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**OPTIONS FOR REFORM OF THE BUSINESS-REGISTRATION SYSTEM:
NEPAL**

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Executive Summary

The governmental purpose of business registration is most often to record information, approve certain activities, and collect taxes. Registration procedures in developed countries typically require much less information from the registrant than do developing countries; applications also require fewer approvals and have lower processing fees.

Entrepreneurs can take full advantage of laws that protect property rights and enforce contracts once they have registered their enterprises, to the extent that such laws are upheld by government. Registration also provides evidence to third parties (e.g., banks) of the existence of an enterprise. For government, registration extends legal status to private sector firms and is a source of statistical and tax collection information.

In Nepal, existing business registration procedures are typical of highly regulated environments in which the government is suspicious of private economic activities. The registration system imposes excessive information and approval burdens, and high fees. One result is that much economic activity takes place outside the boundaries of the legal system in the informal sector. Such a system has several consequences: small firms are discriminated against in favor of large, well-established enterprises; the government loses revenue and information regarding the private sector; and, finally, complex and time consuming registration procedures alter the investment choices of economic agents, and this has consequences for economic growth.

An overwhelming majority of developed and newly-developed countries approach the question of business registration differently than Nepal, requiring less information and making the process less costly for the entrepreneur. Nepal could usefully emulate their experience and adopt solutions appropriate to its own conditions.

The following options, regularly employed in developed countries, indicate how Nepal can streamline existing procedures and lower registration costs:

1. create a single registration authority that has a "decentralized structure";
2. lower, consolidate, or eliminate processing fees;
3. provide for joint public/private review of laws and regulations;
4. simplify the tax system to clearly define tax rates and the tax base;
5. minimize steps required to register;
6. disseminate information regarding simplified registration processes, and the benefits from it;
7. impose time limitations on processing applications;
8. provide recourse to all applicants that have grievances with official decisions; and, finally
9. create structured feedback systems.

Business registration administration currently encompasses multiple agencies at several levels of government that have overlapping jurisdictions. The transition from the present system to the one proposed requires caution to avoid implementation bottlenecks. It also requires extensive retraining of the civil service. Evidence from other countries shows that the more parties involved in the reform, and the more widely disseminated information is, the more successful the reform is likely to be. A tax amnesty is also proposed as part of the reform package.

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1 Introduction

This paper presents options for developing a new system of business registration procedures for Nepal, largely based on similar experiences of other countries, and examines issues crucial for making a transition from the current system to a new one.

Empirical evidence reveals that complicated and time consuming registration procedures are a substantial part of the non-production costs associated with starting a formal enterprise. Current Nepalese law gives several ministries jurisdiction over entrepreneurial activities. In a survey of Nepalese entrepreneurs, Singh (1990) found that two of the most important reasons firms do not register (see Table 1) are (1) the existence of complicated rules, regulations, and laws and (2) administrative red-tape and corruption. Entrepreneur information costs in Nepal are high relative to other countries. Entrepreneurs must invest substantial time and money to learn about specific laws, rules and procedures. They must also expend effort to seek information on how to comply with business registration procedures (i.e., licenses). Costs of entering the formal economy increase each time that entrepreneurs must fill out forms, pay fees, file applications, travel between ministries, or wait in lines. Many Nepalese entrepreneurs have found such costs to be so onerous that they operate informally (Singh, 1990).

Estimates indicate that 45 percent of all of Nepal's economic activity occurs in the informal sector (Singh, 1990). As a result, market locations and exchange systems in the informal sector are well developed. These systems encourage, not hinder, informal economic activity. Complicated procedures to start and legally operate enterprises are absent from the informal sector, as are taxes on transactions.

When entrepreneurs choose to engage in productive activities they operate in either the formal or informal sector. Enterprises in the formal sector have legal rights and responsibilities conferred by organized systems of property and contract. These responsibilities are upheld by a variety of government and non-government institutions. Enterprises in the informal sector operate in an environment where gains from exchange are uncertain because property is insecure and encounters with opportunistic government officials are routine. In such an environment contracts must be self-enforcing, making complex transactions impossible.

Systems of business identification or registration exist in nearly all countries. Information recording, activity approval, and fee payment are common functions of these systems. However, in developed countries such requirements are both less extensive and impose fewer costs on entrepreneurs than in Nepal. Nepal requires enterprises to record more rather than less information, to obtain many approvals instead of few or none at all, and to pay high registration fees. Entrepreneurs must present feasibility studies and project schemes, fill out complicated forms, and follow a labyrinth of administrative procedures. Entrepreneurs are also excluded from any policy process that evaluates costs and recommends new, less-burdensome procedures. Meanwhile, developed countries have reduced or simplified complicated registration procedures.¹

¹Organization for Economic Co-operation and Development, Public Management Studies, Nos. 1 - 3, from the OECD Occasional Paper Series, Paris, 1987 - 1990.

The economic and social reasons for requiring firms to register their activities are very tenuous, except where health, environment, and national security are legitimate concerns. These reasons are tenuous because registration imposes explicit costs for the guarantee of rights that intrinsically belong to economic agents. Collecting taxes on unearned profits or levying fees beyond those needed to maintain the registration authorities are economically unjustified. Governments may, however, have justifiable legal grounds for requiring firms to register. Only governments can extend legal status to firms before, or any time after, they begin operating. This paper contends that business registration should be, at most, a formality that does not hinder entrepreneurs from engaging in the economic activities of their choice.

A distinction should be made between the registration of large enterprises and of small enterprises. Large enterprises are more likely to take advantage of simplified registration requirements than small enterprises. Small enterprises are less likely to perceive substantial benefits to registration. Philippines is a case in point (Quesada, 1989). The government of the Philippines in 1989 introduced a new law, Kalakalan 20, to "promote and develop small enterprises." The law had several components, to (1) define small enterprises (i.e. rural, less than 50,000 pesos), (2) outline registration procedures, and (3) exempt registrants from all taxes (except property taxes and import duties, although firms were expected to comply with minimum wage laws). Results have been less than promising. Simplified registration procedures by themselves cannot be expected to be a strong incentive to informal, small producers to register.

2 Nepal's Current Business Registration System

2.1 Empirical Evidence

One method of assessing the complexity and costliness of registration procedures is to ask informal business owners their reasons for not registering. Table 1 contains the responses of 490 entrepreneurs to the following survey question: "What are your reasons for not registering your business?" The survey was conducted in 1989.

Reply (1)	Total* (2)	Manufacture* (3)	Service* (4)	Trade* (5)	Transport* (6)
Business Unit too Small	63%	62%	65%	71%	32%
No Perceptible Advantage	21%	19%	20%	21%	42%
Business not Sufficiently Profitable	9%	8%	8%	14%	3%
Monetary Cost too High	6%	4%	6%	8%	3%
Excessive Red-Tape & Corruption	23%	26%	22%	21%	13%
Cumbersome Rules & Regulations	34%	36%	25%	47%	39%

Notes: *Percent of all respondents (490).
 *Percent of respondents in each sector.
 Source: S.L. Singh, 1990.

Column 1 contains replies to the survey question. Each respondent could cite **more than one** reason for not registering. Column 2 shows the percent of respondents who thought the category corresponded to one of their reasons for not registering. Sixty-three percent of all respondents thought their enterprise was too small to register. Twenty-one percent thought that there would be no advantage to registering, and 9 percent said that their business was not profitable enough. Altogether, 93 percent of the respondents attributed their reasons for not registering to misinformation about the objectives of registration (i.e., registration is unconditional). The remaining reasons for not registering concern the current system of registration and its administration. While only 6 percent of respondents said that monetary cost was a significant reason for not registering, 23 percent cited red tape and corruption, and 34 percent cited cumbersome rules and regulations as reasons for not registering.

Columns (3) through (6) in table 1 group entrepreneurs' responses by sector. Except for transportation, the responses between sectors are largely similar. The reason most often cited for not registering in the manufacturing, services, and trade sectors is that the business unit was too small (62 percent, 65 percent, and 61 percent for each sector respectively). The next prevalent reason for not registering in those sectors is due to cumbersome rules and regulations (36 percent, 25 percent, and 47 percent for each sector), and the third reason is that there was no perceived advantage to registering (36 percent, 25 percent, and 47 percent for each sector). In the transportation sector the reason most often cited for not registering is that there was no perceived advantage to doing so (42 percent of respondents), the second is cumbersome rules and regulations (39 percent of respondents), and the third reason is that the business was too small (32 percent of respondents). Another reason entrepreneurs gave for not registering is the existence of excessive red tape and corruption (13 percent of respondents). Since the percentage of entrepreneurs in the transportation sector citing red tape and corruption as a reason for not registering is smaller than in other sectors, it is possible to conjecture that registration procedures affect economic sectors differently.

In spite of the troublesome nature of Nepal's business registration system the number of registered firms do correspond broadly with measures of aggregate economic activity. Table 2 contains the number of registered firms in cottage and small industries and medium and large industries between 1985 and 1989. See table 2 below.

	1985/86	1986/87	1987/88	1988/89
<i>Cottage & Small Industries</i>				
Private Firms	683	922 (35)	758 (-18)	592 (-22)
Private Limited	32	37 (16)	39 (5)	43 (10)
Partnerships	195	373 (91)	228 (-39)	74 (-68)
Total	910	1332 (46)	1025 (-23)	709 (-31)
<i>Medium & Large Industries</i>				
Public Limited	9 (13)	12 (33)	-	-
Private Limited	274 (20)	342 (25)	366 (7)	-
Partnership	56 (-47)	85 (52)	97 (14)	-
Proprietorships	441 (8)	516 (17)	565 (9)	-
Total	780 (4)	955 (22)	1028 (8)	-

Source: Statistical Pocketbook: Nepal, 1991

A very high rate of change is observed in the number of registered firms in both cottage and small industries and in medium and large ones in 1986/87. The rate of change drops in 1987/88. What is impressive in these figures is the magnitude of the rates of change, being at times very large and at times extremely small or negative. There is a similar trend for cottage and small industries in 1987/88 and 1988/89.

Aggregate economic activity is measured by examining Gross Domestic Product in current prices, agricultural and non-agricultural share of output, and currency to money supply. The latter measure can be used as a broad indicator of informal-sector activity. See table 3.

	1985/86	1986/87	1987/88	1988/89	1989/90
GDP (Bill. of Current Rps.)	44.4	50.4	57.8	67.8	74.6
Rate of Change in GDP (%)	12.6	13.5	14.7	17.3	9.9
Share of GDP					
Agriculture	-	53.2	52.8	52.5	63.8
Non-Agriculture	-	46.8	47.2	47.5	36.2
Rate of Change Sectoral Output (%)					
Agriculture	-	-	14.03	16.56	16.6
Non-Agriculture	-	-	15.4	18.3	2.4
Ratio of Currency to Money Supply (C/M1)*					
Nepal	0.73	0.73	0.74	0.73	0.72
Korea	0.43	0.40	0.42	0.41	0.41
Spain	0.35	0.35	0.34	0.34	0.34
United States	0.36	0.35	0.37	0.38	0.38

Note: * See also Figure 1 below
Source: Statistical Pocket Book, 1990; International Financial Statistics, February 1992

GDP in current prices rose steadily in the 1985-1989 period at an average annual rate of 13.62 percent, with a maximum annual growth rate of 17.3 percent in 1988. Although the shares of output between agricultural and non-agricultural sectors were stable between 1985 and 1988, in 1989 agricultures' share of output increased. The growth rate of non-agricultural output increased by 15.4 percent in 1987, 18.3 percent in 1988 and only 2.4 percent in 1989. The overwhelming increase in number of firms in 1986/87 (see table 2) preceded the large growth rate of non-agricultural output in 1988. Similarly, the large drops in the number of cottage and small industries in 1987/88 and 1988/89, as well as the very slow growth rate of 1987/88 in medium and large industries, preceded the lower growth rate of non-agricultural output in 1989. Possibly these fluctuations in the number of firms and growth in non-agricultural output are related, but the relationship is tenuous. The only conclusion that can be drawn is that the number of registered businesses in Nepal does not accurately reflect the actual economic activity of all firms.

Figure 1 shows the rate of change of newly registered firms and the non-agricultural GDP deflator for the years 1987/88 -1990/91. The figure confirms the observation that there is large variability in the growth rate of the number of firms. Also, the figure indicates that growth in the number of firms is unrelated to non-agricultural output. In developed countries change in the number of firms is sensitive to economic output. By contrast, in Nepal growth in output seems to be unrelated to the decisions of entrepreneurs to register their firms. Again, due to the small number of data points conclusions are tentative.

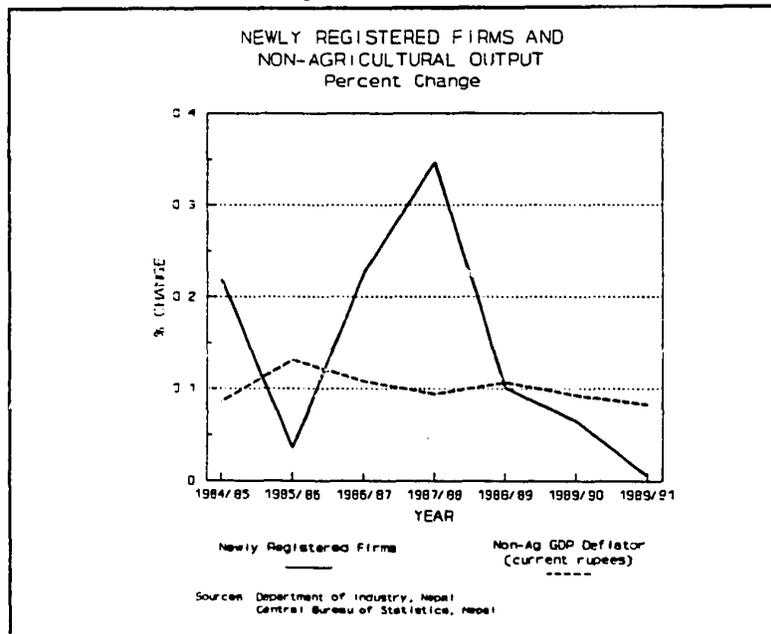


Figure 1

The ratio of currency to money supply is often used to measure the size of the informal sector in an economy. This ratio does not measure the size of the informal sector in absolute terms; consequently, data for Nepal is compared to data for other countries. Observe figure 2 below.

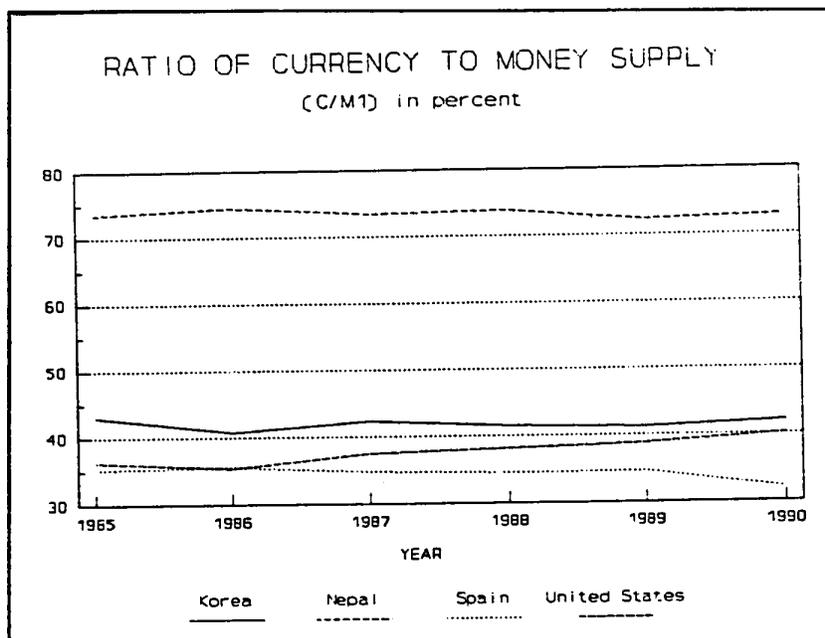


Figure 2

The currency to money supply ratio is substantially lower for the countries that are thought to have very small or nonexistent informal sectors. The ratio averages 0.73 for Nepal, 0.41 for Korea, 0.34 for Spain, and 0.37 for the United States during the period 1985 to 1990. The size of Nepal's informal sector, then, seems relatively large and stable.²

Data in Table 3 suggests that Nepal has not experienced substantial fluctuations in formal or informal economic activity enough to justify the variability displayed in the number of registered firms. Hence, reform of the business registration system ought to be undertaken as a step to expropriate informal economic activity, provide more accurate information on entry and exit, and provide better tax information. While an efficient registration system may not cause rapid economic growth, it can promote greater formal economic activity.

Economic effects of liberalizing the regulatory environment are vividly shown in Figure 3. Figure 3 presents the percent change in reported production from the previous year for goods in six industries. The six industries are sugar processing, tea processing, cotton textiles, leather goods manufacturing, cement manufacturing, and jute goods production. In 1988/89 the government removed industry-specific licensing requirements on sugar, tea, cotton textiles, and leather goods. Production of cement and jute goods, meanwhile, continued to require licenses. The following year, for those industries where licenses were eliminated production jumped, while production stagnated or fell in the industries that still required a license.

²A more accurate measurement of the currency to M1 ratio would take into account the number of Indian Rupees in circulation in Nepal but, unfortunately, such figures are not presently available.

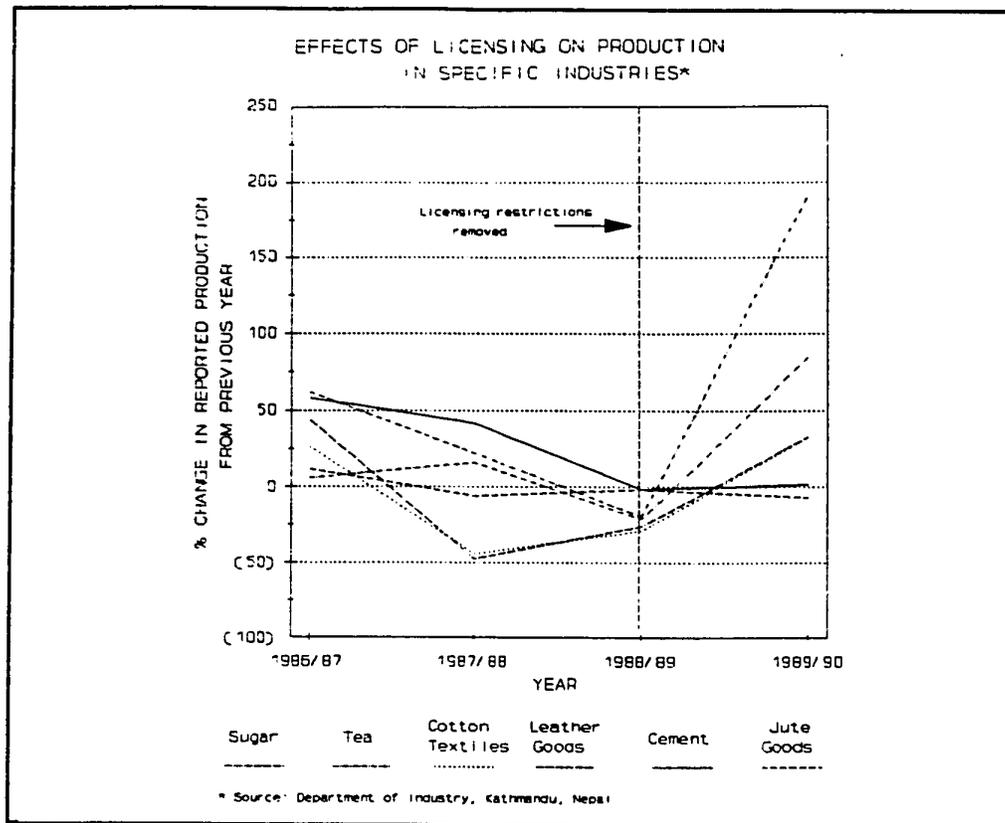


Figure 3

Although Figure 3 refers specifically to the removal of licensing restrictions, it supports the argument that eliminating or simplifying regulatory requirements for business registration could lead to productivity improvements. There are two possible explanations for why production has increased in the liberalized sectors; first, production that previously was hidden is now being reported or, second, licensing requirements had constrained production and, with their removal, production increased.

2.2 Requirements for Business Registration

Before beginning formal operations as a legal business enterprise, a Nepalese entrepreneur must declare the business's industrial classification. The permits, licenses and procedures required of the entrepreneur depend on the industrial classification of the enterprise.

2.2.1 Industrial Policy Act of 1987³

Currently, industries are classified according to the Industrial Policy Act of 1987 based on fixed capital investment, energy utilization capacity, and local raw material consumption.

³At the time of writing the government announced its new Industrial Policy of 1992. The details of this new policy and its extent of divergence from the Industrial Policy of 1987 are not yet known.

The four categories of the classification are: cottage, small, medium, and large industries.

According to the 1987 Act, all firms must register -- cottage industries with the Department of Cottage and Rural Industries and all others with the Department of Industry. Registered firms that need foreign exchange to buy imports or earn foreign exchange from exports must reach specific levels of domestic value-added in their operations -- 10 percent value-added for firms exporting more than 50 percent of output and 15 percent for firms engaging in all other activities. Firms failing to meet these requirements are denied access to foreign exchange. Retroactive taxes on personal income may be demanded (for any number of years) before a firm can register. Whether such taxes are sought depends on the sector in which the enterprise will operate and on the discretion of the registration authorities.

Except cottage industries, all industries must submit numerous applications to several ministries, depending on the firm's classification. Ministries with jurisdiction over some aspect of registration include the Ministry of Industry, Ministry of Commerce, Ministry of Finance, Rastra Bank, Ministry of Forestry, and Ministry of Soils. Registration must be done in person at all locations. To register, these ministries require entrepreneurs to, at a minimum, submit the following documents:

- a. Feasibility report,
- b. Project scheme,
- c. Memorandum of Association,
- d. Articles of Association,
- e. Bank loan certificate if the project is financed by bank credit (it is difficult to get a loan without being registered).

2.2.2 Costs of Registering

The major business registration costs include:

(a) Information costs: as the number of government agencies with jurisdiction over registration increases so will the number of forms and signatures required of the entrepreneur, and the higher will be the cost of finding out the appropriate steps;

(b) Transportation costs: all government agency headquarters are located in Kathmandu, any entrepreneur wishing to submit an application form to the appropriate ministry faces the cost of travel to the capital. The more centralized the registration system is the greater the transportation costs will be for non-Kathmandu residents;

(c) Opportunity cost of time: entrepreneurs' time away from their enterprises means less time to organize their activities and, perhaps, loss of income;

(d) Taxes: two kinds of taxes may be collected during enterprise registration: first, stamp duties and processing fees for applications and, second, retroactive taxes on personal income and profits. Only items (b) and (d) represent financial costs; however, information costs and the opportunity cost of time are factors that entrepreneurs will also consider in their decisions to register.

The above evidence (section 2.1) and case studies (Adhikari, 1991) strongly suggest that business registration requirements are exceedingly cumbersome, sometimes taking years to register a single medium-sized firm. Recently, the government took steps to simplify some registration procedures, particularly those governing foreign-joint ventures. By international standards, however, even these simplified procedures are complex (David, 1991). The new

government recently stated that the private sector will lead the country's development in the next five years. If Nepal is to encourage productive investment in its private sector, formal business registration must be simplified and promoted.

Registration costs are important determinants in an entrepreneur's decision to operate formally or not. However, changes in a registered firm's long-term profit structure may also be important. That is to say, if the costs of registering were negligible and the process was simple, one could envisage scenarios in which the number of registered firms remained relatively small. For example, a firm that registers would be displaying irrational behavior if the tax rate on profits is prohibitively high, unpredictable, or unrealistic (our current understanding of the tax structure is that there is no written corporate tax code and the rule of thumb is that the tax on profits is an increment over the previous year's tax bill), since it would be exposing itself to a possibly unsurmountable tax liability. Another scenario is one where firms that operate informally may, by registering, commit themselves to the costly procedure of applying for yearly governmental approvals for their activities.

The distinction between the up-front cost of registering (information costs, stamp duties, etc.) and profit structure changes that result from registering is an important one. Although an entrepreneur may make both distinctions when deciding to operate formally or not, this paper explores only the up-front costs. However, changes in the profit structure may deter an entrepreneur from registering or even from starting an enterprise.

Licensing

In addition to registering, many firms must also obtain trade or occupation-specific licenses before beginning legal operations. Cottage industries do not require such licenses (though they must be registered).

Other

Besides the central government, local and district government agencies impose extra requirements on entrepreneurs. These extra requirements may include, for instance, retroactive taxes on personal income. Unfortunately, little is known about local and district government registration requirements.

2.2.3 Benefits of Registering

As discussed, registration is very costly under the current regulatory regime. Although exact figures are lacking, preliminary research estimates that the registration process takes approximately six months for a medium-sized industry, requires many signatures, and costs more than 250,000 rupees (U.S. \$5,000).⁴ These costs are quite beyond the means of many entrepreneurs. For such entrepreneurs the rational choice is to not register and suffer the consequences of any possible penalties.

Eight reasons explain why registering a business is necessary for enterprise growth and productivity under Nepal's regulatory system.

(1) Unregistered businesses cannot directly export goods or services. At present, only intermediaries (merchandisers or traders) can export goods or services produced by unregistered businesses. Only registered firms can use Customs facilities. Consequently,

⁴These estimated costs are taken from research done by Surrendra Adhikari and Krishna Paudyal on the costs of business registration.

unregistered firms cannot get hard currency nor can they receive customs drawbacks for the imported inputs that they re-export. Instead, intermediaries earn hard currency and keep customs drawbacks. For instance, Nepalese artisans have to buy bronze or other metals, used in sculpting, from commodity merchandisers. These merchandisers then re-export the finished products to consumers in Japan, Hong Kong, and Singapore.

This situation effectively suppresses producer prices for exportables. Additionally, foreign exchange earnings are possibly less than they might otherwise be. Owners of unregistered firms claim that there are many unregistered firms not presently exporting that would if given the opportunity.

(2) Unregistered businesses cannot import raw material or other inputs at international market prices. Such firms must purchase their inputs from intermediaries who have access to customs facilities and foreign exchange. These restrictions effectively increase the prices that unregistered firms pay for imported inputs, thereby affecting Nepalese products' competitiveness in international markets and raising prices to Nepalese consumers.

(3) Unregistered firms cannot participate in foreign exchange auctions, receive hard currency at the official exchange rate or at the partially convertible rate. An enterprise must be registered or individuals must prove their taxes have been paid to qualify to receive hard currency. These policies effectively increase the cost of hard currency to unregistered firms who must then buy hard currency from secondary sources.

(4) Unregistered businesses are very restricted in their use of electricity. The government, as the sole provider of electricity, regulates commercial users differently than other users. Commercial users have priority in the distribution of electricity during times of peak demand. As a result, production is often disrupted in unregistered firms or they must make arrangements to illegally tap into the electric grid.

(5) Unregistered firms are denied access to land that is designated for commercial use. Such land is often more developed than land in other areas and has better facilities. Consequently, unregistered firms must invest greater resources than registered firms in securing space, water, power, etc.

(6) Unregistered businesses cannot purchase foreign technologies that could improve their productive processes. The government must approve the import of many foreign technologies sought by registered firms, regardless of the exchange rate that is used (i.e., official, auction, or partially convertible). Unregistered firms seeking to acquire foreign technologies must purchase them from secondary sources at prohibitive prices.

Two reasons why, in general, registration is important are:

(7) Unregistered firms cannot legally obtain credit from formal credit markets nor can individuals obtain formal credit without demonstrating their taxes have been paid. This policy effectively increases the cost of raising capital for unregistered firms by increasing its scarcity relative to registered firms.

(8) To the extent the legal system upholds contracts and other agreements, transactions by unregistered firms are not secure or protected. Consequently, such enterprises may be prevented from diversifying, specializing, or achieving greater scale economies.

Registered firms, in principle, can export goods, import raw-materials and foreign technology, and directly access hard-currency markets. Access to undisrupted supplies of electricity and commercial property, while less certain, is at least possible. Registered firms

can seek bank credit and their contracts are secure to the extent that the legal system enforces them. Simplifying and eliminating business registration requirements can be considered a substantive reform.

3 Options to Develop a New Business Registration System

3.1 Features Common to Reformed Business Registration Systems

Developed and developing countries employ a set of reform options to simplify business registration. These options have many features in common. A primary feature is that the options reduce or eliminate many requirements and simplify many more. As a result, these countries impose reasonable requirements to record information, seek approvals, and pay fees. Improving the registration system also reduces the disproportionately large information costs born by small firms.

Options most often employed to reduce and simplify registration requirements and procedures follow. They address the need to (1) remove redundant and costly policies, (2) improve implementation practices, and (3) halt poor enforcement. The options are:

I. Reduce unnecessary requirements

1. Create one registration authority that has a "decentralized" structure (i.e., a central administrative agency with local branches).
2. Lower, consolidate, or eliminate processing fees.
3. Provide for joint public/private review of laws and regulations, prior to their becoming policy.
4. Ease restrictive tax policies that discourage business registration.

II. Improve implementation

1. Simplify and eliminate steps.
 - a) Simplify forms
 - b) Coordinate information requirements
 - c) Provide registrants with proof that official transactions have taken place (to verify dates, payment of fees, etc.)
2. Disseminate information on registration benefits and responsibilities.

III. Provide recourse for governmental non-compliance with standards

1. Impose time limitations on processing applications.
2. Create structured feedback systems from the public to government officials.
3. Provide recourse to all applicants that have grievances with official decisions.

The principles that countries follow to reform their business registration are often similar. However, specific reform mechanisms often differ. For instance, in some countries public institutions register new businesses, while in other countries private institutions register businesses. France uses "Formality Centers," that consolidate the various administrative requirements for businesses that are created, modified or closed. These centers are a type of "one-stop shop" that integrate administrative procedures. They are usually located in the Chambers of Commerce and Industry or other professional institutes to increase accessibility. In Finland, the registration of small and medium enterprises (SMEs) has been simplified by

re-organizing government administration. Instead of creating a single, local one-stop shop, regional offices have consolidated local and central government offices. Application procedures also vary between countries. In the U.S., for instance, entrepreneurs can receive formal status by mail through filing federal, state, and local tax forms and applying for a federal identification number; there is no registration requirement *per se*. In other countries businesses must register with government authorities to receive legal status.

3.2 Characteristics of a New Business Registration System for Nepal

3.2.1 *One registration authority with a "decentralized" structure*

Government extends legal status to and, subsequently, regulates the operation of enterprises. To register a business in Nepal an entrepreneur must obtain approvals from three separate administrative levels. Local government officials require the equivalent of an "operating permit". The district administration, in turn, requires licenses for certain economic activities. Finally, central government offices in Kathmandu must register the business. Further, municipal and district governments may duplicate information that the central government requires. Such duplication is unnecessary and further burdens entrepreneurs and government officials.

Purportedly, local government permits are easy to obtain and are equivalent to a floor-space tax: Standing shops pay minimal taxes while mobile vendors are exempt. District governments require businesses to pay a small tax on signs when registering. Municipal and district government policies, however, vary widely from one location to the next. By contrast, the central government registers and regulates business operations.

Enterprises that operate in multiple districts face increasingly complex conditions as they locate, grow and expand, in new jurisdictions. Decentralization is complicated by these numerous jurisdictions and their separate registration requirements.⁵ Central administration of all registration procedures may increase efficiency in Nepal. Particularly because regulations between jurisdictions is seldom uniform. Nepal's Octroi system of internal tariffs is a notorious example of the results of a lack of central coordination.

Developed countries have created business registration systems in which one agency or "window" has sole authority to inform and register applicants. Such systems create national standards that avoid overlapping layers of requirements. These "windows" may employ a "localized" structure; that is, local or regional access is a chief feature of the system. Such a system decreases entrepreneur costs by lowering the burden of compliance. Costs are also lowered because the task of seeking information about how to register is simplified (itself an important disincentive, see section 2).

Numerous countries have experimented with variations of "one window" business registration systems. Their experience shows that systems comprising a single, registration authority work and are widespread. Some experiences follow (for more detailed information

⁵The State of Colorado, Office of Regulatory Reform, has made significant advances toward resolving issues of decentralizing authority while improving inter-jurisdictional coordination. Each jurisdiction must provide the State office with comprehensive information on the requirements that new businesses must fulfill before their operation can begin. This information is computerized for easy access. Hence, requirements for operating in any jurisdiction are available throughout the State.

see the OECD Public Management Series, 1987 - 90):

Australia: Entrepreneurs can obtain the permits and approvals they need to register their businesses at one location, free of charge. They can also get any other information they might need such as copies of relevant forms. Trained staff are available to discuss regulatory requirements and to access a data base which includes industry-specific information. This service has resulted in substantial savings to the private sector.

Austria: The Federal Ministry of Economic Affairs has established a "Citizen Information Service" that guides and informs the public on private sector regulations.

Canada: The government is creating a new one-window system and is encouraging the private sector to play a lead role in the system's development, operation and financing. In this system non-governmental organizations compete to register firms.

Portugal: Entrepreneurs investing in the tourism sector can now present a single document to one office for approval (not an optimal arrangement as government is still in the business of approving private investment decisions). There are more ambitious plans to establish "mediation services". These services, authorized to act for central and municipal administrations, will issue licenses and permits to the public and businesses, as well as inform them about regulatory procedures.

Spain: A "single-counter" -- the Management Center for Enterprise Creation -- has been established to consolidate in one location the formalities required by all levels of government to set up an SME. The Center seeks to alleviate problems of geographical dispersion and bureaucratic delays in setting up or creating new businesses. The Center receives applications, handles procedural matters, and notifies those concerned of the decision taken.

Turkey: Legislation was passed recently to simplify the procedures for issuing licenses to entrepreneurs. Previously, entrepreneurs applied to numerous authorities and filled out many application forms; these procedures consumed both time and money. The new legislation has greatly simplified matters. Applicants can now submit a single application form and receive prompt authorization.

3.2.2 Lower, consolidate, or eliminate processing fees

Many countries have lowered or eliminated processing fees to encourage business registration. Such a step may not be possible in countries where budgetary constraints demand that fees remain unchanged (that such fees yield much revenue is doubtful). Even in countries such as these, however, the entrepreneur can benefit from consolidated fees. Frequently, registration applicants must pay municipal fees, district or regional fees, and central government fees before their files are processed. Registration fees should be consolidated and their total amount stated explicitly; explicit fees may have the added benefit of discouraging bureaucratic discretion.

Business registration fees in Nepal are excessive when compared to fees levied in

most developed countries. Interviews (Adhikari, 1991) with business registrants reveal that the cost of registering a small industry (inclusive of studies and reports), can be as high as Rupees 150,000 (approximately \$5,000); this cost is not inclusive of any bribes, which are often necessary parts of the transaction. In developed countries business registration fees rarely exceed \$500.

Lowering or eliminating fees may cost the government revenue in the very short term; however, economic reasoning suggests that tax receipts from new enterprises and personal income will be much more important to the Nepalese government in the long term. The cost to the economy of lost business formation is probably much greater than income from registration fees. At a minimum, all fees associated with business registration should be consolidated; there should be one fee (preferably user, i.e., a direct charge to cover service costs) and no hidden costs. Making all fees explicit can improve enforcement against corruption by eliminating some opportunities for corrupt officials.

One potential reform is to abolish administrative charges; for instance, stamp duties on administrative documents, used by many countries, can easily be eliminated. In Nepal stamps must be affixed to many administrative documents. Revenue obtained from stamp duties is generally insignificant. Spain, for instance, recently eliminated stamp duties without a significant loss of revenue.

Processing fees should not be a source of tax revenue. Rather, they should reflect the cost to users of the business registration services provided by government. The program of registering businesses could be self-supportive.

3.2.3 Joint public/private review of laws and regulations

The government can use joint private/public review of business registration laws and regulations to evaluate their effect on the private sector. Such reviews can identify potential problems before policies are implemented. In some developed countries public/private reviews have been particularly successful in identifying ways to simplify procedures and eliminate steps. Similar reviews seem not to have been used, however, in assessing the costs or benefits of new legislation. (Presumably, private sector interests are well represented in advocating legislation that is likely to affect them.)

Some countries' experiences with joint private/public review are related:

- France has established a commission specifically to review legal texts and simplify procedures; representatives have been chosen from both the public and private sectors.
- The U.K. initiated local liaison meetings in which senior government staff from local offices meet informally once a month with private-sector representatives to discuss regulatory issues.

Similar review mechanisms could be implemented in Nepal. The resources required for such activities are small. Government can make prominent gains by encouraging joint reviews. These gains may include better understanding of each others' situation and laws or regulations based on more realistic assumptions.

3.2.4 Tax simplification

Developed countries have solved many tax problems that act as barriers to efficient markets. In Nepal, businesses cannot be taxed until the government recognizes their formal status, but personal incomes are often taxed retroactively. The government levies such retroactive taxes on personal income to recoup revenue that it suspects entrepreneurs have earned before their businesses were formally recognized. Such a practice is a disincentive to entrepreneurs who seek formal, legal status for their enterprises. Further, tax assessments on new firms are sometimes inaccurate or arbitrary and entrepreneurs cannot contest the results. Taxes can be simplified, amnesties can be offered, or retroactive taxes on personal income can be eliminated to induce entrepreneurs and firms to operate as formal entities.

Entrepreneurs in Nepal claim that tax collectors do not assess taxes uniformly but, often, arbitrarily and at their own discretion. For instance, annual income tax assessments are often adjusted at an arbitrary, fixed rate based on presumed annual income growth of 3 percent, no matter if the enterprise has made profits or losses (Jha, 1991). Such a practice inhibits entrepreneurs' willingness to disclose information and encourages tax fraud and evasion. Furthermore, it is possible that such arbitrary taxation policies have contributed to excessive financial burdens on some businesses, perhaps to such an extent that they fail or revert to informality.

It is likely that the indiscriminate nature of tax assessments forces some registered businesses to engage, partially or completely, in informal/unregistered transactions; that is, transactions that take place outside legal jurisdiction. Such tax policies may also discourage entrepreneurs from registering their businesses. The strength of informal economies in Italy and Spain has been linked to similar tax policies (Turnham, et al., 1990).

Many OECD countries have restructured their tax-policy information programs to give firms clear explanations of tax requirements at the time they register their businesses. In Nepal, the greatest step the government can take to improve entrepreneurs' understanding of commercial tax requirements would be to simplify the currently complex and detailed requirements.

3.2.5 Minimize Steps Required to Register

Many governments reform business registration procedures by simplifying and eliminating steps. Simplifying and eliminating steps may require reforms that rationalize the laws governing registration, reduce the amount and types of information required, consolidate and harmonize procedures at different jurisdictional levels, and require separate government departments to share information. Minimizing registration steps also makes implementation and monitoring easier for government officials.

Eliminating steps, including the number of forms, is an obvious starting point for reforming Nepal's business registration procedures. Registration procedures often duplicate requirements and forms often duplicate information. For instance, at one time the Ministry of Industry required eight forms and two studies to register a business; other ministries have similar requirements that requires entrepreneurs to divulge nearly identical information.

Besides simplifying forms and coordinating information requirements, providing applicants with proof of official transactions, for instance by giving dated receipts, is a reform that can improve bureaucratic accountability. Proof of transactions can be a cornerstone in

building a system of checks and balances. One illustrative example of this reform comes from Spain. Any citizen can request that an administration official provide a receipt for a service. The receipt must contain the date of submission of the application, the regulation applying to each case and, where appropriate, the application of the "administrative silence" rules. "Administrative Silence" rules ensure that, if there is no communication to the contrary, acceptance will be automatic within a stipulated time limit.

3.2.6 Disseminate information on registration benefits and requirements

In many developing countries information on registration procedures is scarce; consequently, the costs of seeking information are high. Seldom is information consolidated and disseminated from widely accessible locations. Registration information is not just scarce for the entrepreneur seeking to legally operate a business, however, it is also frequently unavailable to the registration officials. Such officials often lack manuals or codes that specify the appropriate procedures that they are expected to follow; or, worse, such procedures do not exist and are instead left to individual discretion.

One of the easiest and most effective government reforms is to provide entrepreneurs and administrative personnel with information on specific registration procedures. Problems of literacy can be overcome by disseminating explanations on registration procedures via vocal media, e.g., radio broadcasting. A couple of experiences from OECD countries' efforts to disseminate information follow:

- Spain conducted local information campaigns using mobile dissemination programs. Because of the program's success, mobile information stands are now widely used and are well staffed. The program was widely publicized in brochures, posters, radio programs and official channels.
- "Who Answers What in Central Government?" is a government information service publication in Norway. It is a companion volume for civil servants and is published annually. The volume is a fully referenced index to both central and local administrations. The volume is primarily targeted to civil servants, but is also available in commercial book stores.

Nepal can undertake similar dissemination campaigns. Some ministries already have experimented with mobile dissemination campaigns, particularly in rural areas (Humphrey, et al.). Efforts to disseminate information on registration procedures outside the Capitol need not be expensive. Although, they should specifically target owners of small firm who may want to register. Similar means can be used to educate civil servants on the important role they play in Nepal's private-sector led, economic growth. Such information campaigns may influence existing negative attitudes of some government officials toward the private sector.

3.2.7 Set application approval deadlines

Setting application approval deadlines is one means of forcing a bureaucracy to respond in a timely manner, thereby improving implementation. Deadlines effectively transfer responsibility for processing applications from the entrepreneur to government officials.

Developed countries have adopted such measures widely.

Seldom do bureaucrats have incentive to reduce delays in processing applications. Expeditious processing strains their resources (Lipsky, 1980). Monitoring costs, the costs of enforcing bureaucratic performance, would further strain resources. In response, some countries have instituted "positive administrative silence" measures (defined in section 3.2.5).

Spain has successfully experimented with the use of deadlines. Spain's Federation of Municipalities, its State administration, and the Autonomous Community of Madrid have established a "Single Management Center" (referred to in section 3.2.1) to simplify businesses registration. These regulatory agencies approved a decree to take urgent steps for administrative, financial, fiscal, and labor reforms. This decree provides that, absent governmental objections, applications to establish, transfer, or expand businesses will be granted by "positive administrative silence". The agencies must approve all applications within two months from the date of submission, provided that legal requirements are met.

3.2.8 Provide recourse to applicants

Registration procedures can be improved by making recourse available to applicants who wish to contest administrative decisions. In many countries entrepreneurs complain that there is no recourse to an impartial authority. Impartial authorities are important because they can provide checks and balances to arbitrary behavior by government officials. Lacking such checks and balances, the opportunistic behavior of officials can drive firms into informality and deprive the government of revenue.

Many countries have taken measures to improve individual recourse. Almost all such measures involve reforming or creating independent bodies that provide the public impartial advice, on one hand, or impartial rulings on their interests. By adding these checks and balances governmental policies, implementation, and enforcement improve. An overwhelming majority of developed countries employ some combination of the following measures;

Measures that improve policy include:

Legislative Action: Legislation has been passed to provide fast and impartial reviews, thus safeguarding the public interest, e.g., Administrative Decisions Act (Netherlands), Public Administration Act (Norway).

Measures that improve implementation include:

Administrative Appeals: Bureaucrats are obligated to explain decisions, and all responses to applicant inquiries must be made within a limited period of time. These responses can then be used in appeals (Australia).

Targeted commissions, councils and boards: Targeted commissions, councils and boards serve as venues for entrepreneur complaints; examples include the Tax Appeal Commissioners in Ireland and the National Board of Trade and Consumer Interests in Finland.

Counseling and advisory agencies: Counseling and advisory agencies offer free or subsidized advice on legal or financial matters.

Measures that improve enforcement include:

Ombudsmen: Ombudsmen are responsible for specific areas of government activity or

for examining complaints citizen complaints. Ombudsmen are given authority to review appeals and overturn decisions in many countries.

Appeal courts and tribunals: Appeals courts and tribunals make judgements on individual cases; some examples include the Administrative Appeals Tribunal (Australia), Consumer Appeals Board (Finland), Auditor General's Department (Spain), regional administrative courts (Turkey).

Internal controls: Internal control mechanisms ensure that government activities are consistent with legislation and identify and eliminate irregularities, e.g., the U.S. General Accounting Office.

Nepal could adopt any of these administrative control measures. Joint public/private review of any decision to adopt such measures would likely lead to more appropriate administrative controls.

3.2.9 Create structured feedback systems

Structured feedback mechanisms improve two-way communication flows between the government and citizens. Also, they enable government officials to assess the efficiency and costs of legislation and regulation. Creating structured feedback systems is a positive step that governments can take to improve policies, in particular, and to improve implementation and enforcement.⁶ Most structured feedback involves providing advice and information by government and instituting mechanisms to receive complaints, suggestions, and inquiries from citizens. By seeking feedback from citizens on proposed reforms to the business registration system the government can be more certain that appropriate policies and procedures are adapted.

Methods, adopted in many OECD countries, to ensure structured feedback and improve policy performance include:

- soliciting citizens' comments on proposed and draft legislation;⁷
- public hearings;
- non-statutory public notices (Ireland) inviting objections or comment on Ministerial measures;
- public opinion surveys;

Methods of structured feedback that specifically improve implementation and enforcement include:

⁶Hammergren, Linn A., Development and the Politics of Administrative Reform: Lessons from Latin America, Westview Press, Inc.: Boulder, Colorado, 1983.

⁷ For instance, in Austria the Office of the Lower Austrian State Government must send a copy of most draft laws and regulations to the counselling services of the Office and to the counselling services of all district administrations to permit comments. Such legislative drafts and proposals must be accompanied by explanatory notes and a deadline for comment. Copies and information on commenting procedures are available for public inspection and sale.

- "Regional Users Committees" (such as those used in France) that explain administrative procedures and regulations in simple terms, promote two-way exchanges of information, and collect suggestions;
- private individuals' review of government forms for comprehensibility and appropriateness (France);
- reaction cards and suggestion books (Norway & Sweden);
- citizen hot-lines to high-ranking officials (Spain);
- radio call-in/suggestion programs.

While some of these feedback mechanisms are inappropriate for Nepal, most of them are inexpensive and easily implemented. Specifically:

- Public hearings on draft legislation, in the form of open debates or questions and answers, encourage public participation in the registration reform process. Notices of pending hearings can be made in advance to allow time for public comment.
- Awareness of pending legislation and public hearings can be increased through media publications, radio announcements, and public posting of pending legislation and hearing dates. Parliamentary representatives can be encouraged to solicit and respond to feedback.
- Government can contract private-sector firms, at low cost, to conduct public opinion surveys. Similarly, the Government can make grants to university groups for the same purpose.
- "Regional Users Committees" can be incorporated into business service organizations such as the Rotary or local Chambers of Commerce or similar, non-government institutions. Procedure simplification and codification logically precede the formation of such committees.
- Before introducing new forms, test samples can be distributed among business persons for review and recommendation to ensure appropriateness.
- Some ministry offices already use suggestion boxes; this should be continued where they have proven useful and should be encouraged where they have not yet been tried. If suggestion boxes or similar means of feedback are to be effective, a system must be in place for evaluating suggestions for their possible implementation.

Nepal may not yet be ready for some feedback mechanisms. For instance, hot-lines and radio call-ins are not likely to be practicable in Nepal for some time given the state of the country's telecommunications infrastructure.

The previous options to reform business registration systems are mostly uncomplicated and may not require specific legislative action (except, perhaps, tax simplification). Following are two more reforms, systemic in nature, which are likely to require more concerted efforts to effect change.

3.2.10 Licensing and jurisdictions

Licenses are most often justified as a way of promoting product safety and quality for

the consumer. However, make no mistake, licensing individuals for occupational competence imposes costs on entrepreneurs or taxpayers, depending on who pays the tax bill and who bears the burden of the tax (licenses, after all, are in effect a form of tax). In either case, license administration requires a bureaucracy and, consequently, a source of revenue.

Research on licensing in the United States reveals that legislation to introduce occupational licenses is usually initiated by agents already active in that occupation. Their concern is to protect themselves from competition. Comparisons between similar sectors -- those that require and do not require licenses -- show that the licensed sectors have higher prices and lower quality products (Hood, 1991).

For these reasons, policies that require licenses should be avoided. Of course, market mechanisms to sort the good firms from the bad requires a legal system that can settle disputes over product quality or price. Since Nepal does not have such a fully developed legal system, it can benefit by re-assessing its licensing requirements for each industry. The Government should then eliminate licenses whose benefits do not justify their costs.

3.2.11 Related legal issues

An important function of the legal system is to enforce contracts and property rights. Currently, Nepal's contract law requires disputants to litigate within a period of ninety days following a breach of contract. Claims cannot be made after ninety days. From a cultural perspective, this requirement poses particular problems: Nepalese are inclined to try indirect, third party, routes to settle their differences before taking legal action. The legal system, due to this and other reasons, effectively inhibits claimants from litigating contract disputes. An effective system of dispute resolution could reduce risks for entrepreneurs.

3.3 Planning a New Business registration System

Costs of compliance increase when Nepalese entrepreneurs are not fully literate, numerate, or knowledgeable of the law. Providing them access to assistance could make the business registration process much less intimidating. Specific kinds of support might include:

- help in filling out application forms,
- help in delineating registration procedures,
- help in determining which signatures are required,
- ascertaining in what order applications should be submitted to requisite ministries,
- providing information about new circulars issued by various government departments and assessing how these will affect the way business is conducted,
- codifying and publicizing information on regulatory changes,
- directing inquiries as to existing deadlines for application processing,
- answering any other questions entrepreneurs have.

It must be emphasized that each of these kinds of support are only partial solutions that generally address symptoms; underlying causes are addressed only to the extent that the regulatory process becomes more transparent. Such a system can help entrepreneurs deal with existing problems, but does not change underlying policy deficiencies. There are many options, identified in the next section, which developed countries employ to make their own registration systems more transparent and accessible.

4 Transitional Issues: Managing the Reform Process

In many countries, evaluations of registration processes have centered on two basic approaches, each suggesting specific reforms:

1. a comprehensive review of the body of law governing business registration, usually done by an independent commission (e.g., the Law Reform Commission in Australia),
2. clarify and consolidate rules and regulations by sector (as Spain has done in its tourist industry).

Clear criteria are absent to help determine which of these approaches is best suited to Nepal's (or any country's) transition to a more efficient business registration system. However, there are some obvious issues to consider: A sector-specific approach would be useful in a trial run; it would take less time, cost less, be less complicated, meet less resistance, could focus on a narrow target group, and open opportunities for small, short-term gains. On the other hand, if the goal is to completely overhaul the present system a comprehensive review is necessary; such a review would take time, be expensive, require much effort to coordinate, be susceptible to bureaucratic interference, require broad, dispersed support, but could open opportunities for large, medium/long-term gains.

Reform of the existing system should include the following steps:

4.1 Joint Public/Private Review of Laws and Regulations

Before the implementation of new business registration policy and procedures, officials should allow private and informal-sector enterprises to review and comment on the proposed changes (as discussed in sections 3.2.3 and 3.2.8). If there are doubts as to the practicability of the new procedures, they can be pilot tested in a particular sector, for instance, the small and medium-enterprise sector.

Communication between private and public sector interests is important. In developed countries the private sector often plays an active role in advocating new legislation. Information sharing frequently breaks down during implementation, however. Inappropriate or costly procedures and regulations are often a result of poor communication. Consequently, getting the private and public sectors to jointly identify potential reforms and assess their costs and benefits is a first step to develop specific reform proposals.

4.2 Government Officials Trained Specifically in Registration Policies and Procedures

Although not specifically a reform option, governments can improve administrative responsiveness by training personnel in specific policies and procedures. Personnel training can be an effective step toward improving business registration. This step's aim is to increase administrative personnel awareness of the policies and procedures they must follow when granting a business legal status.

Many countries encourage on-going training of government personnel. In addition, training in specific tasks is often required. Instructive examples for personnel training are given: Denmark created a Municipal Training Center to provide local government employees

self-taught training packages to improve their interactions with the public. Norway has developed video courses for the same purpose. Features of these programs are their low costs and demonstrable results.

Training Nepalese officials to better implement business registration procedures will require sustained and directed efforts for results similar to those obtained in OECD countries. Training should begin, perhaps, at a more basic level by specifically addressing bureaucratic attitudes to the private sector's role in development.

4.3 Reform Sequencing During Transition

Reform sequencing is important to the transition to a new business registration system. In countries such as Nepal sequencing may be very important. In part, correct sequencing can help avoid implementation bottlenecks. To implement the reform options outlined in section 3, the transition issues must be considered:

Problems to avoid when creating one authority with a decentralized structure

To create a one-window system requires some preliminary steps. Procedures need to be established, lines of authority demarcated, means to contest decisions instated, fees consolidated, bureaucrats trained, and information printed and disseminated in brochures, forms, samples, etc. Creating a one-window system could become very difficult if done too quickly on too broad a scale. Initially it might be best to limit the effort to one sector.

Problems to avoid when lowering, consolidating, or eliminating processing fees

Fees can be eliminated, lowered and/or consolidated at potentially any point when implementing reforms, but such a step may be a key early inducement to entrepreneurs (de Soto, 1989). Information dissemination necessarily accompanies this step.

Problems to avoid when minimizing steps

Although simplifying and eliminating steps makes filling out forms and filing applications easier, registration authorities may continue exercise their discretion. In fact, streamlining the process may increase the work load of individual bureaucrats who, in turn, will have every incentive to reject applications, perhaps on spurious grounds. Entrepreneurs must be given means to contest spurious decisions to reject applications. Therefore, when steps are simplified or eliminated avenues of recourse must also be created. Simplifying forms and consolidating information are reforms that can be readily implemented. Providing proof of transactions may not improve registration procedures but can improve accountability. To be effective this reform should be integrated with reforms that eliminate or simplify steps.

Problems to avoid in disseminating information on registration benefits and requirements

Information dissemination is a necessary component of all reform efforts. Various media and channels for disseminating information have been discussed (section 3.2.6).

Problems to avoid when introducing deadlines and other time restrictions for processing applications

Enacting application processing deadlines need not precede the implementation of

other reforms. However, simultaneously to enacting deadlines, entrepreneurs and government officials should be given information that explains the implications for having deadlines. If entrepreneurs do not know deadlines exist or are unaware of their implications, benefits to having them are likely to be small.

Problems to avoid when establishing means of structured feedback

Structured feedback mechanisms should be implemented early in all reform programs. However, for structured feedback to be effective, mechanisms should be created that induce bureaucracies to systematically review and implement feedback recommendations. Feedback can be used to evaluate the effects of a reform.

Problems to avoid when creating means of recourse for applicants

Countries without mechanisms to resolve disputes over administrative decisions should create them early in the reform process. Other reforms, such as the elimination of steps, may prove ineffectual when recourse is absent. Recourse can be provided by a number of mechanisms (see discussion in section 3.2.9); Nepal could adopt many of them.

4.4 Tax Amnesty

Current registration procedures require entrepreneurs to pay retroactive taxes and penalties on personal income and profits before they can register a business. Such procedures have two well-known consequences. First, taxes escalate the cost to entrepreneurs of operating formally. When unpaid taxes escalate, incomes grow or tax rates increase, or time simply passes and unpaid tax bills accumulate. Second, taxes bills can cut off sources of future tax revenues by effectively preventing the entrepreneur from operating legitimately.

Without empirical evidence estimates of how much revenue the Nepalese government is losing because of their tax policies are uncertain. The amounts, though, are probably substantial as agents continuously choose to operate informally. Thus, present registration procedures force entrepreneurs to operate at higher transactions costs. These costs are higher because entrepreneurs have to pay for the protection that operating legitimately would otherwise bring at low cost, although they benefit from not paying taxes on their profits.

Because quantifying the precise effects of existing tax laws on business registration is difficult, it becomes impossible to quantify how many agents refuse to operate as formal, legal entities. In consequence, due to the hidden effects of informal activity and the negative effects that high registration costs have on any one sector of the economy in aggregate, a two-pronged policy toward registration procedures is recommended. A first step should be to separate personal taxes from commercial taxes so that all retroactive personal, and commercial taxes do not have to be paid before obtaining legal status. Secondly, the Government should declare a tax amnesty so that penalties on retroactive taxes are, in essence, forgiven. The merit to this approach is that the government does not lose current income and benefits from incorporating future tax gains into its revenue stream as well.⁸ Entrepreneurs also gain as the perceived costs to formal operation drops and they can claim

⁸ For a detailed discussion of the economics of tax amnesties see Malik, Arun S. and Robert M. Schwab, "The Economics of Tax Amnesties," *The Journal of Public Economics* Vol.46, pp. 29-49, 1991.

the benefits of their legitimate status.

Many governments have successfully experimented with permanent tax amnesties. The United States, from 1919 - 1952, maintained an explicit policy of granting criminal immunity to tax evaders who voluntarily paid their delinquent taxes; an identical policy is currently observed in Canada. Research shows that the level of pre-existing cheating may be the most important variable in determining whether revenue will rise or fall after an amnesty is offered (Andreoni, 1991). If initial evasion is large, amnesty may increase tax revenue even if it also generates some increases in cheating (because some present taxpayers anticipate future amnesties or begin to report less). In Nepal the level of evasion is determinably very high.

Over the longer term, insulating business registration from tax collection should act to encourage entrepreneurs to apply for legal status. Simultaneously, fairer taxes and tax collection procedures will reduce the government's need to rely on business registration to expose recalcitrant tax payers.

5. Conclusion

In most countries, the governmental functions of business registration are to record information, approve certain activities, and collect some fees. Business registration systems in developed countries typically require much less information or approvals and impose lower fees than developing countries. In Nepal, the number of requirements to fulfill these functions far exceeds standards in developed countries. Existing procedures are designed to monitor and control the activities of entrepreneurs before their business has even begun. One result is that Nepal's business registration system discriminates in favor of large and existing enterprises. Such requirements discourage entrepreneurs from participating in the economy legally. Another result is that government loses revenue and information about its private sector, and capital is invested in activities not optimal to economic growth.

An overwhelming majority of developed and newly-industrialized countries have found efficient means to regulate business registration. Nepal could usefully emulate their experience and adopt measures appropriate to conditions there. Specific options have been discussed and measures proposed for reforming Nepal's business registration system, particularly reducing and simplifying of steps.

Moreover, many important problems to making a transition to a new business registration system have been identified. The eight specific reform options that are presented are not complicated and can be easily incorporated into the reform process, overcoming many transition problems.

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