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Monitoring the Administrative Barriers to Small Business Development in Russia

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Executive Summary

The goal of the business deregulation program launched by the Ministry of Economic Development and Trade of the Russian Federation in 2001 is a significant reduction in administrative oversight, delays, and overall costs to businesses associated with procedures of registration, licensing, certification, and inspections. Enforcement of the laws underpinning the program is supposed to reduce the regulatory burden on business and foster a freer and less corrupt market economy.

To measure the effectiveness of the changes brought about by the business deregulation program, the Center for Economic and Financial Research (CEFIR)—in cooperation with the Ministry of the Economic Development and Trade (MEDT) of the Russian Federation and the World Bank, and with financial support from USAID—has conducted three rounds of surveys of small businesses in 20 regions of the Russian Federation. The surveys were face-to-face interviews, in which top managers or deputies of 100 firms in each region (20 recently registered and 80 incumbent firms) were asked questions about the administrative burden imposed on them by government regulation. The goal was to uncover the effects of the streamlining initiative of MEDT in the areas of licensing, registration, and inspections.

The survey for incumbent firms consisted of four sections: general firm information and perceptions about the overall business environment in their locality, as well as licensing, certification, and inspections. Focusing on the recent experiences of firms, the questions dealt with a wide variety of indicators of regulatory burdens, such as monetary payments, time and effort costs, number of agencies dealt with, and perceptions about the current level and change over time. By contrast, the questions in the survey of newly registered firms focused on the costs of entering the market: registration, licensing, and certification. In all three rounds, respondents were asked to compare the level of the administrative burden with the previous half-year.

The timing of the survey relates to the enactment of the four new deregulation laws. The first round of monitoring concentrated on the six months before and the six months after the law on protection of rights during inspections came into force. The second round concentrated on a time period after the laws on licensing came into effect. The third round tracked the changes after the new registration law. At present, results of the first two rounds have been analyzed; for the third round, preliminary findings are available.

The primary result of the first round was that in all areas of regulations the situation in 2001 was very far from the target level proclaimed in the legislation. According to legislation that came into effect in July 2002, the process of registering a new business should take five days and cost no more than 2,000 rubles. Data on administrative costs of entry for the second half of 2001 and the first half of 2002 show that the costs of registration were far from the target set by the government and that they were the same in the two rounds of the survey: on average, registration took about a month and cost about 4,500 rubles.
The second round showed noticeable improvements in inspections and licensing—the areas where new laws were enacted between the two rounds. A marked improvement in inspections was observed in the first half of 2002 compared to the first and second halves of 2001. The latter comparisons control for seasonal fluctuations, which the data presently allow only with respect to inspections. On average, the number of inspections in the first half of 2002 fell by 21 percent when compared to the first half of 2001, and by 27 percent when compared to the second half of 2001. Consequently, both the time that management spent on inspections and the costs of inspections to firms decreased.

Abuse of power by the inspecting agencies was still visible as of the first half of 2002, however: 6.4 percent of firms had experienced direct violation of the new law by fire safety inspectors and 5.2 percent by sanitary inspectors. Firms continued to report large numbers of unplanned inspections, especially by the police, for whom the share of unplanned visits was 45 percent. Twelve percent of firms reported that inspections presented a problem that could be characterized as “very serious” or “threatening the existence of the firm.”

Improvement in licensing is impressive. In February 2002, the new law on licensing regulations came into effect. The law stipulated a significant reduction in the number of activities requiring a license, reduced the cost of a license to 1,300 rubles, and increased the term of validity of a license to no less than five years (from 3,000 rubles and three years stipulated in the old law). The share of firms applying for licenses and permits dropped by more than a third, from 29 percent in the second half of 2001 to 19 percent in the first half of 2002. The biggest reduction in applications was for licenses that were legitimate under the 1998 law but no longer required in 2002: the number of firms that applied for such licenses fell from 4.3 percent to 1.7 percent of the whole sample.

While changes in other areas of regulation induce optimism, one must be cautious about comparing fall 2001 to spring 2002. Improvements in the regulatory environment may be caused by a seasonal cycle—not by reforms. Thus, although the number of firms applying for licenses did not grow back in the third round (the second half of 2002), the costs of obtaining a license grew back to the level observed in 2001. At the same time, the number of permits, which are technically not licenses, had fallen.

Other problems persist as well: The cost of acquiring a license still exceeds 1,300 rubles. Almost half of all legitimate licenses are valid for less than five years, the minimum term prescribed by the new law. The perceptions of respondents imply that licensing remains a strong impediment to growth for many firms: 14 percent said that licensing presents a severe problem.

The study has had a strong and positive impact in and outside of government. The survey process has strong support at high levels of government and key findings of the survey have been discussed at the cabinet level. Combined with public debate and wide press coverage (including the CEFIR and World Bank websites), the program has helped establish a forum for open and honest dialogue between government and the private sector that has resulted in improvements to the reforms.
From the start, CEFIR has been particularly active at making the results known to the MEDT, initiator of the reforms. After the first round, a presentation was made for a group of top-level ministry officials, including several deputy ministers. The findings about the large numbers of illegitimate inspections were later discussed by the cabinet. This discussion has contributed to the development of some further initiatives to remove administrative barriers.

The results of the monitoring project also have been widely cited in the press and on the Internet, thus stimulating public discussion. Articles and opinion pieces appeared in most major Russian publications.

Factors contributing to a successful survey process include government commitment, institutional innovation, learning and experimentation, and external catalysis. The survey program was born from the need to replace the MEDT’s process-based monitoring system with an outcome-based system that would better capture the results of deregulation measures enacted by the government. Understanding that need, ministry officials participated in the design of the survey instrument and in the sampling coverage. The fact that the survey was conducted by a private sector think-tank and that its results were publicly disseminated and discussed introduced a key civil-society dimension into the monitoring of key aspects of the government’s reform program. The results of the survey have fed back into policymaking and are likely to lead to corrective policy measures. The development and conduct of the survey enabled all stakeholders to realize the value of outcome-based monitoring as a key part of program monitoring. It is expected that such instruments may be used on other aspects of the government’s reform program, such as the effectiveness of social protection and utility tariff liberalization, and become a vital aid to the government in the implementation of its socio-economic reform program. The World Bank, as an external catalyst, played an important role in the development of the survey instrument. In addition, USAID provided, and continues to provide, financial support.

Valuable lessons have emerged from the study:

- Reforms have had the biggest impact in the localities with stronger fiscal incentives, less concentrated production, and larger representation of small business in the local economy.

- The presence of very large firms in the regions slows progress in licensing but accelerates progress in inspections. In other words, entry barriers are removed relatively slowly, while the burden on existing firms eases relatively quickly. This finding suggests that large companies inherited from Soviet times capture the local government and use administrative procedures to block the entry of new firms into the market. Hence, for successful development of small business and removal of administrative barriers, a local government has to diversify the structure of the economy, lessen the interference of large enterprises, and permit mobility of labor in and out of the town.

- A higher initial (pre-reform) level of small business in a regional economy improves enforcement of new deregulation laws. This result points to the importance of a small business lobby for deregulation reform.
In terms of successful monitoring of reforms, a major lesson learned is that the reforms have to set out clear goals, the outcomes of which can be measured and assessed. In the case of Russian debureaucratization, the adopted laws provided a clear set of rules, providing exact figures for the costs of bureaucratic procedures, lists of licensed activities, and rules for inspecting agencies. These guidelines allowed comparisons of the targeted levels of administrative barriers to the actually observed ones.

Hence, the method of independent monitoring of reforms can be applied in most other countries as long as a set of specific goals of the reforms can be identified. However, one needs to avoid over-reliance on perceptions of the respondents, a flaw of many similar surveys, and concentrate on quantifiable measures.
Implementation Process

Rational and Objectives

The goal of the business deregulation program launched by the Ministry of Economic Development and Trade of the Russian Federation in 2001 is a significant reduction in administrative oversight, delays, and overall costs to businesses that are associated with procedures of registration, licensing, certification, and inspections. Enforcement of these laws, if successful, is supposed to bring down the regulatory burden and allow for a much freer and less corrupt market economy.

Program Description

On request of the Ministry, the Center for Economic and Financial Research (CEFIR) – an independent Moscow think-tank is conducting an ongoing review of the regulatory burden on small businesses. Its program monitors and evaluates the enforcement and success of the deregulation program. In the spring of 2002, in collaboration with the World Bank, and with financial support from USAID, CEFIR conducted the first round of surveys of small businesses in a number of Russian regions. The purpose was to establish the benchmark levels of the regulatory burden from registration, licensing, certification, and inspections before the launch of the government’s deregulation program. The next two rounds, conducted in the fall of 2002 and spring of 2003, were meant to detect change in the costs of administrative regulation over time and also track seasonal variation. Two more rounds are scheduled for the spring of 2004 and spring of 2005.

The survey is being conducted in 20 regions of the Russian federation. The sample of 100 firms to be interviewed in each region was stratified in the following manner: 20 recently registered firms, in most cases during the second half of 2001, and 80 older firms. In addition, in each region up to six consultants who provide intermediary services for registration, licensing, and certification were interviewed.

Face-to-face interviews were conducted with either the top managers of the firms or their deputies. Different questionnaires were used for newly registered firms, intermediaries, and all other firms (that henceforth are referred to as incumbents or “old” firms).

The main survey for incumbent firms consisted of four sections: general firm information and subjective perceptions about the overall business environment in their locality, licensing, certification, and inspections. The questions focused on recent experiences of firms and dealt with a wide variety of indicators of the regulatory burden, such as monetary payments, time and effort costs, number of different agencies dealt with, perceptions about the current level and change over time, etc.

By contrast, the questions in the survey of newly registered firms focused on costs of entering the market: registration, licensing, and certification.
In all three rounds, all of the questions were about the immediately preceding half of a calendar year. In addition, respondents were asked to compare the level of the administrative burden with the previous half-year. The timing of the survey relates to the enactment of the four new deregulation laws in the following way:

- The first round of monitoring concentrated on the six months before and the six months after the *law on protection of rights during inspections* came into force.
- The second round concentrated on a time period after the *laws on licensing* came into effect
- The third round could track the changes after the new *registration law*.

Thus, the goal of the first round was to establish a baseline for comparison with the results of the subsequent rounds and to evaluate how far the current practice was from the legislated targets.

**Results**

At present, results of the first two rounds have been analyzed, and preliminary findings of the third round are available. These results are as follows.

The primary result of the first round was that in all areas of regulations the situation in 2001 was very far from the target level proclaimed in the new legislation. The second round showed noticeable improvements in inspections and licensing (the areas where new laws were enacted between the two rounds). We also observe a marked improvement in inspections in the first half of 2002 compared both to the first and second halves of 2001 (the latter comparisons control for seasonal fluctuations). So far, the data allow controlling for seasonal fluctuations only for inspections.

While changes in other areas of regulation induce optimism, one has to be cautious about comparison of the fall 2001 to the spring 2002: improvements in the regulatory environment may be caused by a seasonal cycle, and not by reforms. Thus, although the number of firms applying for licenses did not grow back in the third round (the second half of 2002), the costs of obtaining a license grew back to the level observed in 2001. At the same time, the number of permits, which are technically not licenses, has fallen.

**Registration**

According to the new legislature, which has come into effect in July 2002, the process of registration a new business should take five days and no more than 2,000 rubles. The law also established “one window” rule: an entrepreneur needs to visit only one government agency in order to register. The first two rounds of the survey took place before the enactment of the new registration law: so far we have information on administrative costs of entry for the 2nd half of 2001 and the 1st half of 2002. The survey showed that the costs of registration were far from the target set by the government and that they were the same in two rounds of the survey: on average, registration took about a month and cost about 4,500 rubles. The third round allowed comparisons of the practice in the fall of 2002, just after the reform, to the pre-reform level. The number of offices visited has indeed decreased by one to the medium number of four. This happened because firms no longer need to visit the local administrations or registration chambers, they
instead go to the tax authorities. Hence, the overall length of the procedure decreased, but the monetary cost has risen, apparently since the tax authorities were not prepared to handle the increased flow of applicants, which stimulated more bribery and payments to intermediaries.

**Inspections**

According to the new inspection law that was implemented in August 2001, planned inspections by a given agency are supposed to take place no more than once every two years. Although the number of unplanned inspections is not regulated, the procedure for their initiation is. Before the new law took force, a large number of firms experienced more than one inspection by each agency. After the enactment of the new law, a significant reduction occurred in the number of inspections by all government agencies.

On average, the number of inspections in the first half of 2002 fell by 21 percent when compared to the first half of 2001, and they fell by 27 percent when compared to the second half of 2001. Consequently, both the time that management spends on inspections and the costs of inspections to firms decreased.

Sixty-one and 73 percent of firms, respectively, have not had a single inspection by fire safety or sanitary inspection agencies in the first half of 2002 (these were the two most problematic inspection agencies among those regulated by the new law). This percentage is higher for all other inspecting agencies. However, during the first half of 2002 fire safety inspectors came to 11 percent of firms more than once, and sanitary inspectors to 9 percent of firms.

Abuse of power by the inspecting agencies is still visible as of the 1st half of 2002, however: 6.4 percent of firms have experienced direct violation of the new law by fire safety inspectors and 5.2 percent of firms by sanitary inspectors. These agencies conducted more than one planned inspection in these firms. Firms also still report large numbers of unplanned inspections, especially by the police department, for whom the share of unplanned visits is 45 percent. 12 percent of firms reported that inspections present a problem for them that can be characterized as “very serious” or “threatening the existence of the firm.”

The irregular nature of the inspections is also emphasized by the fact that during two thirds of all unplanned inspections in the 1st half of 2002, inspectors did not show a warrant; and if they fined the businesses, the fines in about a third of all cases were not based on an official schedule.

**Licensing and Permits**

Improvement in licensing is also impressive. In February 2002, the new law on licensing regulations came into effect. The law stipulated a significant reduction in the number of activities that require licenses, reduced the cost of a license to 1,300 rubles and increased the term of validity of a license to no less than five years (from 3,000 rubles and 3 years stipulated in the old law). Table 5 shows that the share of firms that applied for licenses and permits has dropped from 29 percent for the second half of 2001 to 19 percent for the first half of 2002 (by a third).
The licenses have become easier to obtain: their monetary cost fell by about a quarter from 10,500 rubles to 8,000 rubles and the average length of time needed to acquire a license fell from 37 to 33 days. The average term of validity of the licenses held by the surveyed firms increased to 32.5 months from 29.5 months. [Editor’s note: should this be permits or licenses— one costs 1,300 rubles, the other 8,000 rubles? Also, should a $US number be added alongside the rubles?]

The composition of the licenses and permits changed slightly, in a way that suggests that the reform produced some positive results. Among all licenses and permits applied for by firms, the biggest reduction in applications was for those licenses which were legitimate under the 1998 law but no longer required in 2002: the number of firms that applied for such licenses fell from 4.3 percent to 1.7 percent of the whole sample. The number of other license and permit applications, both legitimate and illegitimate, also fell, but to a lesser extent. [Editor’s note: please define “illegitimate”. Are they fraudulent, illegally imposed by authorities?

Although this is a clear sign of the progress of the reform, the numbers do not give too much cause for optimism. Although improved, the existing practice, has not reached the benchmarks established in the new legislation:

- The number of illegitimate licenses remains high, taking up 33 percent of the total. Moreover, respondents applied for 224 permits in the second round, which constitute one third of the total number of licenses and permits.
- The acquisition costs still exceed 1,300 rubles
- Almost half of all completely legitimate licenses have terms of validity less than 5 years prescribed by the new law.
- The subjective perceptions of respondents point out to the fact that licensing remains a strong impediment to growth for many firms: 14 percent of them said that licensing presents a severe problem (down from 20 percent half a year earlier).

Thus, many problems that remain in licensing and inspections are associated with local enforcement rather than with regulating legislation.

**Impact Analysis**

Since the project started, its results produced an impressive impact on both the public debate and government action:

- CEFIR has established a precedent for credible independent review, with strong government support, of government initiatives
- The survey has established a forum that facilitates open and candid dialogue between government and the private sector.
- Government has fostered a way to obtain a clear assessment of its own reforms, in this case, the reform aimed at lowering administrative barriers to small businesses.
• By generating both public debate and discussions within the government, the study contributed to shaping of further economic policy.
• CEFIR and the World Bank have presented the results to a large national and international audience at seminars with different organizations, in the press, and on the Internet.

From the start, CEFIR has been particularly active at making the results known to the Ministry of the Economic Development and Trade, the initiator of the reforms. After the first round, a presentation was made for a group of top-level officials of the ministry, including several deputy ministers. The findings about the large numbers of illegitimate inspections were later discussed in the Cabinet. This discussion has contributed to the development of some further initiatives in removal of administrative barriers. Thus, the recently adopted amendments to the law on inspection banning all planned inspections in the first three years of a firm’s operations certainly drew on the responses of the businessmen interviewed in the CEFIR survey.

The results of the monitoring project have also been widely cited in the press and Internet, thus stimulating public discussion. Articles and opinion pieces appeared in most major Russian publications, such as the Expert magazine, and the daily newspaper Vedomosti.

Driving Factors

There have been many driving factors that have resulted in a successful establishment of the survey process. These are detailed below:

Government Commitment

This survey was born out of the need of the Ministry of Economic Development and Trade to institutionalize an outcome-based system to monitor the results of some of the deregulation measures passed by the Government. As a result, there was strong interest and participation by ministry officials in the design of the survey instrument as well as the sampling coverage. The ministry also provided help with the acquisition of the needed lists of small businesses, from which CEFIR could later draw samples for interviews. The Russian Cabinet also discussed the results from the survey.

Institutional Innovation

The conduct of the survey through a private sector think-tank and the public dissemination and discussion of the results of the survey have introduced a key civil society dimension in the monitoring of the implementation of key aspects of the Government’s reform program. To the extent that this institutional innovation is a partnership between the Government, the private sector, donor organizations, and civil society, it provides credibility to the results of the survey as well as the implementation of the deregulation reforms. The results of the survey feed back directly into policymaking and will likely lead to corrective policy measures.
Learning and Experimentation

The development and conduct of the survey was a learning experience for both CEFIR as well as the Government. It enabled all stakeholders to realize the value of outcome-based monitoring as a key part of program monitoring. It is also expected that such instruments could be utilized for other aspects of the Government’s reform program, such as the target effectiveness of social protection and utility tariff liberalization, and be a vital aid to the Government in the implementation of its socio-economic reform program.

External Catalysts

The World Bank, as an external catalyst, has played an important role in the development of this instrument. In addition, USAID has provided financial support for carrying out this study and continues to do so.

Lessons Learned

Important lessons were learned both about the factors driving success of reforms and the appropriate methods of monitoring reform. In terms of success of de-bureaucratization, the main lesson is that there are strong complementarities of different reforms — the progress was most apparent in regions and municipalities that are also more progressive in other senses as well.

First of all, the local fiscal federalism arrangements - the extent to which additional local revenues are not taxed by the regional-level budgets - positively affect the dynamics of deregulation reform in inspections. Municipalities with better fiscal incentives have more sizable improvements in regulatory costs of inspections between the rounds, holding everything else constant.

Second, the presence of very large firms in the regions slows down the progress in licensing, but accelerates the progress in inspections: entry barriers are removed with relatively slow pace and burden on existing firms becomes lighter relatively fast. This finding suggests that large companies inherited from the Soviet times capture the local government and use administrative procedures to block the entry of new firms into the market, unless these firms are well connected. Hence, for successful development of small business and removal of administrative barriers, a local government has to diversify the structure of the economy, lessen the interference of large enterprises, and permit mobility of labor in and out of the town. Third, regional economies with a higher number of pre-reform small businesses also have improved enforcement of the new deregulation laws. This result points to the importance of small business lobby for deregulation reform.

In terms of a successful monitoring of reforms, a major lesson learned is that the reforms have to set out clear goals, whose outcome can be measured and assessed. In the case of the Russian de-bureaucratization, the adopted laws provided a clear set of rules, providing exact figures for the costs of bureaucratic procedures, lists of licensed activities, and rules for
inspecting agencies. These guidelines allowed comparisons of the targeted levels of administrative barriers to the actually observed ones.

Hence, such method of independent monitoring of reforms can be applied in most other countries, as long a set of goals of reforms can be identified. One needs to avoid over-reliance on subjective perceptions of the respondents, which are frequently used in similar surveys, and concentrate on exact quantifiable measures.
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