While the agenda of policymaking during an economic downturn traditionally focuses on the need to support demand, past experience indicates that economic crises are an important catalyst for regulatory reforms. Among the reasons for this pattern, a heightened sense of urgency during crises helps to reduce political resistance and push the agenda forward. Second, crises uncover weaknesses in policies, which were hidden by cyclical performance. Moreover, regulatory reforms are also an attractive policy option during economic downturns because they are generally fiscally light-handed and could bring long-term benefits. In fact, economic crises played an important role in 40% of the cases studied in a recent World Bank report on reforming the investment climate.¹

Previous works have identified key challenges to reducing regulatory burdens and offered general lessons (i.e. World Bank 2004, 2006; APEC 2008; and OECD 2009a, 2009b). This article looks at how these lessons can be used to understand regulatory reforms undertaken by economies in the East Asia region over the global economic crisis.

The Economies in East Asia carried out regulatory reforms at full speed

Reducing unjustified regulatory burdens is one of the core elements in improving the investment climate. As noted by the World Development Report 2005, “too often, governments take regulatory approaches that fail to achieve the intended social objectives because of widespread informality, yet harm the investment climate by imposing unnecessary costs and delays, inviting corruption, increasing uncertainty and risk, and creating unjustified barriers to competition.”²

Economies in the East Asia region have made prominent progress in this area in the past decade, with a broad goal of promoting growth. A case in point is Republic of Korea’s 1998 reform, in which the country overhauled its regulatory system. The reform was estimated to have reduced regulatory compliance costs by USD 15 billion.³ Other countries in the region also enacted reforms to reduce regulatory burdens albeit at a more gradual pace.

Over the course of the global economic crisis, the number of reformers in the East Asia region actually increased. According to the Doing Business database, 13 out of 15 economies in the region reformed in one or more regulatory areas in 2009 in efforts to improve the business environment and 12 did so in 2008, compared with eight in 2006 and 2007.⁴,⁵ In other words, over 90% of the economies in the region introduced regulatory reforms in 2009, which is second only to those in Eastern European and Central Asia (Figure 1).

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¹ The East Asia Region as used in this article includes 15 economies. They are Brunei Darussalam; Cambodia; China; Hong Kong SAR, China; Indonesia; Republic of Korea; Lao PDR; Malaysia; Mongolia; the Philippines; Singapore; Taiwan, China; Thailand; Timor-Leste; and Vietnam.
While the economies in the region enacted regulatory reforms across the board, business entry and taxation saw the most progress between 2008 and 2009 (Figure 2). Nine economies eased business entry processes and 11 streamlined taxation. In addition, a few economies also reformed in areas of property registration and dealing with licenses that are closely related to business entry.

The reform efforts designed to ease business entry covered both statutory requirements on entry and business registration administration. Minimum capital requirements, other fees, and related licenses requirements were reduced or eliminated. Merging procedures, one-stop shops and ICT technology were introduced to simplify registration processes. For instance, Indonesia took a two-pronged approach by eliminating certain licenses and cutting fees of multiple categories together with introducing online services. In Malaysia, the Malaysian Institute of Chartered Secretaries and Administrators reduced company incorporation charges and corporate fees; several amendments to the Companies Act simplified business registration and introduced online filing of registration documents; a new one-stop shop for business registration was also implemented. Similarly, Taiwan, China, reduced the paid-in minimum capital requirement by half in 2008—from TWD 1 million to 500,000, and abolished it altogether in April 2009; it also introduced time limits on various registration procedures.

Reforms of taxation systems also covered both tax policies and tax administration. Most notably, a number of these economies simplified structures of corporate income taxes. For instance, in Indonesia, a flat corporate income tax rate was first introduced in the place of progressive tax rates, which was further reduced from 28% in 2008 to 25% in 2010. Malaysia reduced the corporate income tax rate to 26%, and introduced a single-tier tax system, in which profits are taxed after dividend payments are exempted. Thailand introduced concessional 25% rates for newly listed companies. Timor-Leste cut the corporate income tax rate from 30% to 10% and abolished the alternative minimum tax. Several economies in the region also took actions to improve tax administration through simplifying procedures and applying ICT system. In Taiwan, China, both e-filing and e-payment were introduced to value added tax. Thailand also strengthened the implementation of online filing and payments. The Lao PDR consolidated three taxes—business turnover tax, excise tax, and personal income tax withholding—into one simpler form. It also improved the lodgment process and tax office staffing. Complementing the introduction of a new tax law, Timor-Leste streamlined its business tax regime and simplified tax administration.

These reforms brought measurable impact in terms of reducing financial and time costs for companies. The average minimum capital requirements of starting a business as a share of Gross National Income (GNI) per capita in the region were reduced from over 96% to 32% between 2007 and 2009; the average costs as a share of GNI per capita fell from 28% to 19% (Figure 3). Moreover, the time it takes to starting a business was reduced in nine economies over the same period and the regional

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6 The summary is mainly based on Reform Summaries compiled by the Doing Business database, available via http://www.doingbusiness.org/Reformers/.
7 The summary is mainly based on Reform Summaries compiled by the Doing Business database, available via http://www.doingbusiness.org/Reformers/.
8 Some of the changes in tax structures were part of the fiscal stimulus measures economies implemented.
average was cut by six days. The number of annual tax payments was reduced in five economies and the regional average number was reduced from 27 per year to 23 per year between 2007 and 2009. The time it takes to pay taxes was reduced in seven economies between 2007 and 2009; the regional average fell by about two days (Figure 4).

Reforms aimed more at improving country competitiveness in the global economy

While economic crises provide opportunities for reforms, there are also risks that governments introduce regulatory reforms that undermine growth in a longer term. Governments are under the pressure to do “something” over the heat of crises and rapid responses may lead to measures that are popular but harmful in the long run. One example is the introduction of early retirement schemes in several European countries during the 1970s with the objective of improving youth employment. The policy did not deliver intended results and distorted the labor market. Moreover, while regulatory reforms in certain areas can bring short-term gains during downturns, others may not be effective or increase uncertainties in markets and hence, are unpopular. Therefore, it is critical to weigh the tradeoffs between long-term gains and short-term impact when designing regulatory reforms in times of crises.

Judging by the nature of their reforms during the global economic crisis, economies in the East Asia region focused more at improving country competitiveness. In addition to easing business entry and reducing tax burdens, access to credit and trade facilitation were the areas of concentrated reform efforts between 2008 and 2009 (Figure 2). The turmoil in global financial markets lowered investor confidence worldwide and led to capital flights in the region at the onset of the crisis. Improving access to credit can mitigate the impact of capital flights on domestic credit markets while addressing chronic credit constraints faced by companies. In contrast, benefits of the reforms in the other three areas are much more limited in the short-run but can be substantial over the medium-term.

The long-term gains resulting from easing business entry are two-fold while its short-term impact during economic downturns might be negative. Removing unjustified regulatory barriers to market entry can improve competition substantively. A cross-country study on developing countries found that reducing the cost of registration procedures to the level in the United States (0.6% of per capita income) could lead to 20% increase in the number of new entrants. Recent analytical works have demonstrated that competition spurs efficiency and innovation, therefore, contributing to economy-wide productivity and growth. Moreover, a large proportion of firms are in the informal economy in many developing countries: 41% in developing

Reducing regulatory burdens on market entry encourages formalization. However, by the very nature, the easing of business entry can lead to greater turnover of firms and a higher rate of job separation. Despite the fact that the reform creates jobs in new firms, the easing of entry is likely to have negative short-run demand effects when the higher risk of job loss reduces household’s confidence during sharp downturns, such as occurred during the global economic crisis.

Reforms on taxation in the region are characterized by cutting corporate income taxes. Corporate income taxes are the most harmful to long-term growth but do not typically have large demand-side effects during recessions. Corporate income taxes distort investment incentives by adding a wedge between inputs efforts and outcomes. New empirical analysis illustrated that corporate income taxes have the largest negative effect on GDP per capita, followed by labor income taxes, consumption taxes and immovable property taxes. Thereby, reducing corporate income taxes to strengthen overall tax structure could bring potentially large economic gains. Nonetheless, amid a recession, firms may already pay little or no taxes due to sharp declines of profits. Depending on their expectations, firms may not take into account savings on future tax bills. In this context, cutting the most distortive taxes, on corporate income may have little impact on supply and demand.

The tradeoffs between the long-term and short-term impact of regulatory reforms in the area of trade facilitation are similar. Regulatory reforms in this area aim to reduce financial and time costs for importers and exporters by streamlining border and behind-the-border processes. In general, cost reductions through trade facilitation have a demonstrated impact in increasing bilateral trade flows. New empirical analysis found that a delay of 1 day reduces trade by at least 1 percent. A cross-country study illustrated that improvements in port efficiency and the custom environment significantly enhance trade. However, during a global economic downturn, lower consumer confidence depressed demand for foreign goods and services. Lower prices, through cost reductions alone, are unlikely to be able to improve consumer confidence and boost demands. That being said, reforms in trade facilitation can help countries better prepare to reap the benefits of a recovery.

In several economies, reforms during the crisis were part of a broader reform program

Reform generally consists of two stages: initiating and designing reform, and implementing and sustaining reform. The actual process is more dynamic because the two stages can be intertwined and they share a set of technical, political and institutional constraints. In several economies in the region, the observed regulatory reforms over the global economic crisis are not stand-alone measures nor are they new, radical initiatives. Instead, the governments had introduced more comprehensive programs in the reform areas. The reforms during the crisis belonged to the implementation stage of these programs. However, the sharp economic downturn helped to prompt the governments to take quicker actions.

Regulatory burdens have been identified in studies and surveys as major impediments to doing business in these economies (e.g. the World Bank Investment Climate Assessment studies and the Doing Business Project). Against this backdrop, several governments in the region initiated and designed programs to address these constraints in the early 2000s. Strong political leadership often supported these initiatives, seeking improvements in country competitiveness. In some cases, the governments bundled regulatory reforms together with macroeconomic reforms as a tool to recover from the Asia Financial Crisis.

Malaysia’s business registration reform program is a case in point. The discussion of the reform program was initiated by Prime Minister Mahathir Mohamad’s Cabinet in 1999, and the groundwork was laid out between 2001 and 2003. This was achieved in the context of the government’s broad goal of facilitating economic growth and private sector development. In

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15 This may have to be accompanied by complementary measures to counter any weakening of redistribution through tax system.
2004, a comprehensive reform program took off, covering reform of the institutional and administrative framework, legal framework and IT framework. Similarly, in Indonesia, the business registration reforms were placed high on the policy agenda after the first democratic presidential election in 2004 prepared political support and the successful transition from the IMF program in 2005 provided stable macroeconomic conditions. In 2006, the government issued an investment climate policy package. The package covered reforms in five categories and included business registration reform as a component of general investment policies.

Another example is Indonesia’s taxation reform program beginning in 2001. In the aftermath of the Asia Financial Crisis, fiscal sustainability became a top priority of the government. In the meantime, taxation problems were identified as a major constraint to the business environment. As a result, the government designed the taxation reform program within the context of a fiscal adjustment program with a second objective to improve the investment climate. Two consecutive strategies were formulated to achieve the two objectives: a short-term reform strategy focusing on low-hanging fruits (2001–2003) and a medium-term strategy covering a comprehensive set of initiatives (2004–present). Vietnam’s taxation reforms are also part of a comprehensive program. The reform started with a tax reform plan for 2005–2010. It was endorsed by the Politburo and approved by the Prime Minister in 2004. Within the framework of the program, a new tax administration law became effective in 2007, providing a sound legal basis, designed to eliminate gray areas and replace past inconsistent administrations of different taxes.

The processes of the reform programs in these economies tend to be incremental. Although champions of reforms were often identified in the early stages, strong interest group opposition and weak implementation capacity have inhibited quicker progress, even resulting in reversals. Sometimes the governments designed the programs without clear timelines and specific targets and this tended to slow the process. In this environment, the global economic crisis seemed to have helped push the reform agendas forward.

In the case of Malaysia’s business registration reform program, the government successfully established a new institution, the Companies Commission of Malaysia, to lead the reform. However, the government initially did not set specific targets or a timeline for the program. The implementation was slow over 2001-2008 but it did lead to a more efficient and transparent system incorporating information and communication technology (ICT). Amid renewed pressures to improve private sector during the sharp downturn, the government finally introduced a new one-stop shop to further streamline the business registration system in 2009. It achieved further reduction in the time required to complete the process: the time was cut from 13 days to 11 days.

In Indonesia, the government made notable progress in the business registration reform following the issuance of the policy package: reducing the number of requirements for registration, defining maximum processing times and issuing a new investment law in 2007, which stipulated the principle of equal treatment between foreign and domestic investors. However, the government also took a few steps backwards. Following the enactment of the new investment law, a new negative list was issued which specified areas closed to investment or open with restrictions, increasing restrictions on foreign direct investment in several sectors. In 2008, the minimum capital requirements for registration were almost doubled. Against this background, the sharp decline of private sector activities helped to bring the government back on track. In 2009, the government reduced entry costs by cutting fees (e.g. company deed legalization fees, publication fees, and registration fees) and streamlined the process by introducing online services and eliminating certain licenses. As a result, the costs needed to start a business were reduced by almost 52% of gross national income per capita and the time was cut by 16 days.

21 The five categories of reforms are general investment policies, customs, tax, labor and small and medium enterprises (SMEs).
Indonesia's taxation reform program since 2001 has been led by the Directorate General of Taxation (DGT). The implementation of the short-term strategy successfully created a large taxpayer office within the DGT and introduced a modern, electronic system in tax payment processing. In contrast, the implementation of the medium-term strategy had a mixed record. On the positive side, DGT had rolled out the pilot programs to additional offices, created model tax offices for administering small and medium-sized taxpayers, and introduced new technologies. On the negative side, slower progress had been made in implementing some of the more far-reaching reforms by 2007, such as simplifying the tax laws. The varied quality of implementation reflected the political challenges of sustaining a decade-long reform program over different administrations and the technical difficulties of managing a complex reform program. In 2008, a widely praised income tax law was finally passed, introducing a flat corporate income tax rate of 28% in place of previous progressive rates. The reform was an important step forward towards simplifying the tax laws.

Conclusion

During the global economic crisis, economies in the East Asia region carried out regulatory reforms at full speed, taking advantage of the opportunity. The reforms concentrated on areas where the short-term impact on aggregate demand and supply tends to be small but the potential gains to sustain a recovery and to growth are large. The goal of improving country competitiveness seemed to have dominated short-run concerns in the policy agenda. In several economies, these measures were part of broader reform programs rather than stand-alone, radical responses to the crisis. This helps to explain the long-term focus of the reforms. However, the sharp decline of private sector activities during the economic downturn prompted governments to take more decisive actions. Together with macroeconomic and other structural reform policies, these efforts helped to improve investor confidence in the region and strengthen economies.

Reference


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