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POLICY FRAMEWORK PAPER ON BUSINESS LICENSING REFORM AND SIMPLIFICATION



INVESTMENT CLIMATE ADVISORY SERVICES
WORLD BANK GROUP



**International
Finance Corporation**
World Bank Group



World Bank Group
Multilateral Investment
Guarantee Agency



THE WORLD BANK



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The Investment Climate Advisory Services of the World Bank Group (IC) helps governments implement reforms to improve their business environment, and encourage and retain investment, thus fostering competitive markets, growth and job creation. Funding is provided by the World Bank Group (IFC, MIGA, and the World Bank) and over fifteen donor partners working through the multi-donor FIAS platform.

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EXECUTIVE SUMMARY

A well functioning regulatory system is an essential component of modern society. Where regulations work well, they enhance governance and promote stability, progress and prosperity. Licensing is a commonly used and prescriptive type of regulation which affects specified businesses and occupations by regulating entry into markets and conduct within markets. Licenses—which sometimes include use of permits, certification and notifications—typically impose on businesses a range of conditions, obligations and rights. Breaches of licensing conditions typically involve imposition of sanctions by the relevant regulatory authority, such as a fine or revocation of permission to perform an activity.

There are often good reasons for government to regulate markets and businesses, including addressing market failures. Indeed, licensing as a form of regulation has a number of important advantages, such as excluding businesses from entering markets where they might generate health, safety, security or environmental risks.

However, licensing is also often misused and/or poorly administered, generating significant and

unnecessary costs and risks for developing countries. For example, licensing can impede healthily competition and the operation of effective markets, unnecessarily raise business costs and consumer prices, generate scope for corruption and be misused to collect revenues. Many licensing systems have also proliferated over time and grown exponentially beyond control or even measurement. For these reasons, business licensing reform and simplification is an important part of the International Finance Corporation (IFC's) Business Enabling Environment (BEE), which is provided by the World Bank Group (WBG) to support regulatory reform and modernization in developing countries. This paper is part of the supporting activities to develop and communicate the key features and processes underpinning successful Business Licensing Reforms.

Reforming business licensing can generate significant economic, social and environmental benefits for developing countries but can also be difficult, complex and challenging. This paper argues that often the best way to reform licenses is to undertake comprehensive licensing reforms. This includes obtaining top down high level political

commitment to ensure accountability, establishing institutional drivers, such as a private-public working committee and secretariat. It also suggests that the regulators responsible for licenses be required to justify the continuation of each license they administer according to a simple and transparent criteria which has been endorsed at the political level. By reversing the burden of proof, regulatory agencies—the ‘owners’ of licenses—have strong incentives to identify all licenses they administer and consider whether such licenses can be justified because they generate net benefits for society.

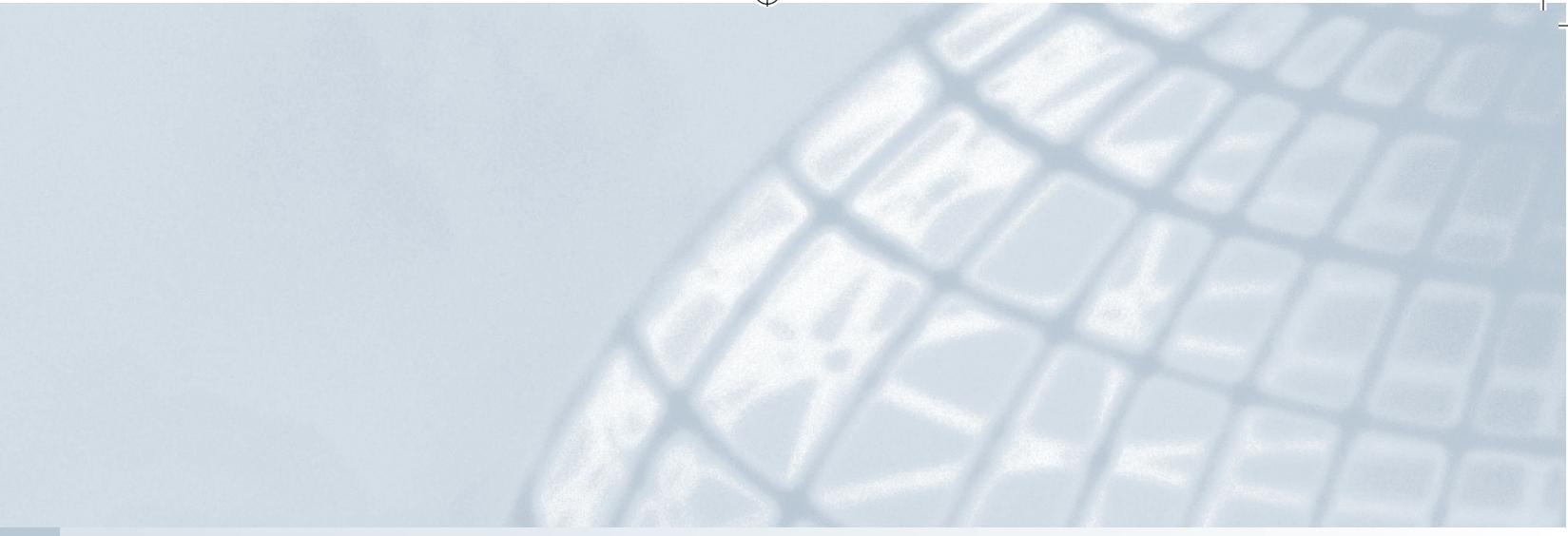
The importance of meaningful, inclusive and timely consultation with stakeholders is also highlighted in this paper. Consultation and other transparency measures can help build public confidence and goodwill, as well as constituencies for successful and sustainable licensing reforms. However, licensing reforms which are in the broader community interest should not require stakeholder consensus, since licensing reforms will often generate opposition from institutions and individuals who derive private benefits from existing licensing arrangements.

It is often preferable to bundle licensing reforms into a single comprehensive reform program. In addition, comprehensive licensing reforms can be

implemented alongside related reforms, such as establishing a light Regulatory Impact Analysis (RIA) system. RIA can be used to screen and provide quality control for new licenses, so that bad licenses or regulatory practices do not re-emerge. Establishing an electronic registry which documents all licensing requirements and can be accessed easily by business and the community can also be a part of a broader regulatory and licensing reform program.

This paper provides advice on how to reform licenses, including project preparation and diagnostics, establishing a focused reform program, reviewing existing licenses, reforming licenses and establishing monitoring and evaluation processes to measure the impacts of licensing reform. This paper is supplemented by a ‘how to’ manual which provides detailed advice and guidance about to reform business licenses.

Advice provided in this paper on how to reform licenses and licensing systems can also be applied to other types of regulation, such as Acts of Parliament, decrees and subordinate regulations. Furthermore, such reforms can be applied at the central government level, state government level (where applicable) and at the local government/municipal level.



INTRODUCTION

Business licensing reform and simplification is a ‘core product’ under International Finance Corporation (IFC’s) Business Enabling Environment (BEE) Business Line which is offered by the World Bank Group (WBG) to support regulatory reform in developing countries. This paper is part of the supporting activities to develop and communicate the key features and processes underpinning successful Business Licensing Reforms in developing countries.

This paper includes an overall introduction to the uses (and abuses) of business licenses, and to the way business licensing reforms can be organized. It also provides a broad overview and framework for licensing reforms. This paper is supported by more detailed case studies of licensing reform in particular sectors, and other guidance for facilities and field operations. This includes a detailed manual on ‘how to’ review and reform licenses and also information about how to apply effective and insightful Monitoring and Evaluation (M&E) to licensing reviews and reforms.

Part One of this paper provides a contextual overview of key issues associated with government regulation. The rationale for government regulation (including licensing) is discussed, along with a description of the benefits and features of good regulatory design. This is followed by a commentary about the costs and problems generated by poor quality regulatory design and poorly administered regulatory systems.

Part Two discusses the features of business licenses, the potential advantages and disadvantages of licensing and a discussion of the use of licensing fees and charges.

Part Three provides an overview of ‘how to’ reform business licenses and licensing systems. It summarizes broad approaches to reform, such as using a comprehensive ‘top-down’ approach to reviewing the stock of existing licenses, or where appropriate using a more targeted approach which focuses on particular types or categories of licenses. The importance of ensuring that licenses are documented in a transparent manner and



that there are effective quality control process for new licenses, to stop bad licenses from reappearing, is also discussed. The four key elements of licensing reform and simplification are then considered, including project preparation and diagnostics, establishing a tailored and focused reform program, reviewing existing licenses and reforming licensing systems. A more detailed discussion and guidance on ‘how to’ reform licenses is provided in a separate manual.

Part Four of this paper focuses on Monitoring and Evaluation (M&E) of licensing reform and

simplification programs. This includes developing an M&E framework and measuring the significance and effects (e.g., the frequency and administrative burdens) generated by different types of licenses. This is followed by a discussion of the use of performance indicators including, outputs (such as the number of entities receiving in-depth advisory IFC services), outcomes (such as the number of licenses repealed or reformed and reductions in burdens on business) and impacts of licensing reforms (such as improvements in investment and employment following licensing reforms).



GOVERNMENT REGULATION

The broader context—government regulation

Governments seek to achieve a wide range of social, economic, environmental, regional and equity objectives through spending, taxation and regulation. Government regulation provides rules, standards and guidance to individuals and organizations. A well functioning regulatory system is an essential component of modern society. Where regulations work well, they enhance governance and promote stability, progress and prosperity.

A well functioning regulatory system provides a stable environment for business by reducing transaction costs, providing certainty and encouraging healthy competition, thus enhancing international competitiveness, investment, growth and employment.

Why regulate—rationale for government regulation?

The basic rationales for various types of government regulation (including licensing) include

addressing identified market failures or achieving other specific ‘public interest’ objectives. It is broadly accepted that the following factors justify government regulation:

- externalities—where unregulated or poorly regulated markets generate uncompensated benefits (public safety) or costs (such as pollution) to others;
- public goods—where individuals who have not contributed to production cannot be prevented from consuming that good, or where consumption does not reduce ability of others to consume. Examples of public goods include broadcast/free to air television and street lighting;
- information failures—where parties to a transaction have incomplete or flawed information about costs, benefits and risks. Examples include a transaction where one party knows more than the other and can include insurance, other financial products and second hand cars;
- natural monopoly—where the nature of a product can result in one producer (or a

small number of producers) exercising non-transitory market power to the detriment of consumers. In such cases licenses can be used to control competition ‘for a market’; and

- public interest objectives—which can include a wide range of specified equity or other broader community preferences, such as protection of resources, reducing greenhouse emissions or protecting persons who have a disability.

It is generally not appropriate to introduce and operate regulatory systems for other reasons, such as to unnecessarily restrict competition to protect favoured businesses interests or generate tax revenues. Furthermore, it is generally accepted that the presence of market failure or public interest objectives only justifies government regulation where the benefits of regulation exceed the costs of the market failure *and* also where regulation is the best (e.g., most efficient) way of achieving policy objectives.

Needless to say, the challenges involved with determining appropriate levels of regulatory interventions include different interpretations of what constitutes public goods, public interest, information failures, etc. Furthermore, societies often attach different values to collective interests, protection of individuals against ‘market failure’, and the importance of individual and entrepreneurial opportunity.

The spectrum of regulation for competition within (and between) markets includes at one end broad framework regulation governing the operation of all markets, such as competition and tax policies. Self regulation is also being used increasingly and successfully in a range of sectors. For example, Hazard Analysis Critical Control Points (HACCP) and Global GAP impose stringent requirements for food producers entering a market.

The spectrum of regulation then includes a range of regulatory approaches and tools which progressively increases government control over the operation of businesses operating in particular

markets. Process and prescriptive regulations, sometimes referred to as ‘command and control’ regulations, are at the other end of the spectrum of regulation, where governments exert a high level of direct control over the operation of markets and businesses operating within particular markets. It is at this most prescriptive end of the spectrum where governments often apply regulatory restrictions on competition and licensing (see Box 1). In other words, licensing is typically part of the ‘command and control’ end of the broad spectrum of government regulation.

Regulatory interventions—from state ownership to competitive markets

In the late twentieth century there was a growing consensus that state ownership of the means of production was a highly inefficient and usually ineffective way of achieving broader social, economic and environmental objectives, especially in the medium and longer terms. Increasingly, the focus of governments has been to establish regulatory institutions, processes and regulations which support the operation of effective markets, which in turn creates the wealth and additional taxation revenues needed to achieve broader societal objectives.

Governments use a range of regulatory interventions to achieve effective markets. For example, economic regulation involves intervening directly in the operation of markets. Social regulations aim to achieve public interest objectives such as protecting health, safety, the environment and social cohesion. In addition, the application of such regulations involves governments employing administrative regulations—sometimes called ‘red tape’—which includes paperwork and administrative formalities through which governments collect information on the operations of businesses (OECD 1997a).

The increased focus of governments on regulation has also resulted in greater attention being given to regulatory governance, management and

Box 1: A Simplified Spectrum of Regulation¹



reform which refers to changes which aim to improve the quality of existing and new regulation, as well as regulatory processes and institutions.

Good practice regulatory requirements

As noted above, a well functioning regulatory system is characterized by regulations having a clear rationale and objectives, such as addressing specified market failure and/or the achievement of other policy outcomes. In addition, 'good practice' outcomes require at the policy level high quality regulatory design and also high quality regulatory administration and practice, as described and summarized in Box 2. Where good practice regulatory outcomes are achieved, a regulatory system will be characterized by both high quality regulatory design and regulatory administration/practice. However, regulatory systems are often characterized by weak regulatory design and/or administration/practice.

¹ This box describes the spectrum of regulation government for competition within and between markets. It does not include regulations governing 'competition for the market', where firms have market power (e.g., monopoly or oligopoly, etc.).

In such cases the regulatory system will perform poorly. The objectives of regulation will not be achieved (or only be partly achieved) and regulations will generate significant unnecessary costs and burdens in the country/region. Where regulatory systems and processes are weak remedial action should be undertaken.

What are the features of good regulatory design?

Well designed and high quality regulations have a number of key features, including:

- minimum requirements used to achieve objectives;
- not being unduly prescriptive in specifying how businesses should operate;
- accessible, transparent and accountable;
- integrated and consistent with other laws/regulations (including international, national and sub-national regulations);
- communicated effectively to business and other stakeholders;

Box 2: Good Practice' Regulatory Requirements

High quality regulatory administration?	Poor quality regulatory administration and practice?
High quality regulatory design?	'Good practice' regulatory outcomes
Poor quality regulatory design?	Good regulatory administration, but poor quality regulation (e.g., regulation is unduly prescriptive and onerous, but regulator is well managed and efficient)

- minimizing administrative compliance burdens on business; and
- enforceable.

These features summarize a more detailed regulatory quality 'checklist' which has been developed and applied by the OECD and several national governments. This checklist can be used as a preliminary diagnostic tool to identify the quality of regulatory design, including specific areas where regulatory design is deficient and requires remedial action. Please see section World Bank Group (2010) and also the 'how to' review and reform licenses manual, for further information regarding this checklist and for detailed information regarding how to review and, where appropriate, reform licenses.

What are the features of good regulatory administration and practice?

Regulatory departments, ministries and agencies administer regulatory regimes such as licensing using prescribed powers, authority and resources.

Governments, the community and key stakeholders (such as business and consumers) expect regulators to be effective, efficient and transparent in enforcing regulations.

The key features of good regulatory administration and practice include:

- sound and transparent governance;
- effective information management;
- good relationship management with stakeholders;
- adequate resourcing of regulatory institutions;
- capacity to efficiently and effectively receive applications from business and monitor compliance;
- ability to address non-compliance; and
- provide adequate response to adverse events.

These features summarize information provided in a more detailed 'checklist' which has

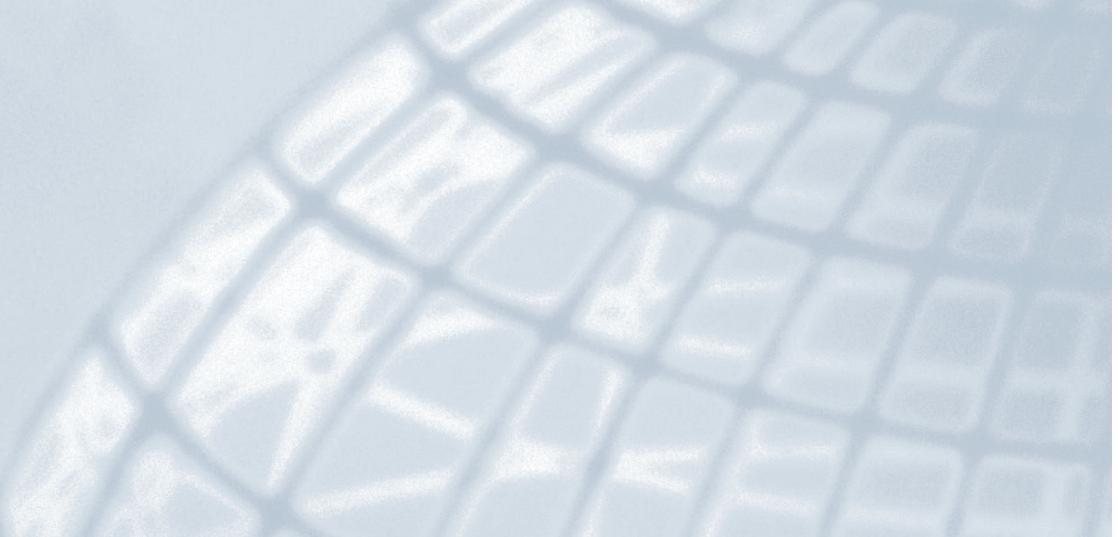


been developed and applied by the OECD and several national governments. This checklist can be used as a preliminary diagnostic tool to identify the quality of regulatory administration, including specific areas where regulatory administration is deficient and requires remedial action. Please also see World Bank Group (2010) and also the 'how to' review and reform licenses manual, for further information about this checklist and for information regarding how to review and, where appropriate reform licensing systems.

But 'good practice' regulatory requirements often not achieved?

In practice, the volume of regulations (as measured by the number of regulations, number of business affected etc) is often enormous. There are often well founded concerns about the quality and complexity of many regulations and how regulations are administered and enforced. Ill conceived, designed or administered regulations can create unnecessary barriers to trade and commerce, impede innovation and increase costs to business and prices paid by consumer, thus unnecessarily dampening economic activity, competitiveness, productivity growth and wealth creation.





LICENSING: A POWERFUL BUT POTENTIALLY DAMAGING REGULATORY INTERVENTION

What is a license?

Business licensing is a commonly used form of regulation which affects specified businesses and occupations by regulating entry into markets and conduct within markets. **Licenses** typically impose on businesses a range of conditions, obligations and rights—often in the form of a specific license, permit or concession. Breaches of specified conditions typically involve imposition of sanctions by the relevant regulatory authority—such as a fine or revocation of permission to perform an activity. Licensing does not include general registration of businesses, including for business name, taxation and statistical purposes. **Permits** are usually (although not always) a sub-set of licenses and typically focus on providing regulatory approval for a defined activity (see Box 3). **Business registration** and licensing reforms have many similarities, but also critical differences. That said, from the end user perspective (e.g., the entrepreneur wanting to register a business and commence business operations) business registration and licensing should be seamless and integrated (see Box 6 for further information).

Box 3: Permits and Licenses No Need to Differentiate

Permits are often a subset of licenses. Permits can include governments providing business with permission (often in the form of a certificate or document) to enter a market and/or undertake a specified activity. Permits can also relate to the use of identified equipment or premises, or approval for particular one-off activities (such as commencing the construction of a building). Permits are used in most countries and are often used in the former Soviet Union and focus on providing formal approval to perform a particular defined activity.

As noted above, the prior approval stage of licensing (including permits) restrict competition and can be a particularly costly form of regulatory intervention. From a business point of view permits and licenses constitute administrative barriers prior to the commencement of a business activity. From a regulation reform perspective, it also makes little sense to differentiate between licenses and permits. The differences between the two are rhetorical. Indeed, there have been cases of reforms involving the elimination of permits, with the prior approval requirements of these permits resurfacing again shortly after as 'licenses'.

Licensing can be distinguished from other types of regulatory requirements by usually obliging the regulated parties to obtain a certification of compliance with regulatory obligations *prior* to the commencement of a given business activity. From an economic and business point of view, licensing is a potentially much more costly and potentially damaging regulatory intervention when compared to other types of regulation (such as broadly applied competition law and accounting rules, or other ‘lighter’ forms of regulation etc). This is because licensing requirements not only impose regulatory compliance burdens (as do most types of regulation), but also can restrict healthy competition by establishing significant and unnecessary entry barriers to particular economic activity and markets. These restrictions can include:

- grant exclusive rights for a supplier to provide a good or service;
- affect the ability of some types of firms to participate in public procurement;
- significantly alter costs of entry or exit to a market; and/or
- create a geographic barrier to the ability of businesses to supply goods or services, invest or supply labor.

Licensing can restrict or reduce the ability of businesses to compete and innovate through:

- control or substantially influence the price at which a good or service is sold;
- altering the ability of suppliers to advertise or market their products;
- setting prescriptive standards for product/service quality that are significantly different from current practice; and/or
- significantly altering costs of some suppliers relative to others.

Unnecessary restrictions on competition and highly prescriptive licenses can be very damaging to the operation of effective markets. They impede competition, innovation in producing and delivering goods and services, and limit the capacity of firms to respond to external shocks (such as significant and unexpected changes in input prices, market conditions and/or changes consumer preferences etc). All of these outcomes reduce significantly levels of productivity, incomes and wealth creation.

As is described in further detail below, licensing and the associated compliance requirements—as with other types of regulation—can also often offer significant discretion to the issuing authorities which may lead to abuse, corruption, uncertainty and other risks.

Cognizant of these constraints and potential negative effects of licensing, most governments seek to limit licensing to a limited number of specified sectors and activities where prior control of the behavior of businesses is deemed necessary to achieve important economic, social, safety, security or environmental outcomes.

The criteria and policies guiding the sectors and activities which should be subject to licensing vary widely between countries. Indeed, there is no definitive list of activities that should or should not be licensed. That said, many developed and developing countries officially limit licensing to business activities affecting the following areas:

- provision of services and goods relating to human and animal health, including the manner of sale of particular goods and services;
- safety or specific risks to human life, such as the sale of pharmaceuticals, medicines and fireworks. This can also include the production, transport, storage, handling and inspections of dangerous goods;
- networked services, such as telecommunications, energy and the financial sector;

- gambling and related activities;
- specified financial services;
- security, businesses involved in provision of law and order services, internal security and national security;
- use of scarce resources, such as natural resources and radio frequencies; and
- environment, including protection of specific environmental amenity (such as use of national parks and reservations).

Specific examples of business activities which traditionally fall within this definition of licensing can be found at World Bank Group (2010) and include:

- construction;
- business activities requiring zoning and/or operating from specific locations;
- professions, such as doctors, lawyers and engineers etc;
- mining exploration, extraction and transportation;
- establishing and operating a bank or financial services;
- importing, exporting or trade in defined types of goods and services;
- use of particular equipment or production, transport, storage, handling and sale of specified materials (such as explosives, dangerous chemicals or pesticides);
- discharging gas, liquids or solid waste; and
- other requirements affecting doing business in particular sectors or for specified activities, including those which impact directly on

national security (e.g., use and storage of weapons or other sensitive goods).

Four features of the licensing process

The features of licenses as well as the process of obtaining and administering licenses varies greatly between and within different countries. That said, licensing typically involves one or more of the following four broad features:

- (1) Search and application:** ‘Search’ where businesses identify regulatory requirements that apply to them, by visiting the offices of regulators, searching the Internet, telephoning or e-mailing relevant officials etc. ‘Application’ is where businesses provide specified information (often after completing a range of specified documents/forms and providing supporting evidence, etc) to a regulator, to apply for a license to conduct specified business activities which are often in a particular sector and for a defined period of time (e.g., one or two years). In some cases, businesses applying for a license also pay a fee or charge to the regulator which is responsible for issuing and administering licenses;
- (2) Prior approval to operate which require specified conditions to be met:** The regulator receives the business application for a license, assesses and verifies the application, ensures specified conditions have been met and provides formal approval to a business to operate in a specified sector. This can include notification, where business informs a regulator that it is in compliance and can then legally deliver a good or service;
- (3) Conditions:** Where businesses are expected to comply with standards, conditions and requirements specified in the license, sometimes including payment of a regular fee or charge. These can often be very onerous for

business and generate significant administrative, compliance and economic costs. License conditions can be applied prior to approval and/or after approval has been granted by the regulator; and

- (4) **Enforcement:** Regulator enforces specified license conditions, standards and requirements through a variety of measures. These can include screening processes prior to approval (e.g., verification of the information provided) and verification processes after the license has been issued, such as audits and inspections etc. Enforcement mechanisms such as inspections can also generate significant and often unnecessary administrative, compliance and economic costs on business.

See World Bank Group (2010) for further information and examples of the specific issues and challenges related to these licensing steps.

Potential benefits of licensing as a regulatory tool

Developed and implemented appropriately, licenses as a regulatory tool offer a number of potential benefits, including:

- the application and notification component of the licensing process allows governments to identify, verify and contact businesses;
- prior approval allows governments to test businesses and exclude those unlikely to meet minimum standards, such as businesses or business activities which generate significant health, safety, security, environmental or other costs and/or risks;
- licenses can allow the controlled use of valuable and scarce community resources, such as

telecommunications spectrum, forests or fisheries; and

- licensing conditions can often be modified relatively easily resulting in adaptable and responsive regulation (including for sectors such as telecommunications where technologies are changing and evolving rapidly).

Potential disadvantages of licensing

However as indicated above there are also significant costs and inherent risks which are often associated with the use of licenses to obtain policy goals. In most countries poor business licensing practices are generally accepted as a serious regulatory constraint to the business enabling environment. Direct costs on business can include unnecessary duplication and inconsistencies, delays, uncertainties and formal (and informal) compliance activities (including administrative, compliance costs and out of pocket expenses) associated with obtaining a license and complying with license requirements. Indirect costs on business and the broader community include lower levels of investment and economic activity, revenue foregone, lower employment, skills development, reduced technology transfer and economic growth. In sum, the key risks and costs which can be generated by licensing include:

- unnecessarily restrict entry into a market and/or competition within a market;
- providing barriers to businesses operating in the informal sector moving to the formal sector;
- severely limit the supply of important goods and services (e.g., taxis or medical services);
- result in standards being unnecessarily high and otherwise distortive;
- be costly and/or difficult for governments to administer and properly enforce; and

- licenses can be misused to provide a highly inefficient and costly way of collecting revenue.

In summary, licensing can be a form of protection that benefits certain officials (in the form of bribes etc) and also businesses where licenses ensure that they do not face healthy competition from other businesses. Such protection is provided at the expense of other businesses (such as those operating in the informal economy); consumers (who pay higher prices have fewer choices); the broader society (in terms of lower levels of wealth creation, investment, employment and economic activity; and governments (in the form of lower taxation and other revenues).

Furthermore, the discretion often provided to officials in issuing, implementing and interpreting licensing criteria can lead to a mushrooming of licenses and associated compliance burdens for businesses. For example, in many developing countries several regulators operating at different levels of government impose the same (or similar) licensing obligations on business, collecting fees and charges etc.

As with other all other forms of regulation, licensing should only be used where net benefits are generated with its use *and* where licensing is the best way of achieving broader specified objectives.

Please see World Bank Group (2010) for information on policy and regulatory alternatives to licensing.

Licenses and inspections are closely linked

As discussed above, licenses and licensing systems are usually characterized by processes which verify whether businesses are complying with licensing conditions, such as reporting requirements, product testing and inspections. Furthermore, licensing is also associated with enforcement processes, which are designed to encourage business to comply with

licensing requirements, often through the use of sanctions for non-compliance (such as fines, temporary or permanent revocation of a license etc).

Inspections of businesses and/or their activities are a commonly used way for verifying business compliance and also can be used as a sanction for previous non-compliance with licensing conditions. As such, they are an important risk management tool for regulators administering licenses. However, from the perspective of business, inspections can also generate unnecessary uncertainty and risks—including that inspectors could solicit bribes and/or abuse discretionary powers etc.

When reviewing and reforming licenses and licensing systems, particular attention should be paid to the role of inspections. Inspections should maximize compliance with licensing requirements by focusing on high risk areas and activities. This means that following licensing reforms, inspections activity could be focused and for some businesses involved in high risk activities inspections may increase. However, in all cases, licensing reforms should aim to minimize uncertainty and unnecessary costs for business (including scope for corruption) generated by inspections (IFC 2006b).

Licensing, fees and charges

Licensing can sometimes involve regulators imposing fees or charges to issue, administer and/or revalidate licenses. In principle, the transparent imposition by the licensing regulator of fees and charges can be appropriate to recover the administrative costs to government of delivering that license service (e.g., on a cost recovery basis).

However in practice problems often occur when licensing authorities—often at the local government level—use their constitutional or otherwise legally secured mandate to impose unnecessary licensing requirements on businesses and/or use

the licensing transaction to raise revenue in excess of reasonable costs incurred by governments in administering a licensing system.

In Zambia, for example, local governments issue business licenses (with associated fees) to financial institutions, law firms, accounting firms, architects, human resource practitioners etc. These licenses are based on local government's general authority to impose levies. However, all the regulated entities are already regulated by the respective professional regulatory bodies and also through other general and specific regulations and licenses applying to these business activities.² Licenses issued for the use of scarce resources, such as use of timber or resources or mining activity, can also involve imposition of high fees which seek to raise additional revenue.

The imposition of what is de facto taxes 'disguised' as license fees and charges create costs and a high level of uncertainty among businesses. Moreover, the use of licensing to raise revenue for local (and national) authorities is generally recognized as an inefficient way to raise revenue compared to broader tax systems. That said, there may be cases where authorities' imposition of fees on business above cost recovery can be justified, as noted in Box 4.

However, in practice these conditions are unlikely to be met, especially where there is a functioning broadly based taxation system in place. Indeed, in this situation the taxation system should be strengthened so that inefficient and costly licensing fees and charges can be wound back over time.

In sum, good and recommendable practices when it comes to licensing and revenue raising are clear. Licenses should generally not be used as vehicle

² The ongoing business licensing reform supported by FIAS aims at streamlining licensing practices in Zambia, including the elimination of duplicative regulatory interventions as the above mentioned.

Box 4: Can Fees and Charges be used to Raise Revenue for Broader Policy Objectives?

There may be cases where the imposition of higher-than-full cost-recovery license fees could be justified. This could occur where those licenses generate direct benefits for the business receiving the license, such as a license accreditation for provision of specified medical services resulting in business being able to charge much higher prices etc. Furthermore, fees and charges may be appropriate where particular businesses generate negative effects on the community, such as a factory generating large amounts of pollution.

Where licenses are used to ration the use of scarce community resources (such as access to spectrum on the airways), then fees and charges can recover monopoly profits generated (although many countries achieve the same outcome more efficiently and effectively through the broader taxation system, through royalties or a resource rent tax).

Where licenses generate broader benefits for the community (such as enhanced health, safety or security outcomes) then imposing licensing fees and charges will generally be inappropriate and impose a wide range of costs on the community. Indeed, in such cases license fees and charges essentially impose a 'tax' on services provided by business which benefit the broader community.

In principle, where there is a broader policy objective such as collecting monopoly profits or improving health, safety or security, then license fees and charges can be applied in the short term as a temporary measure where:

- revenue collected generates identifiable health, safety or security benefits for the community which clearly exceed the direct and indirect costs on business and the community of collecting license fees and charges; and
- licensing revenues are collected more effectively and at lower cost than broader taxation measures (such as royalties for access to scarce resources or consumption taxes).

to raise revenue above cost recovery because it is a highly inefficient revenue collection mechanism, and because it imposes great uncertainty on licensed businesses.



In practice, however, governments—and local governments—are often left with few other choices and tools to raise revenue to fund necessary public services (some of which may be imposed by the national government). A clean cut removal of local governments' access to raise revenue through licenses can have very damaging effects, simply because the revenue flow funding important service provisions falls away. From a regulatory reform perspective, the practical implication of these circumstances is to ensure a parallel reform process in

which the removal of inefficient (e.g., local government) licensing/revenue raising practices are complemented with efforts to compensate the local governments, and to improve revenue collection mechanisms, such as through a local business tax and/or revenue transfers from a central government etc.

These issues are dealt with in further detail in the World Bank Group (2010).





HOW TO REFORM? A FRAMEWORK FOR COMPREHENSIVE BUSINESS LICENSING REFORMS

The previous two sections have described licensing in the context of other regulatory interventions, and have defined some of the features—including benefits and challenges—of business licensing. This section considers *approaches* to reforming business licenses. As noted above, while the focus of this paper is the reform of licenses, these key approaches can be employed beyond licensing and be used to reform other types of existing regulations.

Licensing reviews and reforms will often be implemented through joint IFC Facilities-Foreign Investment Advisory Service (FIAS) projects. In some cases FIAS will take the initial lead in project design, implementation and M&E. However, while projects will be carried out in close cooperation, they will increasingly be under the leadership of IFC Facilities, who are well placed to undertake ongoing engagement with the clients and maintain momentum for reform over the long haul.

Context for reform: Many licensing systems 'out of control'

Regulatory systems and licensing practices in many countries have grown beyond quality control or even measurement. Kenya is a case in point, where in 2006 a study of licenses identified around 300 licensing requirements. Yet the true scope of licensing regulation was far larger, because a subsequent comprehensive inventory found well over 1 300 business licenses and associated fees imposed by more than 60 government agencies and 175 local governments. Furthermore, regulators were continually producing new licenses. Similar findings have been made in a range of other countries.³

³ In Moldova, estimates had indicated there were 400–500 business regulations in 2008. An inventory exercise found 1,300. In Croatia, 300 procedures were initially identified – the total came to almost 1,500 issued by 68 regulators.

As noted above, one of the main reasons for the mushrooming of licenses is that ministries and regulatory bodies, including at local levels, often have a direct financial interest in creating new licenses and business fees because these revenues support staff salaries and provide increased opportunities for corruption. These factors can impede reform and improvements to licenses. In addition, there are a range of broader and generic constraints to licensing reform, cf. Box 5.

Box 5: Why licensing reforms are difficult?

There are a range of barriers to the development of good regulatory and licensing practices, which can include one or more of the following factors:

- ideology, competing values and/or rigid ways of thinking about public policy issues and problems;
- political—electoral, partisan, departmental or regional factors;
- organisational/governance—inertia, group think, vested interest and/or inadequate consultation with the community and stakeholders;
- information overload or poor quality information about objectives, options, impacts and risks and/or competing advice;
- decisions not based on rational evidence based criteria, such as emotiveness and/or overly hasty decisions;
- economic factors, including governments and ministries having limited resources, skills, capabilities and powers; and
- poor timing (pending elections, military coup, civil conflict etc).

Each of these factors (or combinations of two or more of these factors) can potentially generate a wide range of negative regulatory and licensing outcomes, including simple cash corruption/out of pocket expenses, regulatory capture, creation of unnecessary market restrictions (e.g., barriers to entry) and resistance to reform. They can potentially make the task of reviewing and reforming licenses a very challenging, complex and medium to long term exercise.

The need for comprehensive reform

Many countries have launched regulatory reforms targeted at a few priority regulatory constraints, partly in the hope that small reforms will build a momentum for broader regulatory reform. Such limited reforms are often based on a belief that larger reforms are not possible in regulatory systems that are highly captured by vested interests and resistant to change.

Yet small reforms within a large and expanding regulatory system will not substantially nor sustainably improve the overall business environment. This is because reforms aimed at single processes and rules will never catch up with the productive capacities and incentives of governments to create and apply new or amended regulations, licenses, fees, charges and controls.

The way to achieve successful regulatory reform is often to focus on system-wide regulations, regulatory institutions and processes. For this reason, the approach to business licensing advocated under this project is based on ambitious and broad reforms that will produce large short-term pay-offs, but also create systemic improvements to how the government regulates into the future. In other words, when well organized and implemented, business licensing reform can provide early results and generate political support for broader and systematic reforms.

The basic approach

The approach to business licensing reform outlined here builds upon a method pioneered initially by Sweden in 1984, further developed by middle-income countries such as Hungary, Mexico, and Korea in the 1990's, and more recently adapted to transition and developing countries such as Moldova, Ukraine and Kenya.

In essence the approach advocates a comprehensive, top-down, and institutionalized approach to

licensing reforms. Through this approach, reforms are driven forward by an explicit political mandate, if possible also by a quantitative target for the reform, and by strong incentives for regulating agencies to participate constructively in the review process. Each of these components is described below.

An explicit political mandate ensures accountability

A high level political commitment is essential to successfully implement this approach. At the early stages of reform this could include support for research to be undertaken into the nature, scope and impacts of existing licenses and a diagnostic report being prepared. At a later stage, an explicit licensing reform mandate could come in the form of a gazette notice, presidential directive, or an official Cabinet/government announcement. The reform mandate should designate clear responsibilities for the reform, preferably by allocating responsibility to a designated high-level Business Licensing Reform Committee with a Secretariat, and set out the overall process for the reform program. As part of this, the mandate should also establish milestones and deadlines for the review of licenses. This would include deadlines for the submission of ‘licensing data’ from regulators to the Business Licensing Reform Committee, and for the submission to the Government of recommendations by the leading review body. In some cases, the mandate could also establish a quantitative target for the reform, (e.g., a 25% reduction in regulatory administrative burdens over 12–18 months).

See World Bank Group (2010) for examples for political mandates for licensing reforms.

Institutional drivers is important for success

The role of institutions and the benefits of strong institutional underpinnings of reforms are well

established. This also applies for business licensing reforms. Experiences from previous and ongoing pilots have seen significant benefits from private-public working committees (often led by a strong private sector chair) with the support of a small but skilled staff secretariat.

See World Bank Group (2010) for examples of mandate, compositions and impacts of Business Licensing Reform Working Committees.

Reversal of the burden of proof:

At the core of the proposed fast-track business licensing simplification approach is the principle of ‘reversal of the burden of proof’. Under this approach, regulators, (e.g., the ‘owners’ of the reviewed regulation) must prove that regulation matches pre-defined criteria of regulatory quality. If they are unable to justify the regulation, or do not notify its existence past a set deadline, the regulation is repealed by default. This mechanism reverses the incentives of otherwise reluctant regulators to share data and information about ‘their’ regulations. All ‘surviving’ regulations should be listed in a centralized electronic registry of all valid licenses (or regulations) in force (see below for further information on a centralized registry).

Quantifying burdens and setting a target helps monitor progress

It is generally challenging to assess the exact costs on businesses of licenses, the net benefit of a particular regulatory interventions, or to assess the net benefit of a particular license. For example, surveys and other data collection tools can be used to collect relevant information, although they can be costly and time consuming, and it can also be difficult to obtain robust data. Indeed, in the data-poor environments of many developing countries collecting data on the impacts of licenses can be a very challenging task. On the other hand, reforms with clear and quantitative targets tend to focus reform efforts, and provide a

good basis for monitoring reform performance, outcomes and impacts.

Recent experiences with the application of variations of the Standard Cost Model (SCM) suggest a considerable potential in also using this simple approach to quantify existing administrative burdens imposed on businesses. As shown in ongoing reforms in Madagascar, Rwanda and Zambia, hard data on the damaging impacts of the countries' licensing systems create a momentum for reform. In the absence of specified data on particular impacts, it should be noted that as a second best option plausible assumptions can also be used to help estimate through the SCM the administrative burdens generated by licenses (and the potential gains from reforms to licenses).

See World Bank Group (2010) for a paper on the application and experiences with the SCM.

Simple and transparent review criteria

There is a risk that comprehensive licensing reviews are slowed down or results diluted if the review is not guided by clear, simple and transparent review criteria.

One important threshold to consider is the extent to which the review will look at sector specific issues and standards and/or will focus on general issues of administrative streamlining and reducing burdens on business.

See World Bank Group (2010) for further information on sector-specific licensing reform management and issues. Experiences from ongoing pilots suggest there are risks and delays associated with the 'sector' focus as opposed to the 'streamlining' or 'reengineering' perspective (e.g., administrative streamlining). The latter approach has the clear advantage that it can be presented as politically neutral. For example, in reviewing environmental impact certification licenses it

may be preferable to indicate early-on in a reform process that the policy objectives behind the certification are not being reviewed and will be kept 'constant', with the review solely focusing on delivering those specified objectives in a more efficient and effective manner.

Simple review criteria used in a number of licensing reforms include:

- **legality:** is there a legal basis in a parent law or higher ranking regulation to issue the license?
- **necessity:** is the license used to protect the environment, health or safety. Does the license duplication other licenses or regulations? Is it consistent with other regulations?
- **business friendliness:** can the processes and documentation requirements be further streamlined to reduce the administrative burdens imposed on businesses. Is the license unduly prescriptive, is it performance and outcomes focused, is it accessible, transparent and easy to understand, can it be enforced?

These criteria can also be applied for a review of the flow of *new* licenses. A number of countries which have carried through licensing reforms have established 'positive' and/or 'negative' lists of activities that either can be or can't be subject to licensing. Other tools such as Regulatory Impact Analysis (RIA) can also be employed to guard against bad licenses and regulatory practices from re-emerging (see below for further discussion).

See World Bank Group (2010) for a more detailed list of review criteria which can be successfully applied in licensing reforms.

Consultation and validation

As for other reforms, meaningful, inclusive and timely consultation with relevant stakeholders

—though workshops, surveys, meetings etc—is very important to facilitate a successful and sustainable licensing reform program. Such consultation helps ensure there is broad based and ongoing support for the reform and can also assist the reform process directly, by obtaining and validating reform data etc. Under the Business Licensing Reform approach, recommendations for reform are a function of consultation and validation at three different levels: (1) with the regulating agencies, (2) with the private sector, and (3) within the Business Licensing Reform Committee.

Although consultation and validation is important, it is unlikely that all recommendations can enjoy consensus from all participating stakeholders. Reformers should constantly consider how best to mobilize and assure a ‘winning’ coalition of stakeholders, which can ensure needed and sustainable reforms. In other words, reforms are not necessarily consensus based.

See World Bank Group (2010) for an illustration of the overall reform process.

Bundled implementation?

Once a review of existing licenses is complete, licensing reform proposals can be ‘bundled’ together into a comprehensive and integrated reform program, through executive orders or an Act of Parliament. By bundling a large number of license reforms into one ‘omnibus’ reform, resistance to reform can in many cases be successfully overcome. This approach can reduce the political and administrative cost of reform, as well as ensure timely implementation.

That said, in some cases the ‘bundling’ of beneficial licensing reforms can also generate broader opposition to reforms, especially where licensing reforms are implemented slowly and the losers from reforms—such as officials administering licensing systems who solicit and receive

bribes —have time to mobilize and oppose reform. Furthermore, some countries may not have the ability or capacity to implement broader licensing reforms. For example, countries may face constitutional, legislative, political or resource constraints in reviewing all licensing laws/regulations and implementing comprehensive reforms.

Where there is limited interest in (or commitment to) comprehensive licensing reform—such as support for reform being confined to a junior Minister or senior official in one Ministry—a lighter, more flexible approach to implementing reform can be applied. A possible advantage of this approach is that reforms can be further tailored to particular conditions. For example, a license (such as building permits) which has been identified as being problematic might be reviewed and, where appropriate, reformed.

Such targeted reforms can often build greater and more broadly based interest and commitment to undertaking further more substantial reform of licensing. However, implementing such targeted reforms in a sequential manner also has several possible disadvantages, including the benefits from reform being relatively small compared to the top-down fast track approach. In addition, this approach can also give opponents of reform more time to organize and resist licensing reforms.

Therefore, deciding whether to bundle reforms or pursue specific reforms should be undertaken carefully and on a case by case basis.

Finally, reforms can be implemented along side with related reforms, such as Regulatory Impact Analysis (RIA) and electronic registries. These are discussed in further detail in the following discussion.

See World Bank Group (2010) for examples of laws and decrees implementing business licensing reforms.

Ensuring sustainability: Regulatory Impact Analysis (RIA)?

There is little point in reforming business licenses if there are no mechanisms in place to ensure that positive results are not eroded by creeping re-regulation and the re emergence of bad licenses and regulatory practices. Screening mechanisms for new business licenses can help identify and eliminate proposals for bad licenses before they are promulgated. For this reason, the Business Licensing Reform Approach advocates the development and implementation of a ‘light’ Regulatory Impact Analysis (RIA) system as an immediate and integral part of the licensing reform process. This approach needs to be tailored to the individual circumstances in each country and can include developing a clear criteria and processes to verify the quality of proposals for new or amended licenses. The RIA approach can also involve establishing a small oversight body within a central coordinating area of government, to provide ‘quality control’ over suggested new or amended licenses.

A host of documentation about the development of RIA systems is now available and can be accessed on World Bank Group (2010).

Ensuring sustainability: E-Registry

A centralized Electronic Registry of licenses is another mechanism to improve and sustain results of a licensing reform. A registry can hold all valid business licenses, and provide critical data to businesses on licensing requirements. The Business Licensing Reform Approach also advocates the development and implementation of an E-Registry as an immediate and integral part of the licensing reform program.

An E-Registry can document all licenses which apply in a particular jurisdiction, indicate who

is responsible for administering each license and provide their contact details. This registry should be kept up to date and be accessible to all stakeholders, including business. In some cases registries may also provide positive legal security, meaning that licenses must be in the registry in order to apply to business and be legally enforceable.

See World Bank Group (2010) for an overview of E-Registry practices.

How do it: Licensing reform step by step

Although there will always be country specific issues, opportunities, challenges and adaptations, the Business Licensing Reform Approach includes a series of sequential steps involved in the reform process. The reform approach as described above can be summarized in following key steps:

- 1) Project preparation and diagnostics;
- 2) Establishing a tailored and focused reform program;
- 3) Reviewing existing licenses; and
- 4) Reforming licensing systems, establishing processes to ensure bad licenses and regulatory practices do not re appear and implementation of effective and efficient M&E and reporting processes.

Each of these steps include specific tasks and challenges and is supported by a range of standardized documents such as information collection templates, Terms of reference (TORs), mandates, etc. Further information about these four steps for reviewing, reforming and simplifying licenses and related project materials can be found in the World Bank Group (2010).



Box 6: Business registration and licensing reform: similarities and critical differences

Business registration and licensing reforms have many similarities, but also critical differences. From the end user perspective (the entrepreneur wanting to register a business and commence operations) business registration and licensing should be seamless and integrated.

However, business registration and business licensing are based on different policy objectives, are governed by different kinds of laws and institutions, and require different reform approaches. For example, business registration aims to document as a legal entity all businesses and allow identification of businesses for taxation, statistical and regulatory purposes. By contrast, business licensing aims to regulate the conduct and behavior of businesses entering and operating in particular markets. Most business registration reforms evolve around one or more of four basic components:

1. moving registration out of the judiciary;
2. allowing business registration to take place at multiple locations (e.g., not only the capital city, etc);
3. computerization of the registration process and associated activities; and
4. integration of registration activities with other regulatory services and transactions (one stop shops, etc).

These reforms are often different to business licensing reforms, which tend to be more complex and politically sensitive, with greater reform costs and benefits distributed among affected stakeholders. This has important implications for the design and timing of the respective reforms.





WHAT DOES SUCCESS LOOK LIKE?: MONITORING AND EVALUATION OF LICENSING REVIEWS AND REFORMS

Development and application of a comprehensive M&E framework for business licensing

Monitoring and evaluation (M&E) is an important tool for identifying the results, impacts and significance of gains from licensing reviews and reforms. Each project life cycle has three M&E stages, including:

- Stage 1: project design, evaluation design and ex-ante cost/benefit analysis;
- Stage 2: implementation, monitoring and supervision; and
- Stage 3: completion, evaluation and assessment of lessons learned.

When commencing a project and thinking about M&E, it is important to focus on key strategic issues relevant to the licensing project and issues associated with effectiveness, efficiency, sustainability and documenting the IFC role and contribution. M&E is a key project management tool

for thinking through and documenting these issues in a systematic way. Indeed, it is important to have a robust M&E system in place at an early stage of a project, so that the potential gains from reform can be measured during the course of a project and then integrated into the design of future license reforms. Furthermore, such information collection and reporting is also important to meet internal M&E requirements and for projects (and staff) to be recognized when helping to facilitate successful results.

Applying M&E to licensing is both complex and challenging. For example, the impacts and outcomes from licensing reforms—and other regulatory reforms—can sometimes be difficult to measure. Some licensing reforms—in particular countries, for different types of licenses or licenses administered by particular regulators etc—will have very significant impacts. Reforming these licenses can generate very significant improvements such as large reductions in administrative burdens on business, better administration of licenses improving the effectiveness of the regulatory system and reducing the fiscal costs of regulators etc.

By contrast, other licensing reforms will generate smaller gains. For example, some licensing reforms may also focus only on particular significant licenses or groups or clusters of related licenses etc.

Determining the significance of licenses and gains from licenses reform

M&E aims to ensure that reforms are measured and reported on during the life cycle of a reform and according to a standard template which focuses on the impacts of reforms. Therefore, reforms to individual licenses which have significant impacts and generate significant benefits should be reported separately. Reforms to licenses which have less impacts should be grouped together for M&E reporting, so that their combined impacts are significant. The significance of licenses can be determined by reference to the scope of impact (i.e., how many businesses are affected) and intensity of impacts (i.e., according to whether impacts on affected businesses are large, medium or low etc).

M&E provides a readily available operational tool for project managers, and provides a way to ensure project-level comparable performance measurement indicators and targets are employed. The M&E framework and template employed for all licensing reviews and reforms should cover, among others, the Business Enabling Environment (BEE) indicator categories provided below. Furthermore, additional project specific indicators can also be used to supplement these mandatory indicators. Please contact the Business Operations product team for further information. M&E measures will typically involve an assessment of outcomes and impacts before and after licensing reforms and include:

Output indicators

Output indicators measure the quantity of outputs created by the project through the use of inputs

and other activities. Examples include the number of entities (i.e., countries or ministries etc) who received support from the project, the number of reports (assessments, surveys, focus group meetings, manuals etc) completed, the number of new licenses drafted and number of media reports etc.

Outcome indicators

Outcome indicators measure the results which have been achieved and are directly attributable to outputs. Examples include number of licenses repealed or substantially amended, change in the number of procedures/transactions needed to obtain a license, average number of days to obtain a license, and change in the number of firms obtaining a license.

Impact indicators

Impact indicators measure indirect results arising from licensing reforms. Examples include aggregate administrative and/or compliance cost savings to business due to licensing reforms and changes in employment (i.e., formal jobs) in sectors subject to licensing reforms.

For further information about template M&E indicators and measures see:

<http://vcg01.worldbank.org/vc/index.php> &
<http://smartlessons.ifc.org/lessonlisting.asp?id=322>

Tools available to assist in M&E

It is important to note that licensing M&E requires data such as the number of businesses affected by licenses, administrative and/or compliance burdens generated by licenses and changes in investment and employment etc, both before and after reforms are implemented. As noted above, such data are often difficult to obtain.

In some cases government statistics on business and economic activity provide a useful basis and starting point for M&E. However, in other cases

relevant government statistics may be unavailable or unreliable. In either case, further data will be required to undertake proper M&E for license reforms.

A range of specific tools are available to assist—on a case by case basis—in measuring M&E. For example, surveys and focus groups involving business can yield useful information on the impacts of licenses, such as compliance costs, impacts of inspections and out of pocket expenses etc. Experiments can also be constructed and conducted to measure the results of reforms (e.g., municipal level licensing reform using some municipalities as a ‘treatment’ group and similar municipalities as a ‘control’ group to compare outcomes and impacts).

However, it should be noted that these approaches require time and generate resource costs. Furthermore, there are often limitations in the quality of data generated through these approaches which need to be carefully documented and reflected in M&E reports. On balance, the time and resources allocated to data collection and analysis tools should be determined on a case by case basis. For further information and assistance please contact Business Operations Product team at businessop@worldbank.org.

The standard cost model (SCM) can also provide a very useful way of measuring administrative costs and burdens on business resulting from a license or group of licenses. This approach measures the time and cost incurred by business in obtaining licenses and meeting license conditions. Information generated by the SCM can be useful in identifying the significance of particular licenses (including where the gains from reform will be largest) and can assist in developing a targeted license reform program. The SCM can also be used to measure changes in compliance burdens before and after license reforms. Therefore, the impacts of reforms on particular businesses can be measured and the aggregate reductions in compliance burdens can also be estimated. For further information on tools available to assist with M&E.

M&E also involves reviewing and documenting lessons from licensing reforms, such as what worked well, what did not achieve expectations and why. It is also important to measure the perceptions of business and other stakeholders during and after the reform process. These lessons and perceptions should also be documented so that future licensing reforms can be ‘fine tuned’ and build-on the lessons learned from previous reforms.

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