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Reducing bureaucracy and corruption affecting small and medium enterprises

Query

What are the main tools/levers to help reduce the impact of bureaucratic corruption on small and medium size enterprises? Does removing bureaucratic discretion help (e.g. publishing fixed rates for taxes and duties, simplifying business registration procedures, conducting routine transactions electronically rather than in person)? Please cite country examples where possible.

Content

Note

This answer draws on a previous Transparency International Helpdesk answer produced in 2012 on the linkages between bureaucracy and corruption.

Summary

Excessive bureaucracy imposes a disproportionate bureaucratic burden on small and medium size enterprises, creating both incentives and opportunities for bribery and corruption. This can manifest itself in the form of excessive or overly rigid administrative procedures, requirements for unnecessary licences, protracted decision-making processes involving multiple people or committees and a myriad of specific rules that slow down business operations.

Countries across the world have made use of a variety of tools to reduce bureaucracy and limit corruption opportunities affecting small and medium size enterprises. This includes one-stop shops, the use of data-sharing and standardisation, common commencement dates for new rules, as well as simplification of administrative procedures, and tailored guidance to SMEs. ICTs and E-government have also been used to improve administrative regulations and most importantly improve transparency and accountability.

While in some countries such reforms are part of broader anti-corruption strategies, in others bureaucratic reform primarily aims at promoting growth, attract investments, and increase competitiveness. This answer analyses the case of Portugal which implemented extensive and ambitious reforms aimed at reducing bureaucracy, and the case of Georgia, which

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is often referred to as a best practice example in reducing red tape and curbing bureaucratic corruption.

1 The links between corruption and bureaucracy and its impact on SMEs

Evidence of linkages between corruption and bureaucracy

Bureaucracy or red tape, as it is often referred to, is a "derisive term for excessive regulation or rigid conformity to formal rules that is considered redundant or bureaucratic and hinders or prevents action or decision-making. (…) Red tape generally involves the filling out of seemingly unnecessary paperwork, obtaining unnecessary licences, having multiple people or committees approve a decision and various low-level rules that make conducting one's affairs slower, more difficult, or both" (Anti-Corruption Business Portal, 2012).

There is broad consensus that bureaucracy and red tape offer both incentives and opportunities for bribery and corruption. Institutional barriers provide an opportunity for rent-seeking as individuals and businesses may be willing to make illegal payments to circumvent these barriers. Also, in some countries, public officials may create additional bureaucratic procedures as an opportunity for bribe extortion, changing the public sector's incentive system towards a rent-seeking culture (Kaufmann & Wei, 1999; Kurer, 1993; Mauro, 1995; McChesney, 1997; Tanzi, 1998).

The impact of bureaucracy and corruption on small and medium sized enterprises (SMEs)

Survey data has shown that corruption poses a heavy burden on small and medium size firms. On average, 38% of small and medium size enterprises surveyed in the World Bank and IFC Enterprise Survey identify corruption as the major constraint for doing business (World Bank & IFC, 2010).

In some countries, the number of small and medium size companies reporting having to make unofficial payments in order to access public services or issue licences and permits is significantly higher than the number of larger companies. For instance, according to the Enterprise survey, while the percentage of large

companies that reported being expected to give gifts in order to get construction permits in Honduras is approximately 8%, nearly 18% of small firms have reported being expected to give gifts to get such permits (World Bank & IFC, 2010).

Overall, interviews conducted by the UNIDA and UNODC demonstrate that bribery is the most common form of corruption affecting SMEs. Small and medium size companies have reported paying bribes in order to access government services that they are entitled to or requested by law, such as licenses, permits, contracts, tax incentives (UNIDO & UNODC, 2007). Companies have also reported paying bribes in order to speed up procedures or evade the law (UNIDO & UNODC, 2007).

Within this framework, regulation is one of the main areas where opportunities for corruption may arise when dealing with public officials. Therefore, studies have shown that the "*likelihood of SME involvement in corruption increases in relation to the number of procedures required in order to do business in a certain sector*" as well as in relation to the level of discretion enjoyed by public officials in applying such procedures (UNIDO & UNODC, 2007:11).

According to the same study, SMEs are more susceptible to bureaucratic corruption than larger companies due to their structure (e.g. there is often a greater degree of informality and less accountability mechanisms); short-term vision and perspective (as opposed to larger companies, small and medium size enterprises are less concerned about reputation and other long-term negative impacts of corruption); limited financial resources; and their inability to wield influence over officials and institutions, lacking bargaining power to oppose requests for illegal payments from public officials.

In addition, SMEs are also more susceptible to administrative corruption due to the fact that they often lack time and resources to get informed about complex regulations and its requirements, making illegal payments to either cover up mistakes or avoid overly bureaucratic procedures (UNIDA & UNODC, 2007).

2 Tools to reduce bureaucracy and corruption

This section looks at the tools used by different countries aimed at reducing bureaucracy that could be also useful for improving the regulatory environment of

small and medium size enterprises and consequently for discouraging corrupt behaviour.

Bureaucracy reduction initiatives often have the primary aim of easing business operations to foster growth and competition, but evidence shows that they can also have an impact on reducing the opportunities for bureaucratic corruption (Dzhumashev, 2010).

Best practice tools to reduce administrative burden

The OECD has developed a toolkit for administrative simplification and reduction of administrative burdens which highlights initiatives adopted by different countries that have brought good results (OECD, 2006; 2011). While these tools were not designed specifically for small and medium sized enterprises (SMEs), many of them coincide with strategies defined by the European Commission *Models to Reduce the Disproportionate Regulatory Burden on SMEs* (2007) and by the OECD's *Small Business Act* which are aimed specifically at improving SMEs' environment. These include:

Process re-engineering:

Process re-engineering mechanisms are based on the review of requirements made by the government with the aim of reducing their number and facilitating compliance through redesign, eliminations of redundant steps, and use of technology (OECD, 2010). For instance, an administrative burden for companies can be reduced by lifting (part) of the regulations, by exempting groups of companies such as SMEs, and changing the threshold, frequency and scope of reporting and/or inspections, e.g. the establishment of a minimum turnover requiring a business to register for VAT could benefit SMEs (OECD, 2007; European Commission, 2007).

With regards to permits and licenses, process re-engineering mechanisms used by countries include the replacement of authorisations by notifications, simplification of documentary requirements, and the establishment of time limits and 'silent is consent' clauses, where government agencies have a timeframe to respond to requests and the failure to do so implies that all the necessary conditions have been met.

Other mechanisms include the harmonisation of laws and regulations, for example, by reviewing existing regulations to eliminate inconsistencies and duplications and integrating different and fragmented regulations into a (single) comprehensive law (OECD, 2010)

One-stop shops

Governments should seek to provide easier, faster, and more transparent help and guidance to companies and citizens. The establishment of one-stop shops as a single entry to authorities is one of the mechanisms used in several countries. One-stop shops may provide several integrated functions, such as starting a business, post-registration formalities with tax authorities, provision of information on business environment and its requirements, as well issuance of documents, licenses or permits.

In Belgium, for instance, individuals who wish to start their own business can go to a one-stop shop in their neighbourhood, where they receive a single identification number that they use in all communications with the public administration as well as receive support on all the formalities involved in the process. Prior to the one-stop shops' existence, entrepreneurs wishing to register their business had to visit at least four different government agencies (European Commission, 2007).

These service points may also be virtual, providing a single electronic interface for entrepreneurs, such as in Canada where the BizPal, a web-based service, allows businesses to easily generate a customised list of the permits and licences required from all levels of government (federal, provincial/territorial, and municipal). This one-stop shop online resource helps businesses to clarify steps for regulatory approval, and reduce their costs to meet compliance requirements (OECD, 2006).

Common commencement dates

In many countries, SMEs and businesses in general often complain about the lack of information with regards to changes in rules and regulations. In order to avoid misunderstandings in the application of the law, which in fact may also offer further opportunities for corruption as discussed in the previous section, the European Commission has encouraged member states to adopt common commencement dates for new legislation affecting businesses (European Commission, 2007).

For instance, in the United Kingdom, all rules concerning businesses operating in the country can only come to effect on two pre-determined dates each year (6 April and 1 October). This helps small and

medium size companies plan for the new or revised regulation, and helps to avoid excessive regulations and costs (European Commission, 2007).

Data-sharing and standardisation

Businesses often have to submit the same information to different government agencies in different formats and by other means. Data-sharing among these agencies as well as standardisation of formats could decrease the bureaucratic burden on business. This is particularly relevant to SMEs, to reduce the likelihood that these companies are asked to provide the same information to different offices of the public administration (OECD et al., 2012). In Finland, for instance, the post office offers an electronic client service through which companies and associations can make declarations to the authorities which collect statutory data, allowing users to report the data only once. In the Netherlands, companies only have to submit information to the tax authority which is then responsible for sharing it with the Workers Insurance authority (OECD, 2006).

E-government

ICTs (Information and communication technologies) and E-government initiatives are important tools for achieving administrative simplification and reducing regulatory burdens. Moreover, by improving enforcement mechanisms, reducing the discretion enjoyed by public officials and increasing transparency, ICTs may play an important role in reducing corruption and informal sector activities (European Commission, 2007).

There are several ICT based mechanisms which could reduce administrative burdens and facilitate all the procedures discussed above, such as (i) the use of electronic reporting, such as the filing of tax and social security returns online; (ii) data-sharing between authorities, and (iii) online one-stop shops.

In particular, the use of electronic reporting may reduce significantly the costs for small and medium size enterprises for complying with government requirements (OECD et al., 2012).

However, in using ICTs for reducing bureaucracy and consequently bureaucratic corruption affecting small and medium size enterprises, governments should assess whether the majority of small and medium size enterprises operating in the country in question have access to internet and could benefit from the online services.

Guidelines on the regulatory framework

SMEs could also benefit from simple and accessible guidelines and other tailor-made information related to regulatory issues affecting them (UNIDO & UNODC, 2012). In addition, countries should seek to establish clear and "user-friendly" legal frameworks, avoiding complicated and inconsistent legal terms. For instance, in 2003 Bulgaria established a new legal framework aimed at reducing regulatory burden by streamlining legal terms for SMEs, making it easy for companies to comply with regulations (European Commission, 2007).

Other policy tools to be combined with bureaucracy reduction strategies

To reinforce administrative burden reduction programmes and ensure that results are consistent and benefit business and citizens, the OECD (2007; 2010; 2012) has underscored several enabling policy options to be combined with the above described tools. Within this framework, countries should aim to integrate administrative burden strategies with broader regulatory reforms and e-government, where appropriate.

Ex ante controls

Countries have also adopted ex ante controls of the burden introduced by new regulations to minimise new administrative burdens and ensure that new regulations are proportional, rational, and transparent. These controls are usually done through impact assessments and have proven instrumental to ensure that administrative reduction programmes are consistent also in the long run.

Regulatory Impact Assessments (RIA) have been introduced by several countries as means to avoid the introduction of unnecessary regulation as well as analyse the potential impact of draft legislation on small and medium size enterprises (OECD et al., 2012). In Armenia, for example, the government has recently created a legal framework for RIA, through which the potential impact of a new legislation is analysed based on cost-benefit analysis as well as consultations with stakeholders from SMEs and industry. It remains to be seen how the impact assessment will be applied in practice (OECD et al., 2012).

Measurement

Measurement has also become part of the strategy for administrative burden reduction. The most common measurement tool for assessing the cost of burdens is

the standard cost model (SCM). This model allows the measurement of the burden that a single obligation imposes on business, which then allows countries to set reduction targets and measure reduction over time (OECD, 2010).

Coordination, monitoring and stakeholders' engagement

Efficient institutional structures for coordination and monitoring of administrative simplification reforms can be created. It is also essential to involve sub-national levels of government, particularly in dealing with small and medium size enterprises.

Additionally, involving affected stakeholders from the beginning may also ensure that reforms are tackling the 'right' problems. Consultation, therefore, is a key step for a successful reform.

In Rwanda, a specific development policy for SMEs has been created in 2010, following an extensive consultation process. The policy aims, among other things, to simplify the fiscal and regulatory framework for SMEs growth in the country. According to the SMEs consulted during the process, one of the main challenges relates to the difficulty faced by them to understand current regulations as well as the timeliness of registrations at the responsible government bodies (Ministry of Trade and Industry, 2010).

3 3 Case studies of Georgia and Portugal

This section analyses the case of Georgia, which is often referred to as a good example in reducing bureaucratic corruption, and of Portugal, which has implemented extensive and ambitious reforms aimed at reducing bureaucracy. In the case of Portugal, while the initiatives to cut red tape and reduce bureaucracy did not intend primarily to curb corruption, they have helped to increase transparency and accountability, and thus, may have the potential to limit corruption opportunities.

In Georgia, on the other hand, reducing red tape is part of the government's anti-corruption strategy. While the government has yet to establish a special institutional arrangement for SME policy, the business environment for small and medium sized enterprises has improved significantly with the reforms adopted thus far (OECD et al., 2012).

Georgia

In Georgia, before 2003, bribes were needed to get a passport, register property, start a business, or get a license. The excess of administrative procedures combined with the extremely low salaries received by public officials created a huge incentive for corruption in the country. Therefore, bribes were often paid to speed up procedures or circumvent requirements (World Bank, 2012).

In 2005, the government's anti-corruption strategy included tackling bureaucratic corruption. The approach taken was to limit as much as possible the contact between citizens and the state, driven by the idea that the interference of the state should be minimal. In this context, agencies were eliminated, one-stop shops created, the number of inspections reduced, in what is often referred to as one of the most successful approaches to curb bureaucratic corruption (OECD et al., 2012; World Bank, 2012).

The first step was to analyse government agencies, and every license, permit, and inspection required by each of these institutions. The government was convinced that the majority of licenses, permits, and inspections served no legitimate purpose, either because there were tedious processes in place, or because corruption was so endemic that they would not have the intended effect. After extensive discussions with the responsible agencies, the Government decided to reduce the number of required licenses from 909 to 137. These 137 remaining licenses regulate activities which could potentially be a threat to the environment, human health, or national security, for example. Nevertheless, even regulations, such as controlling auto emissions, were eliminated if the agency responsible was considered as not having the capacity to administer or enforce them (World Bank, 2012).

The strategy also encompassed other administrative simplification tools, including:

(i)   **One-stop shops** were established for businesses and citizens. Guidelines were also published, spelling out all the necessary requirements for issuance of licenses or other documents, and pre-determined time limits for the completion of tasks were also imposed. Other unnecessary bureaucratic steps, in particular in corruption prone areas such as construction were removed. In addition, all fees are now paid through banks, and no longer to directly to public officials.

In addition, the government issues a single identification number for companies (notification), without requiring entrepreneurs to apply for several registrations with different authorities (OECD et al., 2012).

(ii) **'Silent is consent' rule**: in order to reduce processing times, the government established timeframes within which departments had to issue most licenses and permits, and the failure of responding to a request would lead to the direct grant of the permit/license.

(iii) '**Regulatory outsourcing'**: this approach means that many goods and services that have undergone regulatory scrutiny in a OECD country do not need to be re-certified in Georgia. For example, food certified in any OECD country can be imported without further certification. A financial institution with a license issued by an OECD country can also establish a branch in the country without further requirements.

(iv) **Streamlining staffing**: the government cut unnecessary ministries and public positions. The government also invested in trainings and improved the salaries in the public sector.

Results and challenges

The results of the anti-corruption strategy in Georgia with regards to reducing red tape are demonstrated in the country's improvement in global assessments such as the World Bank & IFC *Doing Business* and the World Economic Forum *Global Competitiveness Report*. Georgia ranking on the *Doing Business Index* improved from 112th in 2005 to 16th in 2012 (World Bank & IFC, 2012). The country scored particularly well in the rankings closely related to anti-corruption reforms, such as registering property, dealing with construction permits, and starting a business. For example, the number of days needed to obtain a construction permit was reduced from 196 to 98 days and the number of procedures from 25 to 9.

In the *Global Competitiveness* report 2011-2012 which assesses the burden of government regulation, Georgia scored 4,5 (where 1 means extremely burdensome and 7 not burdensome at all), ranking 7th out of 142 countries, ahead of countries such as New Zealand and Australia.

Assessments have also shown that accountability has improved. Interaction with public officials were reduced to a minimum (e.g. 95% of business no longer need any kind of permit or license), and all interaction which is still necessary is recorded electronically. Because obtaining licenses and permits became much faster, the incentives for paying bribes were also reduced (World Bank, 2012).

On the other hand, a number of challenges in implementing these reforms can be identified according to the World Bank (2012), particularly challenges related to:

- Communication: the government failed to communicate all the changes/reforms in a timely manner. Businesses, for example, were still applying for licenses and permits that were no longer required.

- Capacity of government agencies: the government over-estimated the capacity of agencies to adapt quickly to the requirements of one-stop shops and the "silent is consent" rule.

- Pace of reforms: reforms were quite radical as to achieve quick results, leaving an unfinished agenda of institutional reforms (e.g. the creation of regulatory agencies) that now needs to be addressed by the government. Moreover, such reforms were not part of an agenda to improve regulatory quality. The government will have to use this momentum to further implement better regulatory policy and other regulatory quality tools.

- Finding the right balance: further thought should be given to how to protect consumers' rights, the environment as well as certain market allocations while keeping the government's approach to minimum interference and limited interactions between government officials and business. A broader integrity system, with particular attention to checks and balances, should be established to guarantee that corruption at all levels is controlled.

Overall, Chene (2011:3) noted: "while these efforts made Georgia relatively successful in fighting petty bribery, critics paint a more nuanced picture of the situation. They argue that the initial anti-corruption strategy was ad-hoc in nature rather than systemic, with a curative rather than preventive focus, addressing isolated cases of corruption on a case by case basis. Some consider that corruption patterns evolved from rampant petty bribery to more clientelistic forms of corruption".

Portugal

The Portuguese government established in 2006 a Legislative and Administrative Simplification Programme (Simplex) integrated with an e-government programme. The programme primarily aims at quickly improving the efficiency and effectiveness of public service delivery to citizens and business as well as improving competitiveness through better regulatory frameworks (Presidency of the Council of Ministers, 2006; Presidency of the Council of Ministers, 2008).

In the Simplex 2006, the initiatives were divided into key areas of intervention, including:

(i) **Elimination of certificates** by improving information sharing among different departments and authorities and creating an online 'permanent certificate' which can be accessed on the portal Business Online by any public or private body through an access code;

(ii) **Simplification/de-bureaucratisation** aimed at reducing obligations that were disproportionately burdensome or complex for citizens and businesses, and eliminating unnecessary licences, permits;

(iii) **Facilitating access to public services** by improving service integration, information and data sharing, as well as transforming the way people are dealt with at physical contact points. Measures included merging those points and co-locating them, for instance by creating one-stop-shops for business and citizens and merging the provision of services for specific sectors. For example, the "Single logistical window" for the maritime/port system centralises in a common area the information and documentation concerning the various agents in the logistical chain from shipping and transit agents to logistical operators. The platform also allows paperless procedures for decision-making.

Other initiatives include the harmonisation of legislation, e.g. the consolidation of radio and television licensing, prior authorisations and media registers' legislation, and the consolidation of the legal system governing urban development and building work.

In its initial phase, the Simplex programme was based on the principle that reforms should target concrete problems (quick wins) rather than aim at a comprehensive reform targeted at all sectors. Initiatives were thus selected following a bottom-up approach, which has helped removing some key bottlenecks rapidly. In subsequent years the Simplex programme broadened its scope to cover the improvement of regulatory quality more generally, as well as to promote a cultural shift within the public administration with regards to regulatory policy (OECD, 2008).

Although the Portuguese public sector is extremely centralised, within this programme, regional and local levels of government, autonomous regions and municipalities play an active role. They are involved in the legislative procedures via consultations and have to apply a number of the simplification measures taken by the central government. Regions and some municipalities have also developed their own simplification measures, especially relevant and important for small and medium size enterprises.

Results and challenges

Despite the complex environment in which the programme was launched (Portugal was facing – and still faces - large budget deficits and has a structurally weak economy), these reforms have helped the country to lower barriers to trade and investment and reduce administrative and regulatory costs for business. For instance, with the creation of 'on-the-spot-firm', a one-stop shop for company registration, the time required to set up a business was reduced from over 50 days to less than an hour (OECD, 2008).

These and other improvements are reflected in the *Doing Business* assessment (World Bank & IFC, 2012), where Portugal improved significantly in the ranking of 'starting a business' (from 56 in 2011 to 26 in 2012, out of 183 assessed economies).

While reducing bureaucratic corruption is not the primary aim of the programme, there is further potential to reduce corruption opportunities by further decreasing the interaction between public officials and businesses. Nevertheless, the government should stress the importance of transparency and accountability, as well as strengthen its enforcement mechanisms.

On the other hand, the heavy reliance of the programme on e-government also brings challenges related to the country's digital divide. Not all citizens and business, in particular small and medium size enterprises, have access to internet, which could hamper the full implementation of the programme. In fact, the digital divide is a problem in many countries and a fundamental challenge for e-government.

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