jobs. The government explained that by improving securities regulations and attracting domestic and foreign investment, reform "will help industry create $10–15 billion by 2010 and turn the securities sector into an important channel for mobilizing capital."[3]

More attractive capital markets for investors

The initial impact of the reform is greater confidence, evident in market indicators. Vietnam's stock market in 2005 consisted of only 41 listed firms, with a market capitalization of less than $1 billion, or 1.2 percent of GDP. Today, 107 firms are listed on the Ho Chi Min Stock Exchange. And Vietnam's primary index (VNINDEX) has trended steadily up.

Foreign direct investment is also up from $6.2 billion in 2005 to $10.2 billion in 2006. In the first quarter of 2007 foreign direct investment commitments were 55% above the same period in 2006. And private investment funds increased radically during 2006–07. Finally, today three of the largest investment funds in Vietnam are managing almost 4 billion USD.

The World Trade Organization accession in January 2007, new legislation on foreign investment, and the boom in the real estate market make it difficult to attribute these movements directly to the new enterprise and securities regulations. But it is clear that Vietnam has become more attractive to investors. Vietnam's accession to the World Trade Organization has created a better environment for investment, building confidence that the government will adhere to regulations that respect international standards.

Implementation—delicate

Implementation is the most delicate point of the reform. Private sector representatives believe that the implementing decrees and circulars for some sectors deviate from the law, even though a main objective of the new legislation was to unify the previously fragmented system. Despite the stronger corporate governance and investor protections, implementation and compliance are likely to take time.

The Enterprises Law does not contain sufficient enforcement mechanisms. Commercial tribunals do not have jurisdiction over corporate governance matters. Only a few judges specialize in commercial law; fewer still, in corporate governance. Judges may be influenced by the stronger party. And there is a significant case backlog, as many as 80,000 in Hanoi alone. So, enforcement is time consuming and expensive—and the outcome is uncertain.[4] Most disputes are still solved informally with negotiation. If minority shareholders cannot negotiate a satisfactory outcome, they are more likely to sell the shares and terminate the relationship than to seek relief in court.

Infrastructure limitations are also a problem: although the Securities Law has significant disclosure and reporting requirements, the systems to store and monitor the information electronically do not yet exist.

Exploiting momentum for change

Vietnam, in a short time, has reformed the 2 pillars of its legal framework regulating the life of companies—and thus the destiny of private sector. The government built on the success of previous business law reforms to promote future reforms—as a reformer explains, "reform success breeds reform success." Increased legal certainty because of the new securities and enterprises laws will draw more investors and capital to Vietnam.

Notes

1. http://www.time.com/time/magazine/article/0,9171,1592579,00.html?iid=chix-sphere
2. UNDP, http://content.undp.org/go/newsroom/choices-one-million-jobs-created-by-new-enterprise-law-in-viet-nam2003-06.en?categoryID=349425&lang=en
3. Securities Law: Turning Securities Market into Important Capital Mobilization Channel (http://www.cpv.org.vn/details_e.asp?topic=58&subtopic=156&id=BT2650661466)
4. Clifford Chance VILAF-Hong Duc, Vietnam Investment and Legal Guide (2006)

Giving a facelift to the Turkish tax system

Caroline Otonglo and Tea Trumbic

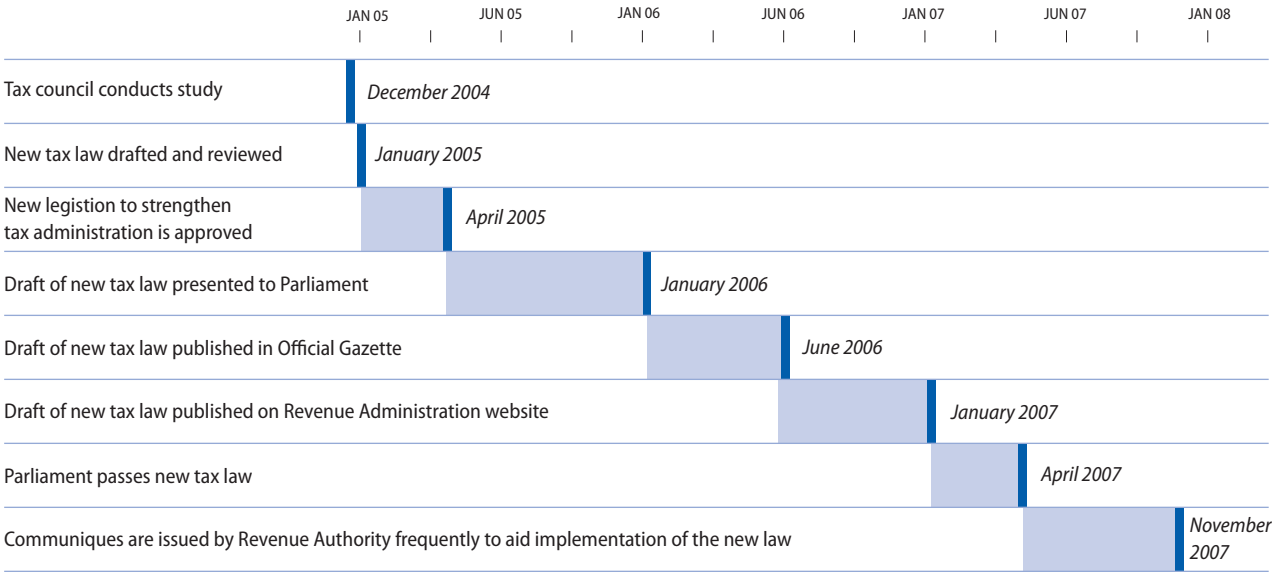
Almost all tax reforms aim at a single goal: to increase revenue. But Turkey's 2007 reform was different—simplifying and modernizing the tax system were the key goals. Ali Babacan, Turkey's State Minister for the Economy, emphasized in October 2005 that "What is important for us is that the system is modernized and aligned with world standards." Income tax was the big problem, both personal and corporate.

Corporate Income Tax Law 5422 was antiquated and uncoordinated, lacking provisions for such modern tax concepts as transfer pricing, thin capitalization, and foreign participation. It was a barrier to pragmatic business planning. The law also contained scores of temporary provisions, almost equal in number to its permanent ones. And some of the temporary provisions overruled the permanent provisions, leading to uncertainty and inefficiency. Add the law's numerous exemptions, clothed as investment incentives, and the result was a clumsy maze for potential investors. "In short," a Revenue Administration Official remarks, "the old corporate tax law was not satisfying the need of foreign investors."

The government was concerned that the corporate tax law was hindering foreign direct investment. Over 2 years foreign investment had jumped from $3 million

FIGURE 1
Timeline of tax reform in Turkey

Source: Doing Business database.



to $20 million, despite the problems with the law. What could be achieved if the problems were solved?

The government thus decided to reform. While it remains too soon to see the effects, the first signs are promising

Weeding out corporate tax bottlenecks

The Tax Council—composed of tax consulting firms, the Revenue Administration, academics from local universities, members of the Association of Turkish Manufacturers and Businessmen (TUSAID), the Chamber of Commerce, and nongovernmental organizations—was fundamental to the reform. The Council conducted a study on the corporate tax law and system. In late 2004 it began drafting a new law, which took about 9 months.

The International Monetary Fund was also involved, mainly by providing technical support to the Turkish government under a 3-year stand-by arrangement. The International Monetary Fund focused on budgetary prospects and policies, tax reforms, measures to strengthen tax administration, plans for implementing the newly approved reforms, and progress in further strengthening and reforming bank supervision.

Once the first draft was complete, it underwent a high-level review under the guidance of the Finance Minister. After that, the draft law was published on the Internet for public comments. The Tax Council then undertook a further review of the draft law, followed by a Revenue Administration appraisal, before its presentation to Parliament for debate in early 2006. The draft was published in the Official Gazette on 21 June 2006 and on the website of the Revenue Administration for public comments on 12 January 2007. It passed into law on 3 April 2007 as the Corporate Income Tax Law 5520. Most of its provisions took effect retroactively, as of 1 January 2006.

Introducing novel concepts for corporate taxation

The reform introduced new corporate taxation concepts and dealt more clearly with areas hardly regulated in the country before. The most novel changes were in transfer pricing, thin capitalization, anti-avoidance measures, foreign participation exemptions, and provisions specific to controlled foreign companies.

The new transfer pricing provisions got the attention of multinationals based in Turkey. Turkey's law now formally adopted the arm's length principle established by the Organisation for Economic Co-operation and Development regime under its Transfer Pricing Guidelines for Multinational Enterprises and Tax Adminis-

trations. Applicable to all transactions between related parties, the provisions introduced new documentation requirements for multinationals operating in the country—in keeping with worldwide trends.

Also remarkable is that for the first time, anti-abuse legislation became part of Turkey's tax law. The goal was to enhance the efficiency of the tax collection system and to seal loopholes, particularly for remittances to tax havens. But to ensure flexibility, the law exempted payments to specific financial institutions from the rigorous demands of the anti-abuse provisions. The Council of Ministers also retained powers to adjust tax rates for certain foreign payments where there was potential for revenue diversion.

The Act widened the income subject to tax for controlled foreign corporations. Under some circumstances the profits of controlled foreign corporations are now taxed as part of the income of its locally resident controlling entity. At the same time the tax paid on the offshore income of the controlled foreign corporation is eligible for a tax credit.

Local holding companies benefited from the new foreign participation exemption. Under certain conditions, dividends and capital gains from offshore subsidiaries are now exempt from income tax in Turkey.

Educating the public—but not soon enough

Once the new law came into effect a key challenge to implementation came from eliminating tax exemptions and allowances, particularly for investment. It was no surprise that eliminating exemptions faced stiff opposition—especially from those who had previously benefited.

Eliminating these exemptions was meant to simplify the tax code by doing away with special treatment. But opponents argued that the elimination removed necessary tax incentives for corporations.

To arrive at a win-win solution, the government offered affected taxpayers a choice. A revenue official explains, "We introduced a 3-year 'grandfathering' system, under which a taxpayer could opt either for a higher tax rate and use investment allowances or for a lower rate without investment allowances."

The new tax concepts also raised challenges. The government official notes, "Despite our intention to modernize our law by introducing modern ideas, there were problems in the practical application of some new concepts, particularly transfer pricing and thin capitalization." Why? There were no clear guidelines on the exact compliance procedures.

The Ministry of Finance attempted to solve the problem with communiqués that further explained and clarified. But the communiqués were late in coming. "We began using the communiqués extensively in late 2007, but we should have started earlier," says a government official.

The delayed communiqués created tax compliance problems because the law was vague on some of the new concepts. Even so, the communiqués, now available to the public through the Internet, have helped. But they can be bulky—some as long as 360 pages.

Effects on revenue—not yet clear

One of the most visible changes introduced by the new law was a 10% reduction in corporate tax rates, from 30% to 20%. On the other hand, the withholding tax rate on profit distribution increased from 10% to 15%.

The new law had an initial negative impact on revenue collection. "Generally," comments an official, "the Revenue Administration reported a reduction in the amount of revenue collected in 2007, given the lowered tax rates." The tax revenue from declared corporate income decreased by YTL 211,401,000 (approximately USD 168,196,393).

FIGURE 2
Turkey's post reform corporate tax rate compared to selected countries, 2006

Source: Doing Business database.

More positively, the amount of declared taxable income increased even as the number of taxpayers remained constant. The reason was that lower tax rates applied: fewer taxpayers understated taxable income, because they expected to pay less tax on the whole.

As a baseline, an expected long-term outcome of tax reform is to increase revenue by broadening the tax base, improving compliance fundamentals and sealing gaps for revenue leakage. A lesson to be learnt from this case study is that while tax rate reductions may generate increased revenues in the medium term, tax revenues do not always increase in the short term since it takes time for revenue base to increase. Turkey expects to collect higher tax returns in the medium term, particularly if the higher gross domestic product growth of 5.3% for 2007 persists. Tax reform has been cited as a driver of the impressive macroeconomic performance.

A public-private partnership brings order to Aqaba's port

Doina Cebotari and Allen Dennis

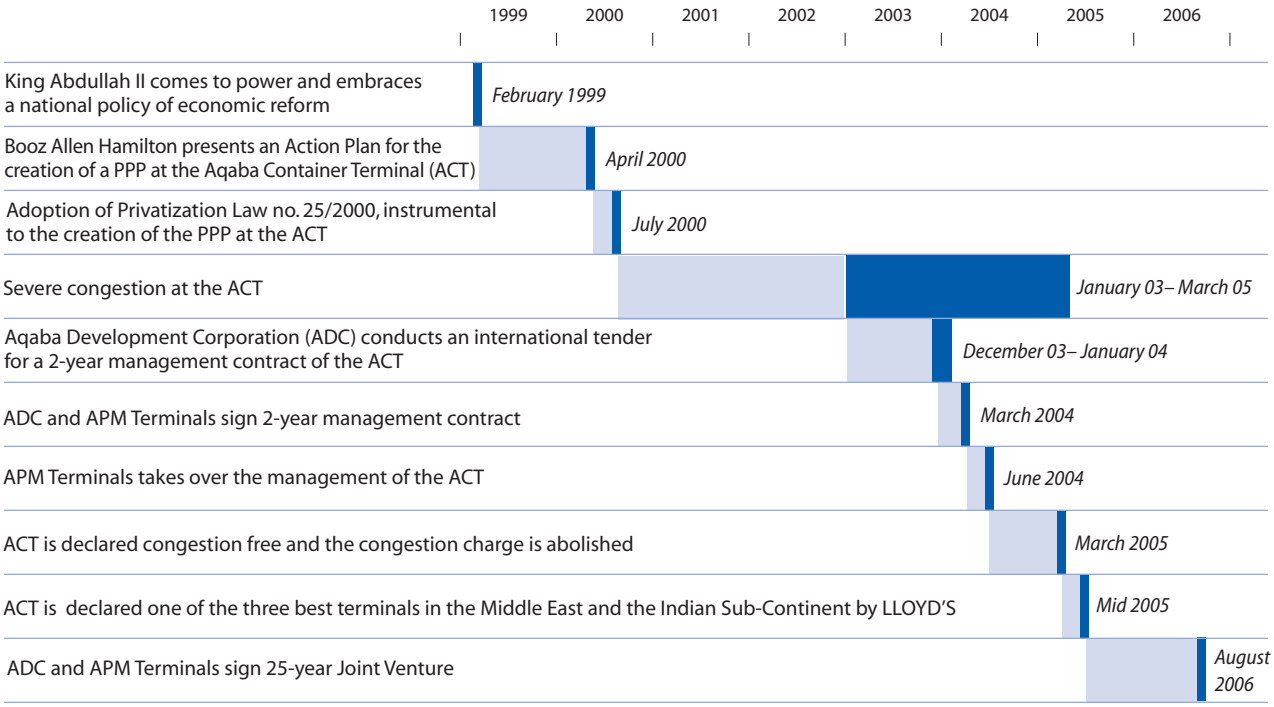
The port of Aqaba, Jordan's only sea port, was the country's biggest hindrance to trade in mid-2003. Waiting times for ships at berth were long, and congestion at the container terminal severe. Major international shipping lines suspended their dealings with the Aqaba Container Terminal. But by the end of 2005 the congestion had disappeared, and the congestion charge was gone—thanks to reforms. Lloyds—the world's leading maritime and transport news and analysis portal—chose the terminal as among the 3 best terminals in the Middle East and the Indian subcontinent.

Long waits to traders at Aqaba

Aqaba is in the northern Red Sea, at the junction of trading routes between 3 continents (Europe, Asia, and Africa) and 4 countries (Iraq, Israel, Saudi Arabia, and Syria,). Because of its multi-modal transport system, it emerged in the 1980s as the third-largest Red Sea port after Suez in Egypt and Jeddah in Saudi Arabia. By the late 1990s the port's importance in the Levant had drastically fallen in the face of stiff competition from Latakia, Beirut, and Dubai. Its low use masked the terminal's poor management and underinvestment in soft and hard infrastruc-

FIGURE 1
Timeline of trade reform at the Port of Aqaba, Jordan

Source: Doing Business database.



ture. It took a crisis to bring about the recognition that the terminal needed a serious change.

In mid-2003 the terminal came to a standstill, experiencing the worst congestion in its history. Vessels docking at the port often faced anchorage waiting times of 150 hours.[1] To compensate for the delays, shipping lines imposed surcharges of $500 per 20-feet container load. Traders also had to bear higher demurrage charges because of the longer storage periods at the port—48 days at their peak.

The congestion compelled some local traders and shipping lines serving Iraq to use ports in more distant Lebanon and Syria. The cost to the Jordanian economy from such congestion was an estimated $120 million a year. But the crisis proved to be a catalyst for a dedicated team of reformers to push ahead with the painful but necessary changes at the port.

Faces of reform—3 champions

The commitment, hard work, and determination of Imad Fakhoury, Nader al-Dahabi, and Ali Abu Al-Ragheb drove reforms through tough opposition.

Fakhoury—chairman of the Aqaba Development Corporation, the central development arm of the Aqaba Special Economic Zone Authority, charged with implementing the 2001–20 master plan for Aqaba region—was key in turning around the terminal. A Harvard alumnus, Fakhoury wrote his thesis on transforming Aqaba into a freeport area. During the mid-2003 crisis he pushed for a public-private partnership to run the port, arguing that this would be "strategically very important to Jordan, its economy, and its in-transit trade."[2] Nader al-Dahabi, chief commissioner of the Aqaba Special Economic Zone Authority during 2004–07, supported him. They worked together to raise awareness and support for the public-private partnership at the terminal.

Abu Al-Ragheb, twice minister of trade and industry (1991–93 and 1995) and prime minister of Jordan (2000-2003), was a prominent architect of economic legislation in Jordan. He oversaw a series of reform laws, among them the Privatization Law 25/2000, which allowed port ownership to be transferred to a neutral party (the Aqaba Development Corporation) that could move ahead rapidly with reforms.

Ultimately, the personal involvement of King Abdullah II himself pushed the project forward in the face of fierce opposition. The king's support was rooted in his commitment to developing Aqaba to drive the growth of Jordan. When in July 2000 the Aqaba Special Economic Zone faced stiff opposition in Parliament,

the king defended the project himself.[3] In 2002 the king paid 2 surprise visits in less than a week to the Customs Department in Aqaba to check on measures to facilitate customs procedures.[4] In mid-2003, when the port of Aqaba was in crisis, the king demanded that a plan be implemented within 3 months to solve the container port problem. Recognizing the key role of Aqaba's port in the success of the Aqaba Special Economic Zone, the king again lent his strong commitment to reforms.

Bringing in the private sector

The investment required to modernize the terminal and make it internationally successful was estimated at $500 million over 2003–28. But Jordan's dire economic situation, the legacy of the financial and currency crises of the early 1990s, meant that such a financial commitment would burden the state budget. Fakhoury was a staunch advocate of getting the private sector involved in the running of the port while maintaining state ownership.

A $1.2 million World Bank feasibility study in 1998 recommended a public-private partnership. Consultants from Booz Allen Hamilton then drafted an action plan based on the recommendations as part of a $15 million, 3-year technical assistance program under the U.S. Agency for International Development.

Creating an ownership structure to drive reforms

The public-private partnership would have been impossible without a transfer in the ownership and control of the port from the Ministry of Transport to the Aqaba Development Corporation in late 2003. The ministry, though not against the reform at the Port of Aqaba, would have been hobbled by the opposing views of its various stakeholders that it would have tried to appease. Unlike the Ministry of Transport, the Aqaba Development Corporation, being a new body, was not entangled in the numerous demands of the stakeholders. In this way it was able to overcome the policy paralysis that doomed earlier restructuring attempts by the ministry. Even so, other battles still had to be fought and won before the reforms could go ahead.

Engaging the opposition and winning public support

The government tried to understand and address the concerns of people opposing the reform. It made every effort to gain public support—through radio shows, publicity campaigns, and press conferences. Some of the toughest and most vocal opposition came from Parliament. The major worry was that the public-private partnership might undermine national security. Mahmoud Kharabsheh, a member of the powerful Legal Affairs, Economic, and Finance com-

mittees, charged that the project would "jeopardize the safety of the country," arguing that a strategic national asset should not fall into the hands of foreigners. To assuage these concerns, the Aqaba Development Corporation, under Fakhoury's guidance, noted that under the model of a public-private partnership, the port would always be government owned. The private agent would be responsible only for providing services.

Rather than immediately enter a long-term public-private partnership, the government decided to start with a management contract lasting 2 years. Under the management contract, the private sector would only be responsible for providing management services and not any port infrastructure. This 2-year period would give Jordanians the possibility of evaluating the performance of the private partners. So, if the concerns were justified, the option would be to not to continue in this policy direction. The 2 years could be seen as a test of the potential viability of a public-private partnership at the container terminal. If the container terminal operator were to prove effective and the public were to be satisfied with its results, a 25-year joint venture would be entered.

The Jordanian Ports and Clearance Workers' Association voiced another major concern: private involvement could bring layoffs. The port was the largest employer in the region, with 5,000 workers on its payroll, so this was a legitimate concern. Fakhoury and al-Dahabi, in more than 20 meetings with the press and the association, emphasized that there would be no involuntary dismissal of port employees. It was a compromise.

The Jordan Shipping Agents Association was initially opposed as well. It claimed that local companies were capable of managing the terminal just as well, provided that they got the necessary equipment. But the reformers countered that no Jordanian company could compare to a global container terminal operator with know-how, cost, and time advantages. A global operator would also benefit from economies of scale in sourcing and knowledge. To assure critics that only the best foreign terminal operator would be chosen, Fakhoury promised a transparent public tender for the management contract.

Hiring the best candidate—transparently

In early 2004 Fakhoury hired consultants from Booz Allen Hamilton to draft 2 terms of reference for the international tender, in line with the best practices in the World Bank Port Toolkit. The first was for the 2-year management contract, and the second for the 25-year joint venture with the Aqaba Development Corporation. Of the 11 leading international container terminal operators invited to participate in the public tender, 8 placed bids.

Hutchinson Ports Holding, P&O Ports, and APM Terminals placed the 3 most attractive offers. APM Terminals—a division of A.P. Moller-Maersk group, with extensive global experience running container terminals in more than 40 countries—offered the highest royalty, the highest equity stake in the 25-year joint venture, and the most attractive expansion plans. On 8 March 2004 APM Terminals signed a 2-year management contract with the Aqaba Development Corporation.

To evaluate APM Terminals' work in the 2-year trial, the Aqaba Development Corporation created performance indicators to measure progress at the container terminal. Meanwhile, the Aqaba Development Corporation lent political support to APM Terminals. Fakhoury and al-Dahabi took the heat from the media, labor unions, clearing agents, and shipping associations for the 18 months before the results became apparent to the public.

Business not as usual

APM Terminals brought considerable expertise to managing the Aqaba Container Port. A first signal of change was visual—cleaning the port to create a new work environment. Patricio Junior, chief executive of APM Terminals Jordan, and his team emphasized human resources, introducing an approach based on hard work, discipline, and merit rather than on tribal affiliation. So, recruitment was transparent and objective, with no tribal favors. Now workers get onsite and overseas training, as well as a better compensation package. Schemes were also put in place to reward workers for their achievements. APM Terminals built an onsite clinic and offered all their employees health insurance, meals, and compensation for transportation. But workers were also not allowed to "moonlight," and insubordinate workers were fired.

The motivated workforce's raised productivity and performance, was aided by the new regime's $30 million investment in soft and hard infrastructure. Gantry cranes, rubber tire cranes, straddle carriers, bomb carts tractors, and other vehicles were purchased and installed soon after the management takeover on 1 June 2004. By June 2005 the container terminal was 100% computerized, with state of the art software.

Flexibility to accommodate local needs

The reforms recognized local norms and cultures, with workers and the new management both willing to adjust. Before the reforms, it was common for port workers to take several breaks, with port operations often coming to a halt because key workers were missing during prayer. Of the 20 hours the port operated, about 2 hours were lost to such breaks. In response, the new managers de-

vised a shift system to accommodate daily prayers among port workers, allowing port operations to continue uninterrupted 24 hours a day.

Easier trade at Aqaba

Reforms at Aqaba started yielding results soon after the management takeover in summer 2004. By February 2005 the anchorage waiting time—129 hours in 2003—was completely gone. And average port stays dropped from 8 days to a few hours, with all congestion surcharges cancelled by 1 March 2005. New shipping companies started using Aqaba's port, including the China Navigation Company. By the end of 2005 the port was dealing with 21 shipping lines and was chosen by Lloyds as among the 3 best terminals in the Middle East and the Indian Subcontinent.

Efficiency improvements are ongoing—but obvious for all to see. By 2007 container dwelling times were down to 16 days, and port productivity had more than tripled, from 9 moves an hour to 28. There was a 14% increase in the number of vessels calling at Aqaba and a 40% increase in the average cargo size per vessel. Most important, all these productivity gains came without any layoffs. The king was so satisfied that he offered Jordanian citizenship to Patricio Junior.

Trade logistics in Jordan improved, as reflected in the *Doing Business* trade indicator.[5] The number of days to import dropped from 28 in 2004 to 22 in 2007, and the number of days to export fell from 28 in 2004 to 19 in 2007. The cost to export also dropped from $720 per 20-foot container in 2004 to $680 in 2007. More improvements are expected.

A remarkable change

The turnaround at Aqaba offers 3 important lessons for policymakers. First, it is essential to have a strong, influential team to champion reforms. In Jordan the King and his reform-minded technocrats brought a visionary approach to Jordan's development and the role of a vibrant and competitive Aqaba port. Even in difficult times, they pushed ahead with the reform agenda.

Second, global best practices, if adapted to the local context, are a good guide. It was clear that the way to modernize and manage the Aqaba Container Terminal was in a private-public partnership. But given all the national concerns in Jordan about the management of a strategic national asset by a foreign company, a graduated approach to the needed reform was adopted—hence the initial offer of a 2-year management contract and a subsequent 25-year joint venture based on an excellent management performance and favorable public opinion.

Third, to obtain the desired results, reformers must work with the best talent around. The Aqaba Development Corporation, under the leadership of Imad Fakhoury, selected APM Terminals to manage Aqaba, but only after a rigorous and transparent selection process that drew the attention of the leading world container terminal operators.

Notes

1. Aqaba Development Corporation, Presentation on the Aqaba Container Terminal Presentation, 2007
2. Ibid.
3. To date, the Aqaba Special Economic Zone Authority and the Aqaba Development Corporation attracted $8 billion of investment in the region in the period 2000-2007, above the 130% initial target. Tax collection increased 40 fold. Most important, 15,000 new jobs were created in the Aqaba region, thus turning the Aqaba Special Economic Zone into a model for the creation of other special economic zones in the country.
4. Riad Al Khouri, "Policy Initiatives and Reforms in the MENA Region, Review Workshop—Governance Case Study of Jordanian Customs," draft paper, February 2004.
5. World Bank Group, Doing Business Jordan Country Profile, www.doingbusiness.org.

Fighting entrenched interests to enforce judgments faster

Lior Ziv

Going through a lawsuit is about arcane rules, unnerving uncertainty, and headaches. And in Poland the headaches used to last long after the lawsuit ended. Enforcing a judgment could be a nightmare. The average judgment took close to half a year to enforce, and hard-to-enforce judgments could take years.

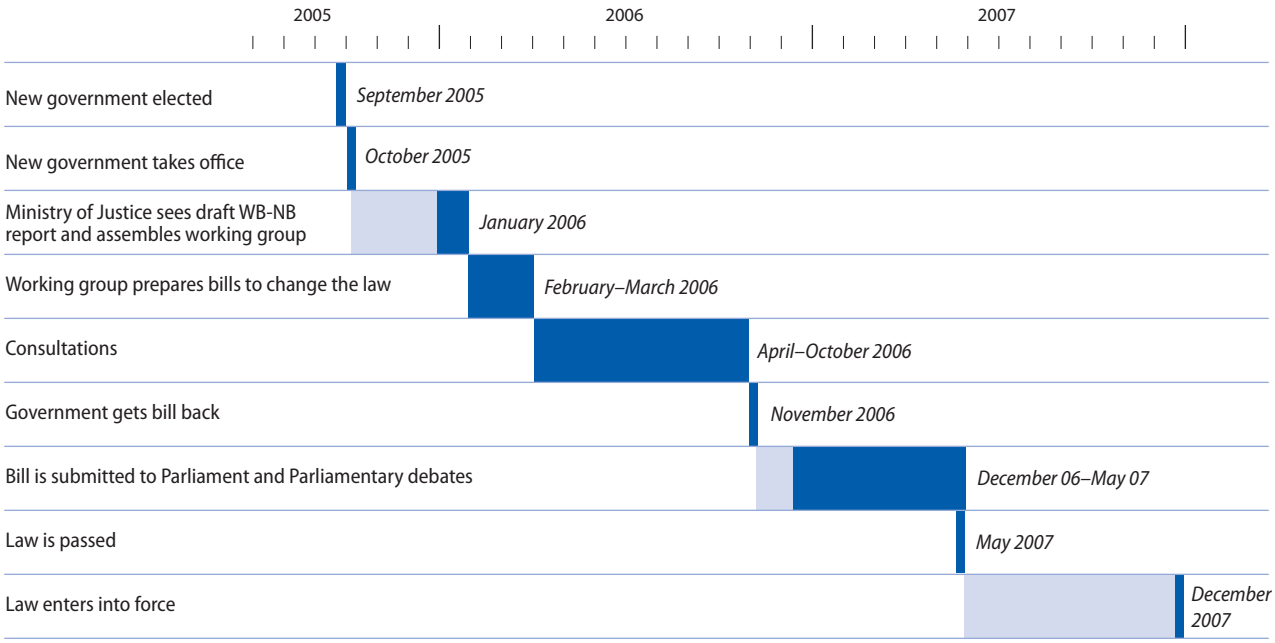
After commissioning a study, the new government decided that the noncompetitive organization of the bailiff profession—mainly responsible for enforcing judgments to collect debt—was to blame for the slow enforcement of judgments. So, in 2007 the Polish government attempted to help litigants by liberalizing the profession.

Enforcing judgments—not so fast!

Apart from voluntary compliance and extralegal enforcement by criminals, there are 2 legal frameworks to enforce judgments. In public enforcement a salaried state employee is responsible for enforcement. In private enforcement a private professional, under close state regulation and supervision, is responsible. These are a "liberal profession," akin to lawyers or notaries.

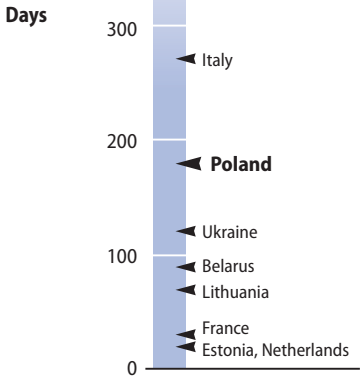
FIGURE 1
Timeline of bailiff reform in Poland

Source: Doing Business database.



Coming from a system of public enforcement under Communist rule, Poland reformed in 1997 to introduce private bailiffs. But this reform did not make enforcement efficient. The 2005 *Doing Business* report ranked Poland as having one of the world's slowest judiciaries—1,000 days to enforce a contract, including 180 days to enforce a judgment (figure 2).

FIGURE 2
Before reform—Poland among Europe's slowest in enforcing judgements



Source: Doing Business database.

Poland's entrenched bailiffs

Prompted by the *Doing Business* findings, the National Bank of Poland and the World Bank drafted a report, *Poland: Legal Barriers to Contract Enforcement*. The report found that the lack of competition among bailiffs contributed to inefficient enforcement. There were 3 problems:

Entry into the profession New bailiffs were highly restricted from entering the market. Only the president of a regional court could request a new bailiff—and only after consulting with the local chamber of bailiffs. The justice minister then had to approve the increase after consulting with the National Council of Bailiffs. The bailiffs, who had a vested interest in keeping new entrants out, thus had considerable influence. And with only a single bailiff allowed per district, creating a new bailiff position required creating a new district—technically difficult because it required redrawing districts to ensure that all remained similar.

New bailiffs were thus rare, leaving Poland with about 1.5 bailiffs per 100,000 inhabitants, among the lowest ratios in Europe. Even as the number of court cases increased by 20% between 2000 and 2003, the number of bailiffs rose just 1.4%.

Territorial competition Because litigants could hire bailiffs only from their own region, competition was limited. Although regions included several districts, in practice the bailiffs worked almost exclusively in their own districts. For enforcements involving real estate, litigants had to hire the bailiff in the same district as the property.

Price competition As fees were legally fixed, bailiffs could not compete on price. So, consumers could not benefit from the lower prices of bailiffs trying to attract business. And there was no price signaling for quality or speed—say, a bailiff charging more for a difficult or especially speedy execution. Hard cases would not get executed because bailiffs would, sometimes by necessity, cherry-pick the easiest and most profitable (for instance, seizing a bank account).

Elections bring reform

The September 2005 elections brought new people to the top of the Justice Ministry. The new team had ambitious reform plans, endorsing the World Bank and National Bank report. Krzysztof Józefowicz, then the Undersecretary of State, says that "broadly speaking, we suggested three things. First, the justice minister should be able to appoint more bailiffs without going through a complicated procedure. Second, the bailiffs should be able to compete with each other regardless of their location. Third, price flexibility should be introduced to bailiff fees."

Interest groups try to block the way

But this was only the beginning of the journey. Interest groups stood between the suggested reforms and their implementation. "During the consultations the bailiffs association reacted very negatively to the proposed reforms," Józefowicz says. Bailiffs had grown used to their secure positions—a regional monopoly and the power to block new entrants.

The disagreement also took place on a more fundamental level. The bailiffs saw themselves as part of a system of public enforcement—as Agata Bartkowiak of the National Bailiff Association put it, "In Poland a bailiff is not an entrepreneur like in the Netherlands; he or she is a body of public authority." According to the Constitutional Court, competition between public authorities is forbidden. That means that the new law is unconstitutional, claimed the bailiffs. The reformers, by contrast, saw the bailiffs as private enforcement officers who should be allowed to compete with each other.

To preserve the status quo and torpedo the reforms, the bailiffs association employed a host of measures. "At first, they wrote articles in legal journals opposing the reforms. Next, they approached people from the legal academy with their arguments. When the act was before Parliament, they tried to influence public opinion and the lawmakers by placing articles in popular newspapers warning about the impending disaster should the reform pass." Once the reform passed, they petitioned the Constitutional Court of Poland to have the new laws declared unconstitutional. That case is still pending, but it did not preclude the law from entering into force.

Overcoming opposition—3 keys

Three factors helped Poland overcome opposition: World Bank support, political savvy, and political will.

First, the World Bank and National Bank report provided an objective benchmark to persuade decisionmakers. According to Józefowicz, "It helped to persuade the lawmakers, even if it did not persuade the bailiffs. The report showed comparatively that there are better ways to handle the execution process." Józefowicz also notes that, "whenever our opponents alleged that we did not know what we were talking about or that we had partisan interests, we could point to the support of the World Bank."

Second, the new justice minister, Zbigniew Ziobro, is not a technocrat but a politician with popular appeal and political instincts. Because he does not hail from the traditional legal establishment, he was unfazed by criticism from that front. This helped him garner the necessary votes in Parliament for approval. Even figures from the other side of the political divide, such as Leszek Balcerowicz, supported the reforms.

Third, the new government had the political will to take on cliques in the legal profession. The main political party in the coalition, Law and Justice, campaigned in the general elections on an anti-establishment ticket to diminish the privileges of powerful vested interests, including lawyers, notaries, and bailiffs.

Reform passes, but with mixed results

The amendment to the Act on Court Bailiffs and Debt Collection finally passed on 24 May 2007, was published on 27 June, and entered into force on 28 December. Józefowicz hopes that the reform will expand the supply of bailiffs, so people will turn less often to "self-help" solutions. The reform was a step forward, but in all 3 fields, the results are mixed:

Entry into the profession The justice minister can now increase the number of bailiffs in a region based on the petition of the judge presiding over the Regional Court. Józefowicz, who meanwhile became president of the Regional Court of Poznan, has already used this power to petition for more bailiffs in his region. Even if the president of the Regional Court in a given region does not petition for an increase, the minister can also increase the number of bailiffs on his own initiative, after consultations with the local bailiff association.

The downside is that it is possible that a minister will not nominate any bailiffs, or not nominate enough of them. In fall 2007 a new party came to power after general elections. According to newspaper reports in April 2008, the new

Minister of Justice plans to add just 35 bailiffs, far fewer than the hundreds expected. This could mean that improvements to the execution system are still years away.

Territorial competition Except for real estate, a creditor is now able to choose any bailiff in the country to execute a judgment, increasing competition. And multiple bailiffs can compete for work in the same district. But now there is another problem: it is more likely that multiple bailiffs will try to execute on the same assets. There are priority rules for such cases, but they are unclear and could bring conflicts. The matter could then go back in front of the judge—and further delay matters. Further reform might be needed.

Price competition Much time went into discussing this issue. But ultimately the reformers had only limited success. Bailiffs are still not able to compete on price because only the variable costs of the bailiff, such as transport or hotel expenses, are freely negotiable. This means that difficult executions remain a problem.

Advice for would-be reformers

Józefowicz has advice for other countries about to embark on similar reforms: rely on comprehensive studies to back up the case, ensure broad political support for reform, and gather a team capable of withstanding criticism. This advice might be relevant for Poland itself, should the new government want to tackle the remaining problems in enforcing judgments. In that case, the headaches of the litigants just might end a little sooner.

Pragmatism leads the way in setting up specialized commercial courts

Sabine Hertveldt

After the 1994 genocide Rwanda recognized that it had to reform its commercial justice institutions. But the country faced a more immediate challenge from the genocide: bringing thousands of perpetrators to justice. So, according to Vincent Karega, minister of state for industry and investment promotion, "the many competing needs, especially due to the legacy of the genocide, made it impossible to embark on commercial justice reforms until 2001."

Kicking off an overhaul of the justice system

In May 2001 President Paul Kagame created the Rwanda Law Reform Commission, giving its 10 members a mandate "to review all existing laws and court rules and to recommend reforms to improve the efficiency of justice."

The president handpicked the 10 members—all lawyers. The commission drafted new laws from July 2001 through December 2003. But once it began deliberations, conflicts multiplied. Disagreements were rife, and debates heated. The chairman, now justice minister, spent months working hard to build a cohesive team, using 3–4 day retreats to hash out the contentious issues. That leadership ultimately helped members build trust and respect—and to compromise. Members with rigid views were persuaded to soften their stance.

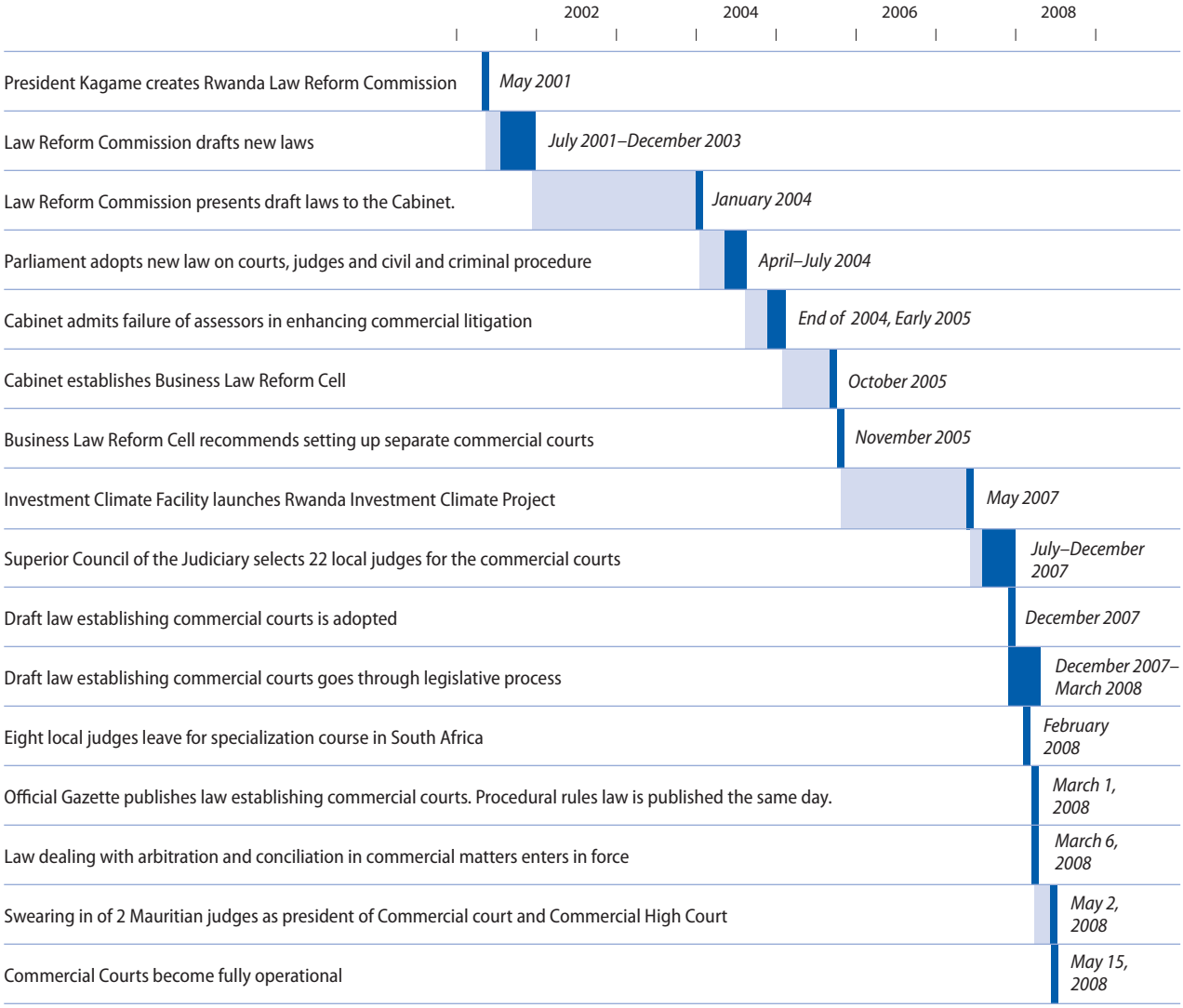
Outside opposition forms quickly

The commission developed into a collegial, effective body, gaining respect from the public by speaking with a single voice. As details of the reform agenda emerged, however, a narrow but politically strong opposition bloc began to form outside. The commission had proposed laying off redundant, incompetent, and corrupt judicial staff. Once this plan became clear, judges and members of the executive started to oppose the reform.

A particularly thorny issue was the independence of the Superior Council of the Judiciary, the body that would appoint future judges. Some members of the executive wanted to be members of the council, but the commission insisted that their executive responsibilities were not reconcilable with appointing judges.

FIGURE 1
Timeline of court reform in Rwanda

Source: Doing Business database.



Listening to stakeholders

President Paul Kagame met with the commission on request, also calling several meetings himself to keep abreast of the deliberations. When the president learned about the opposition from the legal community, he asked some of his ministers to discuss the issues with the committee and other stakeholders.

To diffuse opposition, the president called a large stakeholder meeting to hear out the opposition and its views. About 200 people attended. The debate was heated, with the reformers defending their views against opponents. Afterwards, the president had the final say, requesting that the commission proceed to draft the laws as recommended.

The commission worked hard to gain the public's confidence in the reforms—not easy because at the beginning of the process, the public had little belief that the government could deliver. Previous attempts to reform the judiciary had failed.

A first attempt at new laws

By January 2004 the commission presented draft laws to the Cabinet. With the Ministry of Justice taking the lead in ushering the draft laws through Parliament, the commission provided on-demand technical advice to the parliamentary commissions. Between April and July 2004 Rwanda's Parliament enacted new laws on courts, judges, court staff, public prosecutors, and civil and criminal procedure.

Recognizing that the country's strategy to grow long-term investment was at risk of backsliding because of legal uncertainty, the government passed a law that established 3 specialized commercial chambers within 3 of Rwanda's 12 provincial high courts and 1 specialized commercial chamber within the Kigali High Court. The specialized commercial chambers became operational with the support of the World Bank Competitiveness & Enterprise Development Project (CEDP), which provided $200,000 for the equipment and training of judges.

Specialized commercial chambers end in failure

The 2004 law required that each specialized commercial chamber be composed of 1 professional judge and 2 lay judges, called "assessors." Assessor-assisted courts, functioning in many countries, were new to Rwanda. The assessors, independent and experienced businesspeople who volunteer to assist in ruling on commercial cases, enrich the court with their technical understanding of *Doing Business*. In insurance cases, for example, employees of insurance companies assist the professional judge.

But in Rwanda the assessors were misunderstood. Rather than nominating technical experts, companies nominated their in-house legal counsels to assist the judges. Other potential assessors boycotted the system because the work was voluntary and unpaid. As a result, the courts did not decide any commercial cases during 2004.

After the cabinet admitted assessors' failure to enhance commercial litigation at the end of 2004, the Ministry of Justice had to re-strategize.

Separate commercial courts—from an idea in 2005…

Early in 2005 the prime minister and the ministers for trade and justice signed an order to review all commercial laws in banking, insurance, electronics, trade, and arbitration. The major goals were to adopt international best practices in the legal system and to fulfill the imperatives of Rwanda's regional integration agenda. A 2004 customs union among Kenya, Tanzania, Uganda, and Rwanda spurred efforts to harmonize business laws.

In October 2005 the cabinet established within the Ministry of Justice a Business Law Reform Cell, chaired by Richard Mugisha and composed of 3 members from the private sector and 3 from the public sector. The reform cell was established with the support of the World Bank CEDP which provided the staffing and equipment.

Apart from proposing legislative reforms, the work of the Business Law Reform Cell also included reviewing the institutional framework for implementing legislation in commercial justice and building the machinery for business registration, intellectual property, chattel securities, and land titles. The Business Law Reform Cell prepared fourteen commercial laws that are waiting to be adopted in 2008, including a new bankruptcy law, companies law, secured transactions law and contracts law. The law establishing the business registration services agency was passed in November 2007. The new arbitration and mediation law was already passed in March 2008.

An early recommendation from the Business Law Reform Cell in 2005 was to create separate commercial courts. Today, 3 years later, they exist.

…to realization in March 2008

The Parliament's Chamber of Deputies adopted the draft law establishing separate commercial courts in May 2007. The law provides for 4 new commercial courts dealing with all sorts of commercial cases, ranging from commercial contracts to bankruptcy, tax disputes, transport disputes, intellectual property adjudication, and consumer protection cases.

Of the 4 courts, 3 are lower commercial courts—in Kigali, in the Northern Province, and in the Southern Province. These 3 commercial courts will replace the 3 specialized chambers within the provincial high courts. They will cover all commercial disputes with a value below 20 million Rwandese francs, or about $37,000.

The other court, the Commercial High Court in Kigali, will decide all cases with a value above $37,000 and appeals against decisions from the 3 lower courts.

The government of Rwanda and the Investment Climate Facility for Africa financed the 4 new commercial courts. The Rwanda Investment Climate Project was launched in May 2007 as the first initiative of the Dar es Salaam–based Investment Climate Facility. Along with establishing a new commercial registration agency and improving Rwanda's land titling, this project financed a commercial court to ensure a speedy and effective system of commercial dispute resolution. In total, the Investment Climate Facility spent about $3,600,000 on court logistics, computers, training for judges and hiring of expatriate judges. The Rwandese government gave about $307,000 for the year 2008 as seed fund to start off the commercial courts. The World Bank CEDP spent $255,000 for IT equipment and the appointment of three Rwandese judges. In total, World Bank's CEDP spent $1,500,000 on commercial justice reforms in Rwanda.

Unlike other specialized commercial courts in, say, Tanzania, Rwanda's commercial courts will not fund themselves by charging higher court fees than the ordinary courts. The fees to file a new case is $10 before the commercial high court and $7 before the lower commercial courts.

Legislative back and forth

On 1 March 2008, almost a year after Parliament adopted the first draft law, Rwanda's Official Gazette published the final version, which entered into force on the same day.

Now a single professional judge decides cases in the commercial courts. The law did away with the assessors, which had delayed the introduction of commercial chambers in the higher instance courts. Three professional judges are reserved for appeals that come before the Commercial High Court.

In the 10 months between the first draft and the final version, the law went through Rwanda's usual legislative process: from the Chamber of Deputies to the Senate and back. The Senate proposed an amendment to specify the minimum experience a judge should have to be appointed to the new courts: 3 years for candidates with a doctorate, 5 years for candidates with a bachelor's degree. The amendment also clarified that both Rwandese nationals and foreigners could be appointed judges. Allowing foreigners to the new commercial courts is innovative—in most countries only nationals can serve as judges, regardless of the type of court.

After the Senate's amendment, the law went back to the Chamber of Deputies, which adopted the amendment without much discussion. The Parliament sent the law to the prime minister and the prime minister sent the law to the minister of justice, who advised the president to sign it. The president did so on December 16, 2007.

A new approach to commercial justice

On 1 March, 2008, the same day the law on commercial courts was published, a separate law with procedural rules for the new commercial courts was published as well.

Rwanda is a mix of civil and common law. The procedural rules reflect this pragmatic approach, according to Richard Mugisha: "since civil and common law systems are converging in the globalized world of today, Rwanda has picked the best of both systems. We cherry picked from what works well in the United States, Canada, Britain, Ireland, Mauritius, Kenya, Ghana, Uganda, and Tanzania."

Some of the rules are innovative, such as the introduction of strict deadlines. If judges enforce these deadlines, things might speed up. One example is that a defendant must deliver a written answer within 14 days of receiving the initial complaint. Another is that the judge has a duty to organize, within 21 days of receiving the defendant's answer to the complaint, a preliminary hearing with both parties, where the judge can refer the parties to arbitration or mediation.

The rules on adjournments—extra time to comply with procedural requirements—are meant to avoid delaying tactics. If the judge grants a party extra time and it later turns out the request was not genuine and meant only to delay the process, the judge can impose damages, which must be paid before the next hearing. If they are not paid on time, a further penalty applies.

To avoid flooding the new courts immediately, the new procedural law also regulates which cases pending before the commercial chambers can be transferred to the new courts. By May 2008, a total of 3,300 disputes had been transferred to the 4 new commercial courts. The Commercial High Court alone received over 600 cases from different courts around the country. Each judge will have to prepare and render decisions in at least three cases per week.

A new law dealing with arbitration and conciliation in commercial matters came in force on 6 March 2008. If arbitration succeeds, it may reduce the number of cases that end up before the new commercial courts. Although arbitration centers have existed in Rwanda since 1998, the new law is a major departure

from the previous legal regime, making arbitral awards final and binding. Before, awards from arbitrators were treated as decisions from the courts of first instance that could be appealed to the High Court. The new law is in line with the rationale for arbitration: arbitrators make a final decision that, unlike court decisions, cannot be appealed.

The search for judges—a stumbling block

Although the law on the commercial courts entered into force 1 March 2008, the courts became fully operational only on 15 May 2008. Why? Selecting the judges took longer than expected.

Between July 2007 and December 2007, the Superior Council of the Judiciary selected 22 local judges for the 3 lower commercial courts. Some come from the existing commercial chambers, others from outside the judiciary, such as former legal counsels in commercial banks. On 1 February 2008, 8 of the 22 local judges left for a yearlong specialization course in commercial law in Johannesburg, South Africa, partially funded by the World Bank. The goal is for all 22 local judges to do the same course over the next 3 years on a rotating basis.

To properly staff the Commercial High Court, the Rwandese Supreme Court tried to hire 7 expatriate judges from abroad, including from Mauritius and the United Kingdom. According to Anne Gahongayire, secretary general of the Supreme Court, the court chose Mauritius "because of the existing relationship between the two judiciaries and because the country is bilingual."

On 2 May 2008, 2 Mauritian judges were sworn in: Angeeli Devi, president of the Commercial Court of Kigali City and Benjamin Gerald, president of the Commercial High Court. The 5 others who had previously accepted the position ultimately declined the offer. Their positions in Mauritius did not allow them to leave, and some did not find the package appealing enough. In April 2008 recruitment of expatriate judges was temporarily suspended to give the Supreme Court more time to look for judges with a mixed background in common law and civil law, preferably coming from a country with a mixed system similar to what Rwanda is trying to create. In the future, seven more foreign judges will be hired on a contractual basis for not more than three years to help the local judges run the new courts.

Lessons learned

Reforms do not happen without a good amount of pragmatism. Johnston Businghe, president of Rwanda's High Court, points out that "if we had waited for the courts to get to the perfect starting point, cases would never be heard. Perfection is only obtainable from a work in progress."

Pragmatism drove reformers to copy what works in other countries. Given the reality of a globalized world where distinctions in legal systems become less clear, it did not matter whether procedural rules were specific to civil law or common law countries. But copying models without translating them to the local reality does not work—evident in the experience with the assessors in the commercial chambers.

Over the last years Rwanda has won praise for its vision and lack of corruption. Gross domestic product expanded by an average of 6% a year during the last decade. With an expanding private sector and a new stock exchange since February 2008, the need for an efficient commercial dispute resolution will only grow. The ancient Roman quote from Marcus Tullius Cicero still holds true: "To those who are engaged in commercial dealings, justice is indispensable to the conduct of business."

Enforcing contracts quickly, with help from the neighbors

Anthony Ford and Oliver Lorenz

Anthony Ford, a lawyer with more than 30 years of experience in New Zealand, had just been named Tonga's chief justice in September 2006 when the minister of justice told him that the cabinet was not happy with Tonga's low ease of *Doing Business* in *Doing Business 2007*. The efficiency of contract enforcement was especially poor, where Tonga ranked 126 of 175 countries. The minister asked Ford what could be done.

His answer? Bring technology to litigation. Computerization cut the average time to enforce contracts from 510 days to 350 by October 2007, making Tonga the world's top reformer in contract enforcement. In just over a year the reform struck close to 100% of dormant cases, placed all others on a strict timetable, introduced mediation, and increased the jurisdiction of the Magistrates' Court.

Computerization, computer staff, and computer training

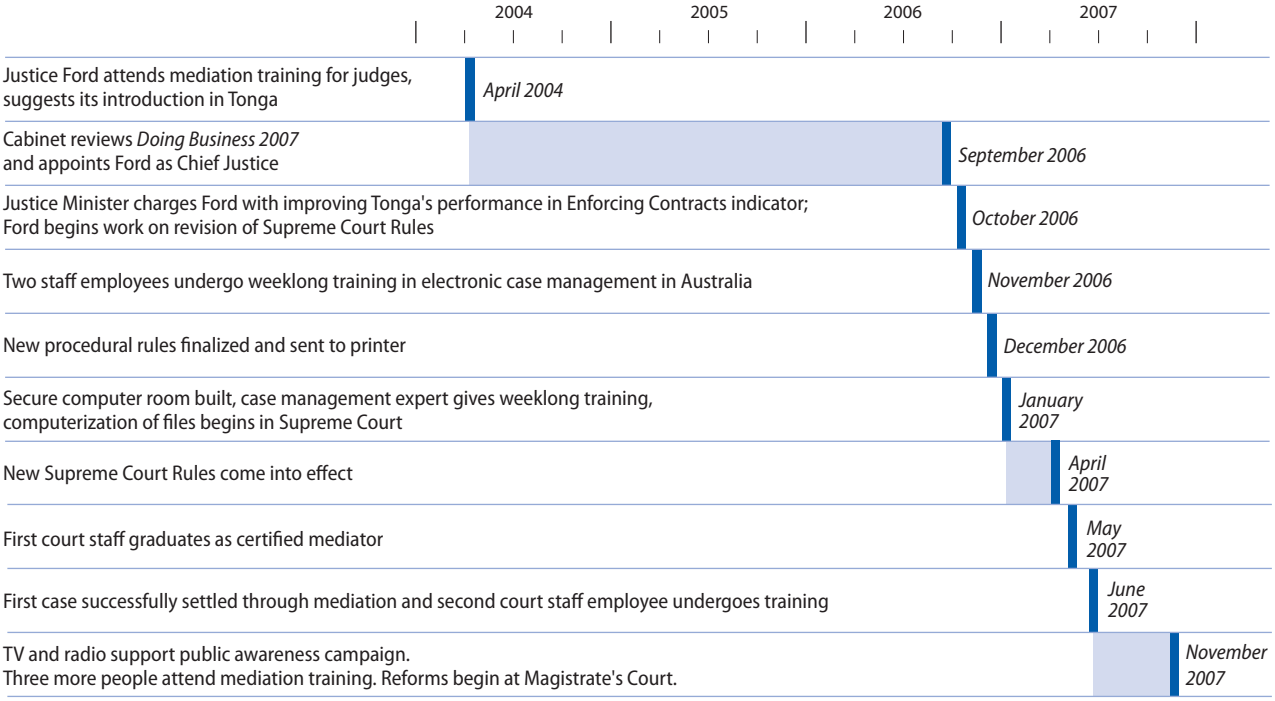
It was clear to Ford that inadequate technology was hampering commercial litigation. At the Supreme Court, the country's highest civil jurisdiction, computers were not available to staff until 2002. And because the staff were not taught to use the computers, they continued to compile court records manually even in 2006. Meanwhile, talks were under way with the Federal Court of Australia about introducing electronic case management to reduce the backlog of hundreds of cases. In 2007, computerizing the court filing system became a priority. The chief justice contacted the Federal Court in Sydney, putting electronic case management on the fast track.

Seeking the motivated

When the court began computerizing old files at the beginning of 2007, the chief justice selected 2 court staff to travel to Australia for a week-long course in case management. Neither had a traditional background in information technology. Sione Taione had been a court interpreter, recently appointed the deputy registrar. But Ford noticed his good understanding of computers and his enthusiasm for computerized case management. The other staff member, word processor operator Loma Lausii, had never been outside Tonga. The novelty only motivated her further. Both selections proved inspired. Sione quickly became an expert on computers and their capabilities for case management. Loma led the team, working overtime to digitize old files.

FIGURE 1
Timeline of court reform in Tonga

Source: Doing Business database.



Security for computers, comfort for staff

After rioting in November 2006 the court saw the need for a secure computer room. Finding the funds that time of year was cumbersome, but Australia agreed to cover the expenses. The work began in January 2007. The room and the adjacent office were air conditioned and fitted with new computers, a printer, and furniture. An expert from the Federal Court of Australia gave on-the-spot training—critical follow-up.

Staff in the computer room enjoyed an air-conditioned workplace. But others did not. Because of tight funding, the chief justice paid personally to install an air-conditioning unit for the general office. Of the gift, Ford says, "in the overall scheme of things this may have only been a small gesture, but it resulted in a highly spirited workforce."

Weeding out dormant files

Computerization meant that all case files had to be examined. While systematically reviewing every document in the court's files, staff discovered several hundred dormant cases. The new Supreme Court rules, in force since April 2007, provided that such cases could be struck down, but only after giving the plaintiff

28 days notice. It was obvious from the sheer number of files that giving notice would be time consuming. And in many cases such notices would serve no purpose because the file indicated that litigation would not go forward.

So, the chief justice decided to strike all cases where no action had been taken for 2 years. He instructed that proceedings be reinstated if the plaintiff complained about the 28-day notice. In the end, 518 actions were struck, with only 10 reinstated on a plaintiff's request.

With only current files in the electronic system, the Supreme Court can track all cases so that none becomes inactive. By administrative order, the registrar must refer to the chief justice any civil litigation file inactive for 3 months. Unless further steps in the proceedings occur within 28 days, the action is struck.

Setting time limits

The computerized case management system, based on the Australian Federal Court's, uses an off-the-shelf spreadsheet program to store case information, including the complete timeline. Long delays are detected automatically. This allows the judge to remain on top of the docket without becoming mired in the details of case administration.

Computers also allow performance measurement. The Sydney District Court—which ranks 11 in the *Doing Business* indicator for contract enforcement—sets the goal of disposing of 98% of its civil cases within 18 months. After discussions with court staff, Ford set the goal of disposing of 90% within 2 years, taking into account the backlog of cases. So far, it has proved feasible.

The court strove for efficiency in other aspects of justice. For example, consistently informing the public of relevant decisions through the local newspapers often discourages similar cases, alleviating the burden on the court. To kick-start the mechanism, the chief justice slashed a prohibitive copying fee for court decisions to be paid by journalists and ordered that copies of all decisions with public relevance be sent to the press. The computer system has already been further refined—for example, by gathering data on juvenile offenders, of interest to UNICEF.

Mediation—successfully implemented

When Ford redrafted the Supreme Court rules at the end of 2006, he included a provision for mediation—virtually unheard of in Tonga. Resistance from the Law Society was thus anticipated. The society president favored striking alternative dispute resolution from the text. But making mediation, initially at the

judge's discretion, contingent on both parties' consent ultimately accommodated his concerns.

The new rules came into effect on 12 April 2007. To encourage parties to consent, nothing said in mediation can be used in a later trial should mediation fail. The mediators may report to the judge only the progress and the outcome. Order 45 also states that reference to mediation is neither justification to stay proceedings nor cause to delay the trial preparation.

To reassure the parties, the rules require that mediation be exercised only by trained or sufficiently experienced persons. Tonga had no formally recognized mediators. With assistance from the Federal Court of Australia, the deputy registrar went to Sydney, where he completed a week of training in a mediation program. Later, the registrar traveled to Wellington, New Zealand, for similar training. Because the court's registrars are respected members of Tongan society, they are suited for the task.

Talk about it

Tonga publicized the benefits of mediation during its inaugural Law Week, a week-long conference in November 2007 rallying judges from Pacific island jurisdictions. On opening day a public awareness workshop was held on mediation. The chief justice spoke on a radio show, to the press, and on television, and the public awareness campaign was also broadcast over the radio. The World Bank Group provided the funding. The Federal Court of Australia helped produce a mock mediation DVD in Tongan, screened nightly on Tongan television during Law Week. About 100 copies of the DVD went out, 1 to every village committee and church committee. According to Ford, the DVD had a tremendous impact in getting the mediation message to the public.

Mediation usage continues to grow, freeing court resources. Most litigants now consent, and 8 in 10 reach settlements out of court. Recognition of the success came from the Tongan government, the country's largest litigator, which agreed to be a party to alternative dispute resolution in December 2007, after initially opposing it. The World Bank Group has funded more mediators to be trained and accredited, and plans to undertake further awareness training with Tonga's Law Society and Magistrates, so that court-referred mediation is fully functional. The Supreme Court is exploring a dedicated building for mediation.

All staff on board

Ford notes the importance of staff support when introducing a new system, especially when the reformer comes from a different country.

From the outset, court staff was excited about the new case management program and the heightened efficiency around the office. Once, the head office of the Ministry of Justice even complained that staff was working until 9 pm on some nights, not taking paid overtime. Ford instructed staff to work regular workweek hours but immediately noted that they responded by working on Saturdays.

Next in line—the Magistrates' Court

At the end of 2006 Tonga increased the jurisdiction of the Magistrates' Court for civil cases from 1,000 to 10,000 pa'anga, or roughly $5,000. The number of cases now eligible for the less formalized and faster Magistrates' Court is substantial, alleviating the burden on the higher jurisdiction. And the measure builds judicial capacity. Magistrates must now have better command of the law, dealing with disputes with 10 times the value at stake. The parliament, initially hesitant, agreed only in exchange for professionalizing judicial education at the lower court. In November 2007 work began to extend the Supreme Court's case management system to the Magistrates' Court and discussions are underway amongst Magistrates to consider making mediation available at the lower court.

The right time for reform

The reform comes with the courts as busy as ever, with about 500 additional criminal cases coming through the system after the November 2006 riots. The reformed procedures enabled the courts to handle the huge influx with diligence. Once this unexpected case load clears, the court should make further inroads on the time to enforce contract claims. The Tongan judicial system is becoming recognized as one of the most efficient in the Pacific islands. Neighboring islands recently expressed interest in the case management system, and the registrar may travel there to pass on the knowledge. Meanwhile, the chief justice has requested a survey of user satisfaction, repeated every 3 years if possible, to gauge progress.

Repaying creditors without imprisoning debtors

Mema Beye and Joanna Nasr

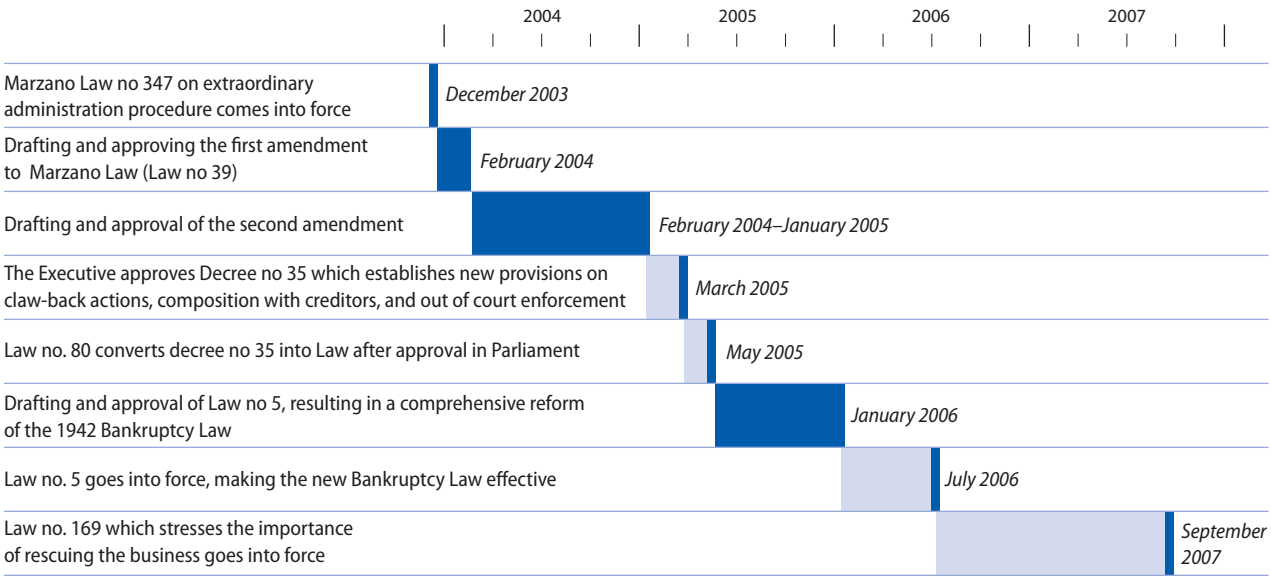
In 2003 Italy's bankruptcy law was over 60 years old—not ideal to keep up with economic transformation. Judges, lawyers, businesses, and creditors all knew that the law needed change. But the process was slow, requiring a jumpstart from major financial crises, like Parmalat's 2003 demise. In the wake of the crisis the Italian government, Parliament, and anyone up for reelection shifted their focus to implementing structural reforms to enhance Italy's competitiveness, especially internationally.

The new law aimed at creating a process similar to Chapter 11 in the United States, transferring the focus of proceedings from liquidation to corporate reorganization and restructuring. This framework strengthened creditors' rights, stimulating the flow of credit to small and medium-size firms.

With the new laws the process no longer takes up 7 years, as before, and it preserves the value of the company. *Doing Business* estimates that creditors are repaid in less than 2 years, with the recovery rate at €0.62 cents per Euro owed—almost double the €0.38 in 2002, according to the Italian Bankers Association. Although the new law provided Italy with an efficient insolvency system, more can be done to implement the law effectively.

FIGURE 1
Timeline of bankruptcy reform in Italy

Source: Doing Business database.



The first step—don't view debtors as criminals

Italy's old bankruptcy procedures were 1-dimensional and inflexible, with major hurdles to successful reorganization. The high costs and expenses of insolvency procedures used up much of the asset value. And the process was long—7–8 years.[1] So, unsecured creditors did not usually recover their claims, with negative spillovers to the whole economy, especially to the reallocation of resources.

Before the reform Italian bankruptcy laws were harsh, treating the debtor as a wrongdoer or a criminal—deprived of the right to vote in elections and disallowed from reentering the market as an entrepreneur or a consumer. To adapt to the modern economy, Italy had to change not only laws and procedures but legal culture and mindsets. The law succeeded in this, imparting a new attitude toward insolvency and bankruptcy. The emphasis shifted to debt restructuring agreements that rescue the business instead of liquidating the debtor's assets. Out-of-court restructuring agreements are the most likely proceeding, taking less time to complete and preserving the business.

Reform came progressively by slowly adopting various laws and decrees in piecemeal. On 1 December 2003 Marzano Law 347 on extraordinary administration was enacted. Law 39 passed on 18 February 2004, amending the Marzano Law. On 14 May 2005 Law 80 on judicial composition with creditors converted into law Decree 35, passed in March 2005. On 9 January 2006 the comprehensive reform Law 5 was passed, going into force on 6 July 2006. The latest reform, Law 169, passed on 12 September 2007 and took effect on 1 January 2008.

Scandals to jumpstart reform

The scandals that struck Italy's market and the demise of Parmalat, Volare Airline, Cirio, and Giacomelli drove the first installments of the bankruptcy law reform. Emergency measures created the political space to negotiate deeper changes in the system. The Italian Constitution (Article 77) allows the government to issue provisional decrees having the force of law, but these decrees must be ratified by Parliament within 60 days. This legislative flexibility allowed the government to start the reform process.

Introducing extraordinary administration

On the heels of Parmalat's failure came the Marzano Law (called the "Parmalat Decree"), set out in Decree Law 347/2003 and amended by Law 39/2004. The Marzano Law tried to streamline the standard procedure of "extraordinary administration" in Decree Law 270/1999 by reducing the administrative burden and extending the time limits of recovery plans. The law brought faster admis-

sion to the special insolvency regime for companies meeting its requirements. Insolvent companies of more than 1,000 employees, at least a year since the insolvency, and debt of €1 billion or more could apply to the minister of production for immediate admission to extraordinary administration and for the appointment of an administrator to manage the business.

The Marzano Law was again amended by Law Marzano Bis on 28 January 2005, which eased the requirements to at least 500 employees, at least 1 year in insolvency, and indebtedness of €300 million.

The main advantage of the extraordinary procedure is that the claims of secured and unsecured creditors are automatically stayed. If the reorganization plan fails in 2 years, it converts into a sale plan or a bankruptcy proceeding. The law allows for the sale of the assets through private companies without administrative and judicial intervention and approval.

The sense of urgency from Parmalat's crisis carried reform forward, in 2 stages. The first, in March 2005, dealt with rescue procedures and claw-back provisions—the cancellation of transactions that preceded the declaration of bankruptcy. The second, in January 2006, simplified and shortened bankruptcy proceedings and clearly defined the roles and responsibilities of the key players.

Tackling obstacles to successful reorganization

The next installment of reform was an urgent measure, enacted in March 2005 as Decree 35/2005. It gave distressed firms tools to overcome the crisis, either through out-of-court agreements or through a formal rescue procedure (concordato preventivo, a settlement between the debtor and creditors requiring court approval). Claw-back provisions, perceived as creating an obstacle to out-of-court restructurings, were also made less severe. The administrator can no longer annul transactions essential to continuing operations that occurred between 6 months and a year before the company declared bankruptcy. On 14 May 2005 Law 80 converted Decree 35/2005 into law and mandated the government to overhaul the 1942 Bankruptcy Act.

For the first time in Italy, Law 80/2005 allowed the debtor to file a debt restructuring agreement before the court—already agreed with creditors and without any prerequisites. Before, the debtor could file a petition for composition only when it could guarantee payment of 100% of the secured claims and 40% of the unsecured claims.

Now, debt restructuring procedures are concluded within the framework of composition with creditors, complemented by an expert report on the feasibility

of the agreement. The creditors then vote on the composition. Secured creditors do not participate because they are expected to be paid in full. The composition needs the approval of the majority of claims admitted to vote. When there are several classes of creditors, all classes vote separately and each approves the composition by majority. The court approves the proposal if the majority of classes approve and if the court believes that the nonconforming classes will be no worse off than in any alternative—similar to the "cram-down deal" in United States law.

Law 80/2005 tackled many impediments to successful reorganization under the old regime. Under the old laws the 40 different creditor priorities and their privileges delayed the process. The new law divided creditors into classes whose interests are homogeneous. The law also introduced the concept of discharge—that is, giving debtors the ability to restart as consumers and entrepreneurs. Informal, out-of-court debt restructuring agreements are now possible, similar to the pre-packaged reorganization procedure in the United States. And under Law 80/2005 a debtor in crisis but not yet in insolvency is entitled to request composition with creditors.

Law 80/2005 also reduced the "look back" period (suspect period) to a year where it was 2 years and to 6 months where it was a year. But the most significant change was providing a detailed list of transactions that cannot be subject to claw-back actions. For example, payments for goods or services rendered and payments of debts incurred to carry on ordinary company business are enforceable. That gives the company the chance to continue operating

Simplifying and shortening proceedings

After the first installments of reform, the Ministry of Justice and the Ministry of Economy and Finance established a joint commission to prepare a comprehensive reform proposal for the bankruptcy law. The commission included 2 working groups, a group with the Ministry of Justice and a group with the Ministry of Economy and Finance. Although both groups agreed on the need to modernize the law, they had different views on what the reform should do. The Ministry of Economy and Finance working group believed it essential to give more power to creditors, accelerate procedures, and ensure the survival of viable companies. But the Ministry of Justice group wanted to preserve Italy's judicial culture, with the power of the court remaining central.

It was thus essential that the Ministry of Economy and Finance build coalitions to ensure its agenda took the lead. With the vigorous support of the Italian Bankers Association, Assonime, and Confindustria, the largest industrial and

commercial associations in the country, the 2 working groups' proposals were merged. The principle was greater creditor involvement in the proceedings. The final proposal, after being made public for comments, became law in January 2006. After 64 years Italy finally had a new bankruptcy law.

The creditors' meeting was put in charge of authorizing and supervising the bankruptcy trustee. The trustee's responsibilities included, to name a few, carrying on ordinary business, liquidating assets, and motioning the judge to substitute the trustee. The judge maintained the power to authorize the trustee to undertake judicial actions when required.

After the general elections in 2006 the government further amended and improved the new law. The purpose was to reaffirm the importance of rescuing a company in financial trouble. The amendments were enacted by Legislative Decree 169 on 12 September 2007 and took effect on 1 January 2008.

Italy's bankruptcy law had to wait a long time for change. The crisis-driven approach meant that some provisions of the old law remained intact and others changed—until January 2006 the criminal provisions remained in force. The result: a slow, piecemeal reform, weakened by economic and political obstacles.

A more effective bankruptcy regime

Italy's comprehensive bankruptcy reform had 6 main aspects. First, it redefined the scope of bankruptcy proceedings from punishing the debtor to satisfying creditors. Second, it expanded the role and scope of the creditors' committee. Third, it modified the rules on executory contracts in bankruptcy. Fourth, it allowed the bankrupt business' operations to continue. Fifth, it introduced discharge from unpaid debt for natural persons. Sixth, it simplified the liquidation of the assets and the distribution of the proceeds among the creditors.

The new regime provided for 3 types of proceedings to implement the changes, aimed at saving troubled companies by preserving the business:

Controlled administration A 2-year moratorium granted to the debtor, with business activities under the supervision of the court and the court-appointed receiver. The controlled administration of companies was later abolished by law no 5/2006.

Composition with creditors (concordato preventivo) A settlement between the debtor and creditors that requires court approval.

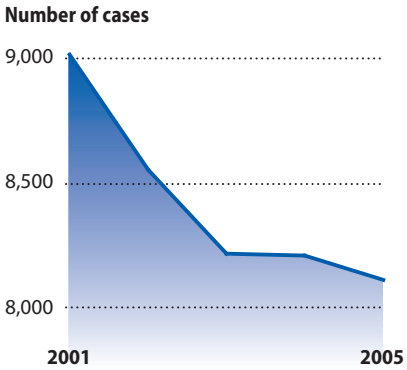
Extraordinary administration An administratively driven restructuring procedure that aims to satisfy creditors' claims while safeguarding the business.

The results—doubling the rate of recovery

Reforming the whole bankruptcy system requires a tough balancing act. If banks cannot protect their credit, they lend less—and at a higher rate. But if entrepreneurs believe that the law empowers creditors to push a company into insolvency, they will be reluctant to start new businesses. The January 2006 law struck the balance by following a new approach that focuses on corporate reorganization and restructuring, not liquidation through bankruptcy. The reform spurred creditors to cooperate with debtors in restructuring companies in crisis.

These provisions are working well on the ground. Most important, the number of bankruptcy cases is down (figure 2). About 85–90% of companies in financial distress now enter an informal workout with creditors, without court involvement.[2] The out-of-court restructuring agreements must be achieved within 6 months from filing—shortening the proceedings and preserving operations. If the debtor is declared insolvent, out-of-court restructuring agreements are resistant to any avoidance action—the agreement is exempted from being revoked by the administrator—as long as an expert assesses the restructuring plan as feasible.

FIGURE 2
Cutting the backlog of insolvency cases



Source: www.guitizia.it

The bankruptcy reform, long overdue, was the result of political choices—what was feasible in Parliament at the time. According to Michele Vietti, chairman of the Commission for the Reform of the Bankruptcy Law, "Those who govern have a responsibility to reform and cannot always wait for the best possible reform. In reality the perfect reform does not exist."

Although not perfect, the new law introduces many innovations. But more must be done for the law to live up to its principles of flexibility, lack of stigma, and direct bargaining between debtor and creditor.

Notes

1. Italian's Bankers Association (ABI).
2. From the newspaper "Il sole24 ore", www.ilsole24ore.com.

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