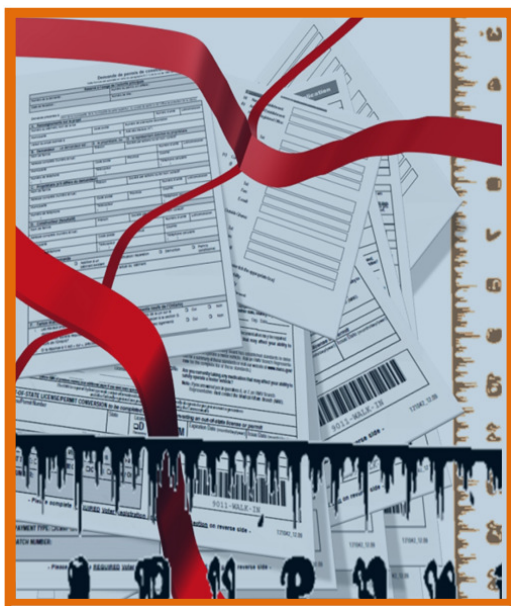


Measuring Red Tape in Developing Countries

Use and adaptation of the Standard Cost Model



Over the last few years the Standard Cost Model (SCM) has become the regulatory reform tool of choice in EU and OECD countries for identifying and reducing regulatory compliance costs. SCM provides a relatively simple methodology to measure and communicate businesses' paperwork obligations arising from compliance with governments' regulations. More recently the SCM has also been adapted and applied in a number of developing countries, including Kenya, Zambia, Vietnam, Burkina Faso and Madagascar. It is still too early days to conclude much on the SCM models general applicability in developing countries. However as part of a broader reform package the SCM has proven capable of strengthening momentum by providing new insights into regulatory obligations, by quantifying the costs and time associated with information obligations both at aggregate and at a rule-specific level.

SCM is a methodology for the measurement of "administrative burdens", imposed on the private sector by laws and secondary regulation¹. Developed in the Netherlands in the early 2000s, SCM contrasted with many previous measurement tools through its high level of detail on specific regulations. This enables a careful analysis of how specific regulatory requirements determine certain administrative activities, which are quantified in terms of time and costs.

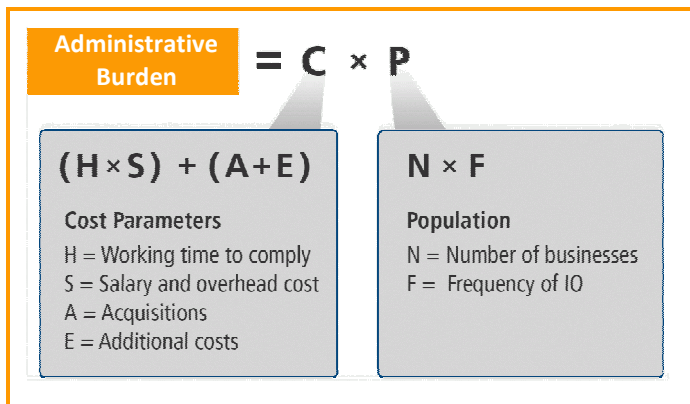
By presenting a cost on society of a specific requirement, a law, an entire jurisdiction – or the savings obtained through a particular simplification measure – it has become a very powerful tool in creating political commitment for regulatory reform and to raise awareness about ongoing reforms. For instance, a large share of the countries implementing SCM – as well as the European Union – have committed to decrease administrative burdens imposed on the private sector by 25% over a period of five years, which is estimated to lead to an increase of GDP by 2-3%. The Netherlands has already reduced its administrative compliance costs by 30%, from an initial level equal to 3.6% of GDP.

The "traditional SCM" (as first developed in the EU/OECD) measures the costs of activities occurring in firms when complying with regulatory requirements. More specifically, the focus is on "obligations arising from regulation to provide information and data to the public sector or third parties", as expressed by the International SCM Manual [reference]. It does not measure direct fees and taxes (direct financial costs), nor does it measure specific investments that firms have to do to comply with the law (substantive compliance costs).

This relatively simple model has proved to provide a useful proxy for administrative compliance costs and its application spread rapidly throughout the OECD countries. The World Bank Group's Investment Climate Advisory Services (FIAS) started using SCM as a diagnostic tool in business licensing reforms in the mid-2000s, and as of 2009 it has been rolled out in projects in Africa, Asia, Eastern Europe and Oceania.

How SCM works

The starting point of SCM is a breakdown of regulation into discreet regulatory requirements – so-called “information obligations” (IO) as they occur in the legal text. The IOs are the core components of SCM. The IOs are analyzed to identify what activities are required within an ordinary firmⁱⁱ, as well as the amount of **working time required for the firm to comply (H)**. The next step is to multiply this time with the **salary costs (S)** (including an overhead percentage, covering general office costs) for the employee who is dealing with the process. Additional costs occurred in the company that are directly related to the application – such as **acquisitions (A)** that are directly related to the application and services acquired from **external service providers (E)** – are thereafter added to arrive at the **total cost for the individual firm (C)**.



The basic formula to calculate administrative burden.

Although the cost for one individual firm may be of certain interest, it is likely to be of higher interest to determine the total annual compliance cost and the effects of simplification of a legal text cost caused on all affected firms in a jurisdiction. This extrapolation is done by simply multiplying the cost of the typical (e.g. normally efficient) firm with the **annual number of occurrences (P)**. If firms have to carry out a certain procedure on a regular basis (such as renewal of a certain license), the **annual frequency (F)** can be multiplied with the **number of affected firms (N)**. If an application procedure for a license is being studied, the easiest and most precise way to arrive at P is to multiply the firm's costs with the total number of licenses per year.

SCM as a tool in business licensing reforms

While being used increasingly around the world, SCM has also seen a continuous evolution and adjustment to new contexts. The International SCM Manual provides some methodological flexibility by presenting a set of choices to be made at the onset of a new regulatory review, but many measurement projects chose to take the development even further. This is also true for the World Bank Group's work with the model; rather than being used as an independent reform tool, it has been used as an integral part in the business licensing reforms where it fulfills two main roles. First, it provides input to the reform work in terms of pointing out regulations and parts thereof in need of reform. Second, it is a powerful monitoring and advocacy tool, enabling the users to set quantitative impact targets. Hence, after the first few years of experimental rollout, some key conclusions on the adaptation of SCM can be presented:

- 1. Measurement of license fees:** In several developing countries, the administrative burdens are limited compared to the license related fees, charges and taxes paid by the firms. This means that a considerable amelioration of the compliance costs can be obtained by lowering and/or simplifying fees, charges and taxes. The fee level is also of importance since high license fees may indicate that the purpose is to make more revenue than to cover only for the cost-recovery, which is not considered optimalⁱⁱⁱ.
- 2. Measurement of waiting time:** Waiting time can often be a severe problem in developing and emerging countries. Although not an actual expense in itself, it can generate a number of costs. A French project^{iv} suggested that waiting time results in 1) “operative costs” which occur when companies face increased overhead costs and lowered productivity; 2) “financial costs” when invested capital does not generate a return, and 3) “social costs” on society due to a decreased recruitment, and even layoffs.

In addition, it is a well-known fact that delays can act as a catalyst for corruption (e.g. “speed money”). The World Bank Group has collected

information on waiting time in most licensing reviews, but due to the complexity in calculating the monetary value of the waiting, most studies have made no attempt to estimate the costs it causes. The problem is both on an analytical (estimating the value of potentially missed opportunities) and a practical level (scarcity of data, difficult to collect information on corruption). For this reason SCM measurements present one dataset on compliance costs (measured in time and value), and the waiting for regulatory approval expressed in days.

- Simplification of data collection and analysis:**
 There have been successful efforts to use simplified data collection processes for SCM. While the default method in the SCM Manual is interviews with individual businesses, a licensing review can often be carried out through a focus group consisting of a few firm representatives. For instance, in some cases SCM has been able to provide a good outcome although the specific instructions on how to comply with IOs (referred to as “data requirements”) have not been assessed. Additional measurements will however be needed to judge how far the simplification can go and in what situations such a simplified model is appropriate.

Survey methodology is also used to measure how the private sector is affected by licenses. A survey often

SCM	Doing Business Indicators	Business Surveys
<p>Annual administrative burdens imposed on the private sector by information obligations (“obligations arising from regulation to provide information and data to the public sector or third parties”).</p> <p><i>E.g. a legal requirement to keep a register of sales, or to submit a license application.</i></p>	<p>Time and official cost a synthetic firm should expect if a standardized process in a certain pre-determined scenario is carried out in accordance with the law.</p> <p><i>E.g. An SME of a certain size, geographic location, etc. applies for a construction permit and utility connections when building a warehouse with a number of predefined features.</i></p>	<p>Annual administrative burdens per firm</p> <p><i>E.g. time spent on dealing with licenses annually per firm, official costs, bribes paid, hiring of external staff, waiting time for each license, etc.</i></p>

The Primary Unit of Observation of SCM, Doing Business Indicators and Business Surveys.

calculates the average cost of licenses for a representative sample of firms with a focus on the total regulatory compliance cost for companies. On the other hand, SCM looks for the “standard” compliance costs for each individual license that is being measured. While the survey methodology can provide more reliable information about the actual administrative costs (e.g. taking into account “administrative discretion” in the implementation of regulations) and measure the share of companies facing issues such as delays, demands to re-submit applications, and bribes while identifying relationships between different factors (sub-national jurisdiction v. delays, etc.), SCM will provide a more detailed description of time consumption for individual regulations and components thereof. It should also be mentioned that while a typical SCM process has a significant advantage, being less costly in terms of time and budget, the survey provides more robust data on the full range of experiences of a scientific sample of businesses, which can be used for a rigorous scientific analysis.

SCM and other measurement tools¹

The World Bank Group uses other tools to measure how the business environment is affected by licenses. The most well-known are the annual Doing Business (DB) indicators, a global comparative measurement of the time taken for small and medium sized companies dealing with red tape. However, the purpose and methodology of DB and SCM differ significantly. While on the one hand it is crucial for DB to use the same, pre-defined, methodology and assumptions in all studied countries, SCM is built on a more flexible approach which is adjustable to the specific environment. SCM has no aspirations of comparability in this sense and methodological decisions can be taken based on the particular project and its context. Therefore, the results of SCM may be more difficult to use for comparison purposes.

The Future of SCM in Developing Countries

The Standard Cost Model has seen a significant success as a tool for measurement of regulatory compliance costs in developed countries. From this initial diffusion across the EU and OECD, it has also proven useful in business licensing reviews in several developing countries. Through the World Bank Group's work, it has been adapted to the new circumstances, and found its particular role among a range of measurement tools, such as Doing Business and business surveys. At the same time, the model is likely to continue its development further through the use of new approaches and methodologies. Key challenges include the use of the model in poor data environments and to set limits for how much it can be simplified, when applied to developing and emerging economies.

The World Bank Group's Investment Climate Department cooperates with a network of the most qualified consultants in the field and has assisted clients in carrying out standard cost measurements in a range of developing and emerging countries. It has also advised on strengthening and application of SCM in leading OECD Countries, including the Netherlands and Denmark. Additionally, SCM has been integrated in other products, such as comprehensive business license reforms.

For further information see
www.wbginvestmentclimate.org
or contact: BusinessOP@worldbank.org

A Fictive Example

A fictive SCM is carried out to measure the compliance costs of a certain business license. It starts with the collection of information from the private sector through a focus group. During the session, the characteristics of an application procedure for a certain license are identified and it is established that in a normally efficient firm, one manager and one secretary are involved in the application, with average hourly tariffs of \$20 and \$10 respectively. While the manager spends eight hours on the process, the secretary's input is seven hours.

The application also requires a set of updated financial figures related to the firm, and since most firms applying for this license happen to be SMEs choosing to outsource their accounting, they need to request the accounting firm for help. The accountants charge \$50 per hour and spend two hours on preparing the required figures – this causes an external cost of \$100. In addition, a special envelope has to be purchased for all documents, which result in an acquisition cost of \$5. The applicant will eventually also pay a license fee, resulting in a direct financial cost of \$500.

This means that the process requires a total internal time consumption of $8+7=15$ hours, and the total internal cost of the firm is $\$160+\$70=\$230$. In addition to the internal cost, the acquisitions, external costs and direct financial costs add up to another \$605 – making the total \$835. Table 1 describes the process and how the time and cost for the individual firm is calculated.

One of the activities included in the first step is an application for a required tax clearance certificate. This certificate bears no cost, but the waiting time is three days. The processing of the license on the other hand, takes three weeks (15 working days). In total, this results in 18 days of waiting time per license application.

The project further learns from the regulator that it received 800 applications for this license in the previous year. Hence, in order to calculate the total compliance cost for the license on a national level the above figures are multiplied with 800.

Activity	Time required for input by manager (tariff: \$20/hour)	Time required for input by secretary (tariff: \$10/hour)	Other costs
1. Collecting required information:	1 hour	1 hour	Assistance from accountant: 2 hours x \$ 50 = \$100 Envelope: \$5
2. Compiling application:	2 hours	-	
3. Lodging application:	-	3 hours	License Fee: \$500
4. Follow-up/revise:	4 hours	1 hour	
5. Receive license:	1 hour	2 hours	
TOTAL TIME:	8 hours	7 hours	
COST:	8 x \$20 = \$160	7 x \$10 = \$70	\$605

Time and cost of a license application procedure

	Per firm	Total in jurisdiction
Internal time	15 h	12,000 h
Costs (internal + external)	\$835	\$668,000
Waiting time	18 days	14,400 days

Extrapolation of time and cost of an individual firm to the entire population of 800 annual applications.

Notes

ⁱ The SCM was first developed to be used to measure administrative burdens of the private sector. However it can and has been used to measure burdens imposed on other entities, such as charities and the voluntary sector in England; and citizens and public owned businesses in the Netherlands.

ⁱⁱ The International SCM Manual describes these "Normally Efficient Companies" as those that "handle their administrative tasks neither better nor worse than may be reasonably expected"

ⁱⁱⁱ See Corthay, Laurent, 2009: "Local Taxes, Regulations, and the Business Environment" Investment climate in Practice Note No. 5, April 2009 for a description of why licensing fees should not be used for generation of revenue.

^{iv} DGME/SQS, 2006: Cost of delays for businesses: Methodology (v.1). <http://regplus.eu/delays.doc>

^v A detailed comparison between SCM and other tools for measurement of administrative costs is available in Annex 2 of "Here Is Your Money! Using the Standard Cost Model to Measure Regulatory Compliance Costs in Developing Countries", published by the Investment Climate Advisory Services in 2010.