



USAID
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Reducing Administrative Corruption in Ukraine

Regulatory Reform USAID | BIZPRO

SUBMITTED TO
USAID/Washington

SUBMITTED BY
Nathan Associates Inc.

UNDER CONTRACT NO.
PCE-I-03-00-00013-00
Task Order 003

November 2005

TECHNICAL REPORT

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This opinions expressed herein are those of the authors and do not necessarily reflect those of the United States Agency for International Development.

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Executive Summary

The hypothesis examined in this case study is that public-private dialogue groups on the local level, if endowed with sufficient resources, technical and financial, can reduce administrative corruption as part of the general process of regulatory reform. Three factors enable the effective functioning of these groups. The first is a common local interest in economic development. As Mancur Olson says about the “stationary bandit,” even parasitic local authorities have an interest in local economic development. Even more narrowly, they have an interest in moving firms into the formal sector through business registration. In both cases, the prosperity that ensues will increase their chances to reap rewards. The second is that local business communities have interest in some types of reform, and they can negotiate with local authorities to get it. The final factor is that localities do not exist in isolation. Their reforms must be supported at regional and national levels, and they must compete with other localities for investment and other assets. Reform efforts need technical resources to conform to national legal and regulatory norms.

The difference between effective and ineffective efforts, at least in the Ukraine case, seems to depend on local businesses’ and governments’ realizing their own interests and having sufficient financial and technical resources to coordinate with national legal and economic requirements.

We describe a component in the USAID BIZPRO Project in Ukraine that promoted local regulatory reform to reduce burdens on business, including reducing levels of corruption by providing material and technical support to local public-private dialogue groups in areas with supportive local administrations, in a generally supportive national legal environment. In BIZPRO’s local regulatory reform activity in 2002–2005, 805 regulatory changes were proposed; 431 were enacted, and 233 were in the process of enactment as of April 2005. The subjects included a wide variety of relations between private business and government from licenses and registrations, the assessment and payment of taxes, government procurement, and the rental of public property.

The effort was successful in reducing corruption, even in comparison with a parallel national effort supported by the national government of Ukraine. The reasons for BIZPRO’s relative success lie in both enthusiastic local governments that volunteered for the project and the

superior resources brought to bear on the project. Some of these changes have had considerable impact on the costs of doing business. While one cannot generalize for all 805 proposed changes on the basis of 66 follow-up impact evaluation studies done under BIZPRO (15 of which were reviewed for this report), they do give an indication of impact, including impact on corruption. In addition, national authorities relied heavily on BIZPRO experience and experts in developing and implementing the Law on Fundamentals of the State Regulatory Policy in the Sphere of Economic Activity enacted in January 2004.

Our study concentrated on four reforms in three cities in two oblasts¹. For the three cities where the team conducted interviews, the time required for the procedures studied declined by 5–10 days—a 23 - 64 percent reduction, official costs by \$3–\$10 for individual—a 46 - 77 percent reduction (much more for companies), bribes by as much as \$30—a 74 percent reduction, and the incidence of bribery, where recorded, by more. The BIZPRO project reported data for eight cities where it assisted business registration reform. There, time required for the procedures studied declined by roughly 10 days—a 46 - 48 percent decline, official costs by \$20–\$30—a 31 - 56 percent decline, and the number of people reporting paying bribes by 10–30 percent.

The dialogue groups worked when they were supported by local administrations and local businesses and received adequate material and technical support. There is some indication that similar groups promoted by the Ukraine government without the resources, and perhaps with less enthusiastic local support, did not work.

But as more extensive data become available from BIZPRO, further analysis will be useful.

Two questions arise. The more difficult question is whether this approach would work in other countries. Public-private dialogue groups have been a feature of USAID and other regulatory reform efforts in areas as diverse as Russia and Guinea. In most cases, baseline and follow-up data do not show the efficacy of these efforts as clearly as in the present case.

The other question is whether the resources applied to promoting this reform through public-private dialogue is worth the expense. The answer to the second question depends on the answer to the first. If significant reductions in the cost imposed on businesses from corruption can be achieved, those reductions can be weighed against the costs of regulatory reform programs.

¹ An administrative regions that still exist in certain former Soviet Republics.

1. Introduction

Much USAID anticorruption activity is connected to business regulation reform. Regulation of private business is a notorious locus for corruption because each regulation presents an occasion for extracting a bribe or “rent.” In many countries, opening a business, obtaining licenses or certifications, getting customs clearance, and undergoing inspections by a variety of regulatory agencies open doors for officials to extract bribes. But businesses too may initiate corruption—speed up business registration, obtain permits and licenses, circumvent the rules, avoid paying fines for violating regulations, or take advantage of competitors. Limiting governmental interference in business operations, streamlining administrative procedures, reducing regulators’ discretion, and creating room for appeals are all methods for reducing corruption as well as increasing the efficiency of regulation.

A succession of surveys in the past decade have highlighted the burden on Ukrainian business posed by government regulations and requirements (See Appendix A).

In Ukraine, as in other civil law countries, before an enterprise begins operations, it must register either as an individual entrepreneur or other legal entity to gain a legal identity for tax, social insurance, and statistical purposes. In addition, enterprises in certain industries (e.g., tobacco, alcohol) must be licensed to ensure compliance with restrictions. Finally, enterprises must obtain permits from labor, safety and hygiene, and building authorities, as well as permits for utility connections. Enterprises that need to use public premises must also secure authorization for access to those premises. When registrations, licenses, and permits are secured, the enterprise can operate, but must continue to undergo inspections, meet reporting requirements, and pay dues. Failing to comply subjects the enterprise to punishment, and each regulatory function is an occasion for extracting rents.

Administrative corruption in Ukraine is an ongoing challenge to economic growth and legitimacy of the political regime. In 2005, 70.2 percent of businessmen surveyed in Ukraine reported that they paid bribes, compared to 78 percent in Russia and 55 percent in China. The

average bribe in Ukraine was 4.8 percent of sales. Russia's reported level is 2.5 percent and China's 2.6 percent. Nicaragua's was 7 percent and Guatemala's 7.4 percent.²

Ukraine should be able to grow rapidly: it is the second-largest country in Europe, with a population of almost 50 million, and good mineral and agricultural resources. But its economic growth has lagged behind that of many other former Soviet states in Eastern Europe. Many factors contribute to this lag—previous fracturing of the Soviet economy, political instability, problems with privatization and general policies—but the costs of doing business, especially costs attributable to regulation, are a major factor. The costs of doing business have been monitored since 1996 in surveys supported by various donors, including the United States (see Appendix A). These costs keep much economic activity informal, which burdens the formal sector and impedes the development of formal enterprises.

Some of the burden is connected with costs and delays, some with corruption. Corruption thrives among the confusing and complex regulations to which Ukrainian businesses, especially small and medium-sized businesses, are subject, as is thoroughly described in the USAID Mission's 2003–2007 Country Strategy for Ukraine.

The hypothesis examined here is that regulatory reform aimed at streamlining administrative procedures can reduce corruption. When procedures are clearly defined, do not leave space for multiple interpretations or discretion, and do not require businesses to spend inordinate time meeting administrative requirements or making visits to bureaucrats, and when businesses are well informed about procedures and their own rights, opportunities for corruption are reduced.

Public-private dialogue on the local level in designing reforms is a mechanism that can ensure success for reforms if endowed with sufficient technical and financial resources. Three factors enable the effective functioning of such groups. The first is a common interest in local economic development on the part of local government authorities and local businesses. As Mancur Olson says about the "stationary bandit," even parasitic local authorities have an interest in economic development, or at least in moving firms into the formal sector through business registration. For both groups, the prosperity that ensues from economic development increases their chances to reap rewards. The second factor that enables public-private dialogue is that local business communities have an interest in some types of reform and can negotiate with local authorities to get it. The final factor is that localities do not exist in isolation. Reforms must be supported at local and national levels, and each locality must compete with other localities for investment and other assets. Reform efforts need technical resources to conform to national legal and regulatory norms. The national environment needs to be supportive; and when it is, particular localities have compelling reasons not to want to lag behind.

² *World Development Report 2005: A Better Investment Climate for Everyone*, Washington: World Bank, 2005, p. 246.

Of course, local business might resist certain reforms and protect certain sorts of corruption to avoid outside competition, but in the Ukrainian cases studied, this does not seem to have happened.

The present report examines how the USAID | BIZPRO, by providing material and technical support to foster local public-private dialogue, an anticorruption tool common in USAID projects, pursued administrative and regulatory reform in areas with supportive local administrations, in a generally supportive national legal environment. BIZPRO used preliminary and follow-up studies to trace project impacts. The authors of this report reviewed these and other documents and studies on corruption and anticorruption efforts in Ukraine, including USAID program documents and implementing partners' reports, and interviewed USAID and BIZPRO staff, independent experts in the United States and Ukraine, and local participants in the BIZPRO project in Ukraine. This report presents findings and conclusions about the implementation of BIZPRO.

2. Findings on BIZPRO and Regulatory Reform

This section examines regulatory reform efforts supported by BIZPRO in Ukraine in 2002-2004. To understand what might have contributed to the project's success or failure in reducing corruption, we looked at the country context in which the project was initiated and implemented, programs and activities that preceded the project, the scope of work, project implementation approach, and impact. We looked closely at two administrative regions—the Kherson and Ivano-Frankivsk oblasts—and particular regulatory reforms implemented in several municipalities in those oblasts.

Country Context

Ukraine has a severe problem with administrative corruption, particularly in the context of business regulation. Business regulation problems were a major cost to doing business in Ukraine, and corruption a major obstacle to the country's development. The need for regulatory reform was obvious to all parties.

By the mid-1990s the Ukrainian government came to understand that its efforts to accelerate the development of the Ukrainian economy, eliminate corruption, and create a prosperous society would not be successful without deep and systemic regulatory reform. However, at that time the government lacked analytical capacity and experience in implementing such reform. It needed assistance in designing a clear strategy for implementing an effective regulatory policy.

Understanding the importance of regulatory reform for Ukraine, USAID began providing assistance to the Ukrainian government in this effort. The first step that Ukraine took toward creating a favorable regulatory environment that was supported by USAID was issuing the presidential decree On Eliminating Obstacles Impeding the Development of Entrepreneurship (No. 79/98) in February 1998. Another presidential decree, On Some Measures on Deregulating Entrepreneurial Activity (No. 817/98), aimed at creating a better regulatory

environment, was also drafted with the assistance from USAID and was signed in July 1998. These two decrees set the foundation for the national policies for regulatory reform and business development. With assistance from USAID's NEWBIZNET Project (the predecessor of BIZPRO), the government created the State Committee for Entrepreneurship Development, later renamed the State Committee on Regulatory Policy and Entrepreneurship (SCRPE), to develop and implement regulatory policy and promote entrepreneurship.

During the period 1998–1999 the Ukrainian government and USAID continued to implement regulatory reform. As a result of this common effort, in January 2000, the president signed the decree On Introduction of a Single State Regulatory Policy in the Sphere of Entrepreneurship Decree (No. 89/2000). The decree required ministries and local governments to revise and develop regulations according to principles and methods established by the decree. The new decree also promoted public–private dialogue by establishing coordinating councils on entrepreneurship at the national and oblast levels and public forums at all levels to discuss regulatory initiatives. To implement this decree, the national government, with assistance from USAID, drafted the Methodology on Preparing Justifications for Draft Regulations. The methodology was adopted by the Cabinet of Ministers' Resolution No. 767 in May 2000.

These measures created the foundations for regulatory reform and an improved regulatory environment. They were far from sufficient, however.

Previous USAID Interventions

USAID has been involved in policy and regulatory reform in Ukraine since 1997. By 2001, when the BIZPRO project started, about 20 USAID-sponsored projects had been implemented.³ USAID supported the Interagency Commission on Economic Reform, the State Committee on Economic Reform, and the State Committee on Regulatory Policy and Entrepreneurship. The latter was assisted through the USAID-funded NEWBIZNET, Regulatory Reform, and Commercial Law Reform projects, and the IFC Post Privatization project.

USAID has provided assistance on regulatory reform through these and other projects to Parliament and other government units at the national, oblast, and municipal levels. The Regulatory Reform Project implemented between 1998 and 2002 provided technical assistance in developing uniform state regulatory policy⁴ and institutional strengthening of the State Committee for Regulatory Reform and Entrepreneurship and assisted the oblast administrations of Lviv, Ternopil (later replaced with Donetsk and in 1999 with Crimea), and Kharkiv “in developing local capacity for policy and regulatory reform.” The Community

³ USAID BIZPRO Contract 2000

⁴ Background from the USAID amendment to the BIZPRO contract 2002.

Partnerships Program and the Eurasia Foundation provided additional assistance for developing local and oblast business associations and alliances and their capacity to undertake regulatory reform.

To make regulations more effective and efficient, the Regulatory Reform Project assisted the Ukrainian government in drafting the Methodology for Justification of New Regulations, which was adopted in 2000 and served as guidance for developing and adopting policies on drafting and enacting regulations on the national and local levels. It required regulatory impact cost-benefit analysis and the eliciting of public comments on draft regulations. (BIZPRO later expanded on this and used elements in drafting the Law on Fundamentals of State Regulatory Policy in the Sphere of Economic Activity.) At the local level, four comprehensive packages of specific regulatory reform proposals – package decisions – on the use of municipal property were developed and implemented in pilot cities. The four package decisions included rental of business premises, purchase and improvement of land parcels, passenger transport concessions, and use of city property for advertising.

BIZPRO Regulatory Reform Initiative

The BIZPRO project began in November 2000. Its goals included regulatory reform and the strengthening and promotion of business associations. Regulatory burdens and corruption were mentioned in the request for proposals and contract scope of work. A regulatory reform indicator was to track changes in the cost of doing business and regular surveys were conducted, but there were no particular requirement regarding corruption.

BIZPRO was planning to adopt a regulatory reform project approach working on the local level by bringing together the government and private sector to identify problems, set realistic goals, and find potential solutions. In its first year, while the project focused primarily on institutional strengthening of the business associations throughout the country, it also began supporting public-private dialogue meetings between associations and local governments in several regions aimed at improving the regulatory environment. This resulted in a number of reforms, including a pilot one-stop shop for business registration in Ivano-Frankivsk that popularized the one-stop shop principle in Ukraine and became a model for others. More than 150 one-stop registration shops have been created since then.⁵

⁵ “One_Stop Shop: Assessment of its Efficiency,” lecture by Anna Melnuk, BIZPRO.
<http://www.bizpro.org.ua/clients/bizpro/bpuaua.nsf/index?openpage>

BIZPRO Regulatory Reform Intensification

SCOPE OF WORK

In April 2002, USAID amended BIZPRO to implement a discrete 18-month effort, to continue activities on local regulatory reform begun under the Regulatory Reform Initiative Project. The persistent influence of corruption on the business environment also led USAID to include corruption as an issue integral to the BIZPRO regulatory reform activity amendment:

Regulatory reform will reduce red tape, simplify compliance procedures, and reduce compliance costs. In addition, corruption will be reduced as complex, ambiguous regulations and regulatory procedures that allow corruption to thrive are systematically amended and repealed, and replaced with more streamlined and transparent regulations that reduce time and costs in compliance for SME's.⁶

Some of the reforms promoted were to be related to regulations in local public property management and privatization that were subject to regular abuse and corruption:

These local regulations [regulations existing before reform] thus enabled favoritism and corruption among local officials that effectively controlled the use of any city property by local business. Each sector, in effect became the subject of local "rackets." The adoption of open, transparent regulatory schemes has, in virtually every instance, led to an increase in revenues directly proportionate to the reduction in bribery, corruption and "unofficial" payments made by business to local officials for access to information about, or permission to use, such property.⁷

The amendment required BIZPRO to monitor and evaluate the impact of project support through statistical analysis. Though no targets or indicators were suggested for monitoring and evaluating the impact of the project on corruption, BIZPRO was required to use the World Bank annual Regulatory Cost Assessment Survey to monitor the impacts of regulatory reform in certain locations.

The amendment was to assist public and private sectors at the local level in improving the local regulatory environment by addressing the most important problems impeding business development, including the burden of business regulation at the local level. This activity was seen as presenting an opportunity to "deliver targeted technical assistance to municipalities and local governments that improved the local business environment."⁸ In 2003, an amendment was made to support the one-stop shop for permits that supplemented USAID's activity on regulatory reform implementation.

⁶ Buy-in to BIZPRO for USAID Ukraine Regulatory Reform Component. Statement of Work. April 9, 2002

⁷ P.4, Ibid.

⁸ Project Review 2003, p. 3.

PROJECT IMPLEMENTATION APPROACH

In late 2001 or early 2002 it was decided that BIZPRO would assist the public and private sectors in promoting regulatory reform on the local level through policy dialogue. Before the amendment, BIZPRO had promoted coalitions to identify issues for businesses and lobby governments for reforms. Inspired to some extent by a study tour to Romania, a business coalition established a one-stop shop for registration in Ivano-Frankivsk, and other reforms in other regions were achieved.

Through consultations with USAID, the SCRPE, and other USAID implementing partners,⁹ BIZPRO selected 32 municipalities in eight oblasts in which to implement the project: the capital and three smaller cities in each oblast. One important selection criterion was the willingness of the local administration to cooperate. Kyiv, the country's largest city, was excluded. The goal of BIZPRO's activity was to improve the local business environment by addressing the most important problems caused by ineffective or excessive regulation. Problems were to be identified by local public and private sector representatives, and ways to solve those problems that would take into account the interests of both businesses and the local governments were to be discussed.

A business association or implementing partner was selected in each oblast to provide administrative support and serve as the contact for BIZPRO headquarters. Starting in May 2002, BIZPRO helped each oblast form a working group of 22 members, who were paid the equivalent of \$230 per month.¹⁰ These groups included oblast government representatives, the local representatives of the State Committee for Regulatory Policy and Entrepreneurship, local business representatives, representatives from the governments of each of the four municipalities, representatives of the oblast offices of selected national ministries, and representatives of the local NGOs. A corps of four specialist consultants provided each group with guidance and advice on legal and economic issues and trained the groups in the methodologies of regulatory impact analysis and evaluation. The consultants were selected in each oblast from among leading local experts who had a legal or economic background, thorough knowledge of the problems of the business environment, and solid experience in working in local governments or NGOs. The working groups met all day on Saturdays to discuss issues to be addressed in regulatory reform in their oblast and did preparatory work during the week.

The groups were tasked with drafting regulations or amendments to regulations that conformed to national norms using methods developed by BIZPRO. BIZPRO consultants provided training and technical assistance and facilitated meetings. For each proposed regulation, the group drafted analytical notes that contained a prognosis of the regulation's

⁹ "Implementing partner" generally refers to an NGO.

¹⁰ The average monthly salary in Ukraine in the first quarter of 2005 according to the Ministry of Finance and the Department of Statistics was UAH 676.57 (US\$135.32).

impact on corruption, cost-benefit analysis of the regulation, and indicators to measure the regulation's impact. For example, the notes attached to the regulation of parking payments in Kolomyia (November 11, 2003) by the town council described (1) the problem, (2) the goal of the regulation, (3) the mechanism of regulation, (4) the likely effect of the regulation in general, and (5) the likely effect of the regulation on corruption. The note also describes follow-on legislation and specifies indicators of effectiveness (e.g., increase in government receipts, the number of cars accommodated, time required for payment, less bribery). Analytical notes were based partly on discussions of each revised regulation conducted before the regulation was submitted to local legislatures.

In addition to regular meetings of working groups in each oblast, other meetings were also organized, such as a quarterly meeting to inform attendees (local public and private sector representatives) about developments in regulatory reform in the oblast and nationally and to discuss local issues. The consultants received ongoing training from BIZPRO on techniques of regulatory impact analysis and evaluation, according to the OECD and other state-of-the-art approaches.

To measure the impact of new regulations, in each of the eight selected oblasts an independent monitoring organization, usually a local social research group or NGO, did a baseline study of the situation preceding implementation of a selected local regulation and a follow-up study six or more months after implementation of that regulation.

Toward the end of 2003, USAID made a decision to expand BIZPRO's regulatory reform activities and make the activity more demand-driven. All 25 oblasts of Ukraine and all 176 cities of oblast significance were invited to apply for participation in BIZPRO's work on regulatory reform, either for public-private dialogue similar to that of the earlier working groups, or for one-stop permit shops (as distinguished from shops for business registration). BIZPRO supported one-stop shops for permits in 38 cities in this stage. In the interim, many other Ukrainian cities started implementing regulatory reforms to meet Ukrainian legal and policy requirements established by the Law on Fundamentals of the State Regulatory Policy enacted in January 2004. Among reforms that became very popular was a one-stop shop for business registration (not permits). Between 2002 and 2004, more than 150 one-stop registration shops were established in Ukraine.¹¹ Most of them followed the BIZPRO principle that was adopted with the project's support.

With this new approach, the previously established working groups ceased being paid in November 2003. Because not all of the cities from the first phase of the project were involved in the second phase, some of the working groups from the first phase continued meeting on their own until March or April 2004. In cities where BIZPRO continued working after expanding in late 2003, working groups have since been partly replaced by other groups. In

¹¹ "One Stop Shop: Assessment of its Efficiency," lecture by Anna Melnuk, BIZPRO.
<http://www.bizpro.org.ua/clients/bizpro/bpuaua.nsf/index?openpage>.

2004, USAID also decided to integrate BIZPRO's regulatory reform experience at the local level more with national policymaking.

Under BIZPRO's local regulatory reform activity in 2002–2005, 805 regulatory changes were proposed; 431 were enacted, and 233 were in the process of enactment as of April 2005. The regulations selected for revision cover a wide variety of subjects, as illustrated in Table 2-1.

Table 2-1
Regulations Changed by BIZPRO, July 2002–April 2005

Regulatory Area	Number of Regulations
Entrepreneurship development	126
Sales in market places	58
Regulatory policy	127
Business registration	34
Local taxes and fees	101
Communal property	119
Land relations	89
Permits	179
Transport	32
Total	865

Source: BIZPRO Office, 2005.

Some of these reforms were very small, others more substantial. BIZPRO did not conduct baseline and follow-up surveys for all these reforms, but only for 66 reforms, by the time the present study was done. For this report, we reviewed 16 reforms conducted in 12 cities in two oblasts (out of eight where BIZPRO was working in its first phase). Among these 16 reforms, 7 reforms were for business registration and 4 were for permits for placement of trade and service facilities. Other reforms were in procurement, renting communal properties, tax on trade at the marketplace, and fire-safety permits for newly constructed facilities. Surveys for 15 of these reforms had direct questions about unofficial payments (bribery and extortion) and most follow-up surveys showed declines in bribery, but declines varied widely. In almost all cases, the time required for procedures declined, businesses had fewer direct contacts with bureaucrats and spent less time waiting in lines, the number of documents was reduced, knowledge about procedures and fees increased, and overall satisfaction with reformed procedures went up. Although it is hard to generalize about all 431 changes enacted on the basis of 16 studies done under BIZPRO, the studies do indicate a significant impact on corruption.

Although these BIZPRO surveys conducted to assess particular reforms reflected improvements, other independent surveys that assess overall business climate in some of the

cities where BIZPRO worked did not always do so. Table 2-2 compares survey data collected by IFC in 2001 and 2004. This discrepancy should not be surprising because a few isolated regulatory reforms should not be expected to cause a radical change in the overall business environment, and because whatever dynamic will stem from the BIZPRO effort has not yet had time to work itself out.

Table 2-2

Results of IFC Survey on Business Environment in Ukrainian Cities

City	Business environment in my city is better than in most Ukrainian regions		Business environment in my city encourages investment and invites business development		State officials in my city are honest and do not demand bribes		Local authorities help start-ups		Local authorities comply with legislation		Local authorities create equal conditions for everyone	
	2000	2004	2000	2004	2000	2004	2000	2004	2000	2004	2000	2004
Ivano-Frankivsk	X	✓	X	X	X	S	X	✓	✓	S	X	X
Kherson	X	S	X	S	X	X	X	X	X	S	X	X
Vinnitsa	X	X	X	X	X	X	✓	S	✓	X	X	X
Lutsk	X	X	✓	X	X	X	X	X	✓	X	X	X
Lviv	X	X	X	X	X	X	X	X	✓	X	X	X
Odessa	✓	X	X	X	X	X	X	X	X	X	X	X
Kharkiv	X	X	X	X	X	X	X	X	X	X	X	X
Khemelnitsky	✓	X	✓	X	X	X	✓	✓	✓	✓	X	X

✓ – most respondent agreed with the statement.

X – most respondent did not agree with the statement.

S – respondents were split

SOURCE: IFC. *Business Environment in Ukraine, 2001 and 2004*

BIZPRO Reform Activity in Oblasts and Cities

BIZPRO's local regulatory reform activities were implemented in 32 cities in eight oblasts during the first phase in 2002–2003, and in 52 cities from all over the country from 2004 on. In this section, we take a closer look at how the project was implemented and what results were achieved in reducing corruption in two oblasts: Kherson and Ivano-Frankivsk.

IVANO-FRANKIVSK AND KHERSON OBLASTS OVERVIEW

Ivano-Frankivsk oblast is situated in the western part of Ukraine; it occupies about 2.3 percent of the territory of the Ukraine and has a population of about 1.4 million. Kherson oblast is in

the southeastern part of the country; it occupies 4.7 percent of the territory of the country and has a population of about 1.14 million. Ivano-Frankivsk is more industrial than Kherson, although the population in Kherson is more urban (60 percent) than that of Ivano-Frankivsk (42 percent).

As of July 2002, nearly 19,000 enterprises operated in Ivano-Frankivsk oblast, most of them small. About 22 percent were in industry, 25 percent in construction, 34 percent in trade, and 2 percent in services. In Kherson oblast, most small businesses are in the commercial and service sectors (39.8 percent): 15.7 percent are in industrial service, 8.1 percent in agriculture, 3.2 percent in hotel and restaurant service, and 4.2 percent in transportation.

Since 1997, local authorities in both oblasts have been implementing small business support and regulatory reform programs as parts of national programs. As a result, Kherson oblast, for example, now has nine business centers, two business incubators, three business support foundations, and 68 business associations of different kinds.¹² Coordinating Councils on Entrepreneurship Development were established in each rayon and city of the oblast as a form of public-private dialogue. In addition, the Oblast Public Council, headed by the governor, was established in December 2004 to implement state regulatory policy in the oblast. In Ivano-Frankivsk, business promotion also was an oblast focus in 2003-2004. In 2003, 15 new business centers were established.¹³

In response to the National Regulatory Reform Law and requirements of the State Committee for Regulatory Reform and Entrepreneurship (SCRRE), the oblast, rayon, and city administrations in both oblasts draft annual work plans for regulations to be developed and implemented, although implementation is not always on target. Thus, in 2004, administrations in Kherson oblast were planning to develop 138 regulations, although only 32 were drafted and only 9 approved by the SCRRE. According to the Oblast Administration report, the low rate of approval by the SCRRE was because the regulatory act development processes in the oblast did not comply sufficiently with the principles outlined in national law. Draft regulations were not necessarily accompanied by cost-benefit and regulatory impact analyses and often were not publicized properly, and their implementation was not always evaluated. According to the 2005 annual plan, 49 regulatory acts are to be developed in the oblast.¹⁴

Despite all reforms and efforts, the local business communities were not enthusiastic about the environment in the regions. The amount of time that enterprise managers reported

¹²Other government sources such as Analysis of Implementation of the Oblast Business Development Local Program of 2003-2004, provide different numbers: 11 business centers, 5 business support foundations

¹³ Uzagal'nenii zvit pro xid realizatzii zaxodiv regional'nix program rozvitku malovo predpriemnitzva na 2003-2004 roki. <http://www.dkrp.gov.ua/kompred/control/uk/publish>.

¹⁴Status of implementation of the state regulatory policy in economic development in Kherson oblast in 2004. Report by the Kherson Oblast Administration. <http://www.oda.kherson.ua/cgi-bin/control.pl?type=body&lang=uk&id=../control/uk/data/regact/vidom.html>

spending dealing with officials declined by 4 percent in Kherson and by just 1 percent in Ivano-Frankivsk from 2001 to 2002:

	<u>2001</u>	<u>2002</u>
Kherson	20 percent	16 percent
Ivano-Frankivsk	15 percent	14 percent
Ukraine average	14 percent	15 percent

In 2001, more than 46 percent of businessmen in Kherson and 31 percent in Ivano-Frankivsk said that the permitting system was a major or significant barrier to business activities, while the average in Ukraine was 43 percent. In 2001, it took on average 46 days in Kherson to register a new business – higher than the 43-day average in Ukraine and more than double the 21 days in Ivano-Frankivsk.¹⁵

In a 2003 IFC survey,¹⁶ only 14 percent of respondents viewed the city of Kherson as encouraging investment and business development, while in Ivano-Frankivsk, 20 percent did (the city of Poltava had the highest rate at 53 percent and Simferopol the lowest at 6 percent). In a 2003 survey sponsored by the Ministry of Economy and European Integration of Ukraine and financially supported by several donors, respondents rated Kherson city's business environment at 7 on a 1–10 scale, with 10 indicating the environment had a "severe problem."

Ivano-Frankivsk City had a long history of working with the BIZPRO project before the local regulatory reform activity was launched in 2002. The city was the first in Ukraine to implement a one-stop shop for new business registration. Before it established its one-stop shop for registration, Ivano-Frankivsk ranked low in business environment surveys. The Business Environment Survey of May 2001, supported by the IFC and USAID, reported that 55.7 percent of enterprises considered registration a burden—Ivano-Frankivsk was ranked next to last among 25 oblast centers. In a ranking of transparency and corruption, it ranked 14th.

BIZPRO had worked in Kherson oblast before April 2002, when it intensified its regulatory reform efforts as a result of the amendment to its contract. Kherson oblast was one of eight oblasts selected for the intensification of BIZPRO's work. From spring 2002 through November 2003, BIZPRO worked in Kherson, Nova Kakhovka, and Kakhovka.¹⁷ It tried to expand to a fourth city (Styuryupinsk) but a lack of commitment by the municipalities ended the attempt. BIZPRO helped to establish a working group in the oblast and identified and trained four local consultants to provide technical assistance to the group. An implementing partner organization, Successful Woman, provided administrative support, and an independent monitor, the League of Professional Trainers, based in the city of Kherson, conducted surveys in cities where reforms were implemented in order to evaluate the impact of those reforms.

¹⁵ IFC. Business Environment in Ukraine, 2004

¹⁶ IFC. Business Environment in Ukraine, 2003

¹⁷ At the end of November 2003, BIZPRO graduated those cities from its assistance effort.

During the period before BIZPRO's expansion throughout the country (early 2002 to late 2003), the working group in Kherson oblast initiated 85 reforms. More than 30 were implemented in Kherson oblast with the support of BIZPRO. Among them were regulations on trade in the food market, drafting and enacting regulations, one-stop shops for business registration,¹⁸ rates for using communal property, local taxes and fees, permits for placement of trade and service facilities, permits and rates for leasing immovable communal property, permits for placement of outdoor advertisements, communally owned land lease and privatization, rules for placing small structures and buildings, permits issuing one-stop shops, and others. During this period, the monitoring group conducted 13 baseline surveys and 6 follow-up surveys.¹⁹

Although for each new regulation or amendment, the potential corruption impact was established, the extent to which different regulations addressed corruption varied. But even small changes in rules or regulations can have a significant effect on corruption and eventually economic growth. For example, to curb the proliferation of illegal taxis in Nova Kakhovka, city administrators reduced the business tax on taxi cabs. Taxi registrations went from 4 to more than 30, reduced the opportunity for corrupt practices by illegal taxis and traffic police, and boosted city revenue.

BIZPRO ACTIVITY

BIZPRO began work in both oblasts under the Regulatory Reform Initiative in 2003. In both locations the project was well received by the local governments. The project applied its standard approach by setting up working groups, selecting implementing partners (local NGOs) and independent monitoring organizations (survey groups), and assigning four consultants to provide facilitation and technical assistance in each oblast.

Extensive training and technical assistance provided to the working group meant they were able to develop many new regulations, about a third of which have been adopted. Between early 2002 and late 2003, the working group in Kherson oblast initiated 85 reforms, more than 30 of which were implemented. Among them were regulations on trade in the food market, drafting and enacting regulations, one-stop shops for business registration,²⁰ rates for using communal property, local taxes and fees, permits for placement of trade and service facilities, permits and rates for leasing immovable communal property, permits for placement of outdoor advertisements, communally owned land lease and privatization, rules for building

¹⁸In Kherson city, a one-stop shop for business registration was opened primarily as a result of BIZPRO work in 2002.

¹⁹The BIZPRO contract does not require monitoring of all project-assisted and -enacted regulations.

²⁰In Kherson city, a one-stop shop for business registration was opened primarily as a result of BIZPRO's previous work in the city. The Regulatory Reform Initiative inherited this reform and provided further assistance in implementing one-stop shops.

small structures, and others. During this period, the monitoring group in Kherson oblast participating municipalities conducted 13 baseline and 6 follow-up surveys.

Although for each new regulation or amendment potential corruption impact was established, the extent to which different regulations addressed corruption varied. But even small changes in rules or regulations could have a significant effect on corruption or the shadow economy and eventually economic growth. For example, to curb the proliferation of illegal taxis in Nova Kakhovka, city administrators reduced the business tax on taxi cabs. Taxi registration went from 4 to more than 30, reducing the opportunity for corrupt practices involving illegal taxis and traffic police, and boosted city revenue as well.

Three well-documented reforms reduced corruption: one-stop shops, temporary trade permits, and public (communal) property leasing in Ivano-Frankivsk and Kherson oblasts.

ONE-STOP SHOPS

One-stop shops for business registration have been widely adopted in Ukraine, and BIZPRO's role here was considerable. The shops' organization and services vary:

One-stop shops were created on the initiative of local authorities, but the state agencies that actually delivered the services (and were not subordinate to the local authorities) often did not fully support the process. As a result, one-stop shops varied in the services they provided, and elements such as cost, availability of information, incidence of unofficial payments and complexity of the assessment process remained much as before.²¹

To some extent, these variations are the result of lack of national legislation regulating the establishment of one-stop shops. In other words, the agencies that were not subordinated to the local government were not obligated by any legislation to participate in one-stop shops. The fact that some of them did participate was a considerable accomplishment. Business registration consists of registration and post-registration. Registration consists of filing a business with the Unified Registry and receiving a certificate of registration. This procedure is usually simple and does not trigger many complaints. Post-registration consists of obtaining a business stamp (seal), opening a bank account, and visiting a number of government agencies to register with them. The BIZPRO model of one-stop shops combines registration and post-registration, significantly reducing registration time, the number of direct contacts and, ultimately, corruption.

Ivano-Frankivsk, Kolomyia, Kherson, and Nova Kakhovka all had one-stop shops assisted by BIZPRO. In all of them, eight departments sent representatives to a Registration Chamber (e.g., municipality, health insurance, tax, statistics, pensions, unemployment insurance,

²¹ IFC. *Business Environment in Ukraine 2004*.

workmen's compensation, and police to approve the seal every firm needs).²² Chambers in all Kherson locations are in the city hall; in Kolomyia the chamber is on premises provided by a local business association. The Kolomyia municipality has agreed it will eventually assume the costs for it. Hours of operation vary by expected workload.

One-stop shops operate in one of two ways. In Ivano-Frankivsk and Kherson, for example, the chamber director or registrar accepts documentation from the registrants while representatives from other agencies are present to answer questions and process documents. In Nova Kakhovka and Kolomyia, registrants submit documentation to the registrar on certain days; on other days officials assemble at the chamber to review documents together in the chamber and process them. As a result, the registrants contact only one official instead of eight or nine.

In addition, each one-stop shop has detailed information on display that provides a list of documents that registrants have to submit for registration, references to laws regulating registration, business registration costs, and other information that makes business registration procedure transparent and understandable.

Exhibit 2-1

Business Registration Improvements in Kolomyia

<p>In Kolomyia, "Under the previous process for business registration, entrepreneurs were forced to ask for approval behind the closed doors of officials' offices. This caused many entrepreneurs to make donations to the agency's 'development fund' in</p>	<p>order to receive their approvals...Under the new procedures, individual entrepreneurs were spending 45 percent of what they previously paid, [\$17 vs \$37], and corporations are spending only 65 percent."²³</p>
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REFORM IMPACT ON CORRUPTION

Results have been positive. In all cases, transparency increased and graft and bribery decreased. Registration in Kolomyia now takes only 10 days, compared to the former average of 28 days, and requires only 3 visits rather than 24. Registration in Kherson now takes 13.5 days for legal persons instead of 21, and 10.8 days for natural persons instead of 16. Registration of legal persons in Nova Kakhovka takes 8 rather than 29.7 days, and for natural persons 9.3 instead of 22.7 days.

²² After the Law on Business Registration was adopted in 2004, the Kherson Chamber experienced some problems bringing agencies together. Four agencies (Pension Fund, Tax Administration, Social Protection Fund, and Statistics Department) left the chamber.

²³ Volodomyr Buryy, Zachary Morford, and Paige Snider, "Business Start-Up and One-Stop Shops: Principles for Success from Ukraine and Abroad, Kyiv," BIZPRO, August 2002.

Illegal payments for business registration in Kherson after the one-stop shop opened in November 2002 declined from \$5.75 to \$0.87²⁴ for legal persons, but rose from \$2.46 to \$2.82 for individuals.²⁵ Overall registration costs declined in Kherson from \$155.59 for legal persons to \$85.00, and from \$18.34 to \$9.79 for natural persons. In Nova Kakhovka illegal payments declined from \$2.60 to \$0.59 for legal persons and from \$1.93 to \$0.97 for natural persons. Payment amounts fell from \$74.47 for legal persons to \$50.79, and from \$14.99 to \$8.47 for natural persons.

In Kolomyia, the number of registrants did not rise significantly, but the town's tax revenues rose slightly. The average number of visits to the registration office declined from 8.7 to an average of 2.5. But despite a decline, registrants still needed separate visits to various departments (86.7 percent had to visit the tax office, and 46.7 the police to get their seal authorized). Official registration costs declined from \$13 to \$10. Previously, 36.8 percent made some sort of payment (e.g., "shared gifts" – such as a bottle of vodka, cigarettes, or candy). In the post-survey, only 4.6 percent indicated unofficial costs, and the amounts declined from \$39 to \$5–\$10. In Kherson and Nova Kakhovka, surveys also showed a reduction in unofficial payments.

Baseline and follow-up surveys were conducted in eight cities where one-stop shops for registration were established with BIZPRO assistance. The surveys showed that average time for registration of individual entrepreneurs dropped from 17.2 days to 9.2 days, and for companies, from 23.7 to 12.3 days (lengthy procedures can trigger corruption). Registration costs dropped from \$36.17 to \$16.05 for individual entrepreneurs and from \$99.06 to \$68.11 for companies (costly procedures and nontransparent cost structure can lead to corruption). The number of visits to registration authorities (opportunities for corruption through direct contacts) dropped on average from 8.9 times to 3.1 times for individual entrepreneurs and from 14.7 to 3.9 times for companies. Respondents who made "unofficial payments" (bribes) dropped from 22.4 percent to 13.7 percent among individual entrepreneurs and from 35.1 percent to 5.6 percent for companies.²⁶ These results reveal the advantage of BIZPRO's business registration one-stop shop in comparison with about 125 established between 2002 and 2003 outside the project. Under the BIZPRO model, all government agencies participate in the shop, while in shops established independently by local government not all agencies participate (in Donetsk, only 4; in Poltava, only 6). Businesses still have to visit some agencies directly.

²⁴ Constant exchange rate was used.

²⁵ BIZPRO consultants explained this raise as a possible misunderstanding by business of the registration fee structure. It has also suggested that the registration process during the first couple of months was still a learning process and some mistakes were made that could be viewed as extortion.

²⁶ BIZPRO's estimates of average dynamics of cost and duration of registration procedure, frequency of bribes, and number of visits to different agencies during the registration process for eight registration one-stop shops, 2004

The variety of approaches to one-stop shops used in Ukraine may explain the results of the 2003 IFC survey. IFC survey data for 2003 showed no reduction in the incidence of unofficial payments throughout Ukraine by the one-stop shop initiative. Approximately one in three respondents registering or re-registering reported making unofficial payments, whether they registered at one-stop shops or not. Of those using standard procedures, 29 percent admitted making unofficial payments; of those using one-stop shops, 33 percent.²⁷ Obviously, the one-stop shop model developed and implemented with BIZPRO support demonstrated significant improvements and impact.

From late 2003, BIZPRO started providing assistance to 39 towns in establishing one-stop shops for permits. Kolomyia and Nova Kakhovka are among those towns. Early reports indicate that these are successful.

TEMPORARY TRADE PERMITS

Kolomyia's trade permits (Regulatory Rules for Temporary Entities in Retail and Services in the Kolomyia City Area) cover all kinds of kiosks, pavilions, and even open-air tables on which goods are displayed, food and drink served, and personal services provided. Those seeking permits must submit drawings of how their establishment will look and have them approved by the construction authorities. Other agencies also participate in the procedure. The purpose of reform was to unify the permit operations through a one-stop shop and by doing this, streamline registration procedure, reduce opportunity for officials to use their personal discretion, reduce time for registration, clarify procedures, and reduce opportunities for direct contact, which often lead to corruption.

The follow-up survey notes a decrease in time spent in obtaining a permit from 137 to 121.4 days. Far fewer applicants were rejected (or had to go back to repeat steps) at various stages, and those rejected received fuller explanations of the reason for their rejection. The total actual time required for meeting officials fell by almost half – to a little more than four hours. The number of required visits to government offices changed little, and lease terms even seem to have shortened. The official costs of the process remained roughly the same, the incidence of unofficial payments halved, but respondents remained silent on amounts. At roughly the same time reform was being implemented, tax authorities were conducting intensive investigations. This might have predisposed respondents to think that surveyors were connected with the tax service, so they refused to give information – thus anticorruption responses are not as good as they might be.

²⁷ Ibid.

Communal Premise Leasing

Nova Kakhovka's municipal regulations until 2002 did not clearly define municipal property, specify a process for setting rents, or provide a clear procedure for leasing communal property. These deficiencies facilitated abuses by public officials. Reform was needed to eliminate these deficiencies and that would ultimately reduce opportunities for corruption.

In the fall of 2002, Nova Kakhovka city representatives at the BIZPRO-sponsored working group proposed to address the problem by amending the regulation. After studying the legal framework and the experience of other municipalities, they drafted amendments and prepared a supporting analytical note with assistance from BIZPRO-supported consultants and group members. In late 2002, 26 business and local government representatives discussed the amended regulation and agreed that it would reduce corruption by increasing predictability, reducing unofficial payments, and providing for transparent decision making.

Since implementing the amended regulation, the city has signed 14 percent more leases and received 36.7 percent more in utility payments. Businesses pay 36 percent less in leasing costs and submit 17.8 percent fewer documents. Leasing applicants who reported making unofficial payments fell from 51.3 percent to 16 percent. Businesses surveyed admitted that city administration provided better information about leasing regulation after the amendment was enacted.

3. Conclusions

This section summarizes the lessons learned from the regulatory reform implemented by local working groups through public-private dialogue and regulatory impact analysis supported by BIZPRO, and studies of the impact of ensuing reforms on corruption. All three of these elements were critical in BIZPRO's success. Ukraine was already promoting local public-private dialogue on regulatory reform before BIZPRO. USAID and other donors had been supporting some of this promotion. In this context, it appears that BIZPRO made three differential impacts. First, it provided models and was a first mover, a policy entrepreneur providing analytic techniques and institutional approaches. All participants in the reform process—in the central government, in oblasts, in working groups, and in civil society—expressed appreciation for BIZPRO. Secondly, because they were well staffed, selected, and supported, the BIZPRO-assisted working groups had a proportionally higher impact than many other initiatives by local governments. Finally, by working both in the oblasts and at the center, BIZPRO was more effective in its policy impact.

Seven aspects seem critical: (1) local implementation combined with national access, (2) selection of geographical targets, (3) public-private dialogue, (4) provision of technical expertise, (5) material support, (6) corruption assessment, and (7) empirical studies—baseline and follow up.

1. *Local Implementation with Channels to the National Level.* BIZPRO was to work on the local level but use BIZPRO's other program components and other USAID-sponsored projects to reach the national level. This enabled the project to communicate efficiently about issues from the bottom to the top. The BIZPRO project director and USAID personnel stated that they effectively operated at the local level because the political and legal situation enabled them to do so. In a parallel activity run by the same management in Moldova, a top-down approach was taken because there was political will and greater centralization of regulations at the national level. In addition, the local regulatory reform activity in Ukraine was launched when possibilities for movement at the national level were limited. Both factors—the legal, political, and regulatory environment and the relationship of the U.S. government with Ukraine's central and local governments—need to be considered when determining whether to focus at the local level.

2. *Selection of Geographical Targets.* During 2002, BIZPRO limited participating regions to eight, which were selected through consultations with USAID, the SCRPE, and other USAID implementing partners. The commitment of local governments was a major criterion for selection. BIZPRO clearly emphasized anticorruption in its discussion with local governments. Participation was expanded in 2004 from eight oblasts to all oblasts of Ukraine. The first group consisted of 32 localities in eight oblasts; now the targets are all over the country. More formal and transparent selection and scattering of targets are easier to defend on the grounds of public policy but impose two kinds of costs: (1) budgetary because of travel and more stakeholders to deal with, and (2) programmatic, in that all aspects of a politically sensitive commitment by local governments may be difficult to finalize in public. For Ukraine the results will soon be apparent, but situations around the world obviously differ.
3. *Public-Private Dialogue.* The model of the working group composition that BIZPRO used (representatives of the local governments from four cities of the regions, from the business community, and from the national government) seems to be effective for generating, drafting, and discussing local regulations. The complementary expertise of working group members was helpful. This structure was effective but apparently fragile (see next paragraph). The framework used by BIZPRO starting in 2004 was less strict in composition and operations and did not use financial incentives for working group members. It is too early to say if this framework was effective or more sustainable.
4. *Incentives and Material Support.* Budgetary support helped ensure working groups' success during the first phase of the project, 2002-2003. During that period, BIZPRO provided each member of working groups a generous monthly honorarium (according to Ukraine standards) to encourage participation and cover travel expenses related to weekly meetings. These honoraria were terminated, and the groups kept functioning. But local consultants, administrative support groups, and survey groups were still funded. When funding for the working group members stopped abruptly in late 2003, working groups stopped functioning as frequently as they had previously. Apparently, funding (fees and expenses for the working groups) was significant in keeping groups operating on a regular basis. Local governments have funded parallel efforts, but they have fewer resources. Without BIZPRO consultants, the working groups have ceased functioning on a regular basis. No strategy to sustain groups was discussed with their members.²⁸ During 2004-2005, while working in 52 cities, BIZPRO eased requirements for working group composition and functions, relying more on local initiatives in establishing groups in compliance with the Ukrainian laws, policies, and programs. Even when BIZPRO stopped paying members of groups, it still paid the consultants who assisted them. It is too early to judge if the latest model is sustainable.

²⁸ It is not clear that the groups were intended to be "sustainable." In any case, no specific steps to promote their continuance have been taken.

5. *Technical Expertise in Regulation and Analysis.* Analyses by BIZPRO working groups was based on requirements of Ukrainian law and regulations. BIZPRO made the analyses more sophisticated by providing expert consultants and training. Sophistication, however, has a budgetary and sometimes a political cost. The value of doing sophisticated analyses for every local regulatory change is being questioned; in fact local governments appear to be following a “rule of reason,” analyzing only major changes. Furthermore, Ukraine, like many Eastern European countries, has a highly educated public. Other countries may find this level of analysis a burden.
6. *Corruption Assessment as a Part of Regulation Analysis.* BIZPRO complemented analysis required by Ukrainian law with additional components, including corruption impact assessment. Such surveys, however, might be too costly for each regulation enacted.
7. *Empirical Baseline and Follow-up Studies.* This study would not be possible without the existing baseline and follow-up studies carried out by BIZPRO. In some cases, special studies could be obviated by detailed empirical cost-of-doing-business surveys of the sort fairly common in Eastern Europe and the former Soviet Union (see Appendix A). Such studies are now being piloted in other parts of the world, and undoubtedly appropriate data will be forthcoming over the years. Without surveys it is difficult to determine whether regulatory reform projects are reducing the costs of doing business, especially corruption. But studies have budgetary and political costs. For example, BIZPRO has not made some follow-up results public because of the sensitivity of local administrations. Addressing political costs requires seeking a balance; addressing budgetary costs requires seeking economies of scale, for example, by piggybacking on existing surveys of the sort cited elsewhere in this study. And although project evaluations need to be completed along with the project, public interest is really in the continuing and systemic impact of regulatory reform on costs. Finally, given the sensitivity of the data, some argue for alternative data-gathering techniques. But the credibility of the survey data has been hard to counter with other data sources.

We started with 16 of the 66 post-reform impact surveys. In some areas these interventions were not as successful as in others. Disaggregated data were not available on all 66 impact surveys. But in most cases the impact analysis showed effects on costs, time required, and levels of corruption. Because we did not study unsuccessful areas, we can only surmise that in the case of unsuccessful reform efforts, local governments were less committed, local businesses less active, and implementers less technically competent.

Now to deal with our initial hypothesis. Reforms implemented in the BIZPRO program were designed to address corruption specifically by streamlining administrative procedures, limiting discretion, and improving clarity. Businesses spent significantly less time and had fewer direct interactions with bureaucrats. Procedures were clearly defined and well understood by the businesses. Surveys assessing the effectiveness of reforms demonstrated significant reduction in corruption, proving our hypothesis.

The public-private dialogue groups worked when they were supported by the local administrations and local business and provided with adequate material and technical support. There is some indication that similar groups, promoted by the Ukraine government, without the resources, and perhaps with less enthusiastic local support, did not work. The difference between effective and ineffective efforts at least in the Ukraine case seems to depend on local business and government realizing their interests and having sufficient resources to coordinate with national legal and economic requirements.

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But as more extensive data become available from BIZPRO, further analysis will be useful.

The Two Issues to Address

Two questions arise. The more difficult question is whether this approach would work in other countries. Public-private dialogue groups have been a feature of USAID and other regulatory reform efforts in areas as diverse as Russia and Guinea. In most cases, baseline and follow-up data do not show the efficacy of these efforts as clearly as in the present case.

The other question is whether the resources applied to promoting this reform through public-private dialogue is worth the expense. The answer to the second question depends on the answer to the first. If significant reductions in the cost imposed on businesses from corruption can be achieved, those reductions can be weighed against the costs of regulatory reform programs.

Appendix A. Studies of Corruption in Ukraine

The IFC and the Norwegian Embassy funded three studies: Ukraine: An Assessment of the Business Enabling Environment (2002), Business Environment in Ukraine 2003, and Business Environment in Ukraine 2004.²⁹ These are the latest of a series of IFC studies going back to 1996. Until 2001, IFC surveys were conducted in selected regions and then expanded to cover the whole country. The 2004 study was based on a poll of 2,500 executives of SMEs (companies with less than 1,000 employees) from the 23 oblast capitals, as well as Kyiv and Simferopol. Only agriculture was excluded. The sample was drawn from a list provided by the State Statistics Committee and thus presumably included all registered businesses. For reference, 9 percent of the surveyed firms had 250-1,000 employees. The sample was weighted to accurately represent cities, company size, and sector. Respondents were drawn from capitals, not the secondary centers where most BIZPRO activity has been and from which most of our cases are drawn. The 2003 survey covered 2,014 firms. Data also appear to come from oblast centers but the study says it is representative of “all firms.” The 2003 sample is comparable to all surveys since 2000.

The reports discuss specific areas of business regulation in detail, though these areas differ from year to year. Areas addressed include steps required to open a new business (business registration, licenses, permits), product certifications and inspections, taxation, access to external financing, and foreign trade procedures. (The 2004 report covers exports, the 2003 report, customs.) Table A-1 presents what entrepreneurs thought the major areas for problems were. In several of these areas, corruption or unofficial payments are cited as a problem.

²⁹ *Business Environment in Ukraine 2004* mostly draws on 2003 data; the Ukrainian version is *biznes-seredovishche v ukraini* 2004. All are available on the IFC website.

Table A-1
Serious or Very Serious Barriers According to Entrepreneurs

Problem	Percentage
Unstable legislation	80
Corruption	72
Political instability	65
Unfair competition	61
Regulation of business activities	55
Meddling of local authorities	53
Interference of central authorities	50

SOURCE: IFC. *Business Environment in Ukraine 2004*.

Also in 1999, 2002, and 2004, the World Bank conducted similar studies sometimes referred to as cost-of-doing-business or business-environment studies.³⁰ These are less wide-ranging than the IFC studies, but provide more focused data on corruption. The 2004 World Bank study was based on a survey of 2,100 firms from a sample frame provided by the State Tax Administration. The sample was weighted by region. Though questions and categories are often remarkably parallel, somewhat different data collection techniques were used. Table A-2 disaggregates some of the corruption data for the two oblasts on which we have focused. Exhibit A-1 presents the difficulties businesses face in the business environment and in regulations. The 2004 study also shows in what connection bribes were paid and the change in corruption levels between 2002 and 2004 and sometimes 1999 (Table A-3).

National data are also available in the Business Environment and Enterprise Performance 1999-2000 Survey for Ukraine, which is based on a smaller sample of 150 respondents.³¹ The latest full data are from 1999-2000; later data exist but have not been released. Some of this latter data are also available through the 2002 BEEPS survey sponsored by the EBRD.³² Exhibit A-2 indicates the type of information on corruption solicited for the 1999-2000 study.

³⁰ These were conducted by the Ministry of Economy, with Andrii Palianytsia listed as author, though the 2004 study says that the 2002 study was “done by the World Bank.” Andrii Palianytsia, *Cost of Doing Business Survey 2002*, cited in World Bank Publications and Research Ukraine. Ibid for 2003. For 2004, Andrii Palianytsia, “Business Environment Study: Ukraine, 2004,” available from the World Bank website. Data are for 1999, 2002 and 2004.

³¹ <http://info.worldbank.org/governance/beeps>.

³² See, inter alia, Cheryl Gray, Joel Hellman, and Randi Ryterman, “Anticorruption in Transition 2: Anticorruption in Enterprise State Interactions in Europe and Central Asia, 1999-2002,” Washington, D.C.: World Bank, 2004.

Table A-2*Business Regulation Data Disaggregated for Ivano-Frankivsk and Kherson Oblast*

	Ivano-Frankivsk	Kherson	Ukraine Average	Kyiv
Registration costs (total not just bribes) \$	23	47	45	58
Licensing costs (total not just bribes) \$	95	180	160	250
Average inspection frequency per annum	7	11	10	10
Average inspection cost (total not just bribes) \$	30	125	130	170

Note: Some data are derived from "visual estimates" or original graphed data. The 2004 WB survey does not credit any district with not demanding bribes, but Ivano-Frankivsk is credited for not hindering private business development, helping startups, providing local infrastructure, and having an above average business environment. Kherson is credited with none of the above, and for reference the Kyiv administration is credited with complying with legislation and not hindering private business development

SOURCE: World Bank and the Ministry of Economy and European Integration of Ukraine 2004 Survey.

Exhibit A-1*Difficulties Faced By Businesses***Business Environment Characteristics**

- Rules changed too frequently
- Necessity to pay informally
- Costs are too high
- Requirements depend on officials
- Courts cannot protect
- Use of state power in unfair competition
- Overlapping and duplicating rules
- Rules are too complex
- Selective law enforcement for political reasons
- Too much time spent

Regulatory Areas

- Getting land
- Construction permits
- Unplanned tax inspections
- Customs for import
- Licensing
- Non-tax fiscal inspections
- Other permits
- Customs for export
- Accountancy rules for taxes
- Certification
- Reporting requirements
- Planned tax audits
- Environmental regulations

SOURCE: World Bank. Business Environment Study, Ukraine 2004.

Table A-3
Bribes Paid in 1999, 2002, and 2004

Sector Inspections	2004		2002		1999	
	% Paying	\$	% Paying	\$	% Paying	\$
Other	3.8	34.7	1	47.2	NA	NA
Labor	1.8	19.8	1.1	93.4	NA	NA
Architecture	3.1	48.7	0.6	69.4	NA	NA
R E G I S T R A T I O N W I T H T A X I N S P E C T O R A T E F O R V A T						
KRU	4.1	NA	0.8	NA	NA	NA
Consumer protection	4.3	89.9	1.5	NA		
Business registration	39.1	76.9	61.9	90.6	NA	NA
Pension fund	1.3	25.5	0.8	NA	NA	NA
Police	8	65.4	3.6	84.6	NA	NA
Sanitary	9.7	63.9	6.8	95.4	NA	NA
Fire Department	12.3	48.1	10.9	95.5	NA	NA
Product certifications	12.9	50.7	12.5	81	NA	NA
Tax	13.6	95.6	9.9	218	NA	NA
Hygiene and sanitary permits	13.8	22.3	17.8	42.1	NA	NA
Re-construction permits	19	80.1	21.7	145.4	NA	NA
R E G U L A T I O N S O N T A X E S						
Licensing	20.8	73.6	18.6	264.7	19	140
Occupancy permits (after construction)	24.8	246.9	20.5	155.6	21.3	82
Construction permits	31.5	235.8	22.8	248.7	25	634
Environment protection	1.9	NA	1	64.7	NA	NA
Antimonopoly committee	0.5	NA	0.1	NA	NA	NA

Note: Figures cover only "unofficial payments," not "voluntary payments," which are roughly as large and with a roughly parallel trend. Businesses make voluntary payments in the form of currency or goods and services to various funds or in the form of subscriptions to periodicals. Though legal, such payments are often prompted by regulatory agencies. Unofficial payments are bribes paid in currency or in-kind contributions to specific officials. Data received on this indicator in most cases are lower than actual instances. Their utility lies mostly in comparative analysis.

SOURCE: World Bank. Business Environment Survey, Ukraine 2004.

Exhibit A-2*Questions for the BEEPS 1999-2000 Survey*

-
- Firms in my line of business usually know in advance how much the “additional payment” is.
 - More than one official will require payment for the same service.
 - If a firm makes an “additional payment” the service is delivered as agreed.
 - Of total unofficial payments per annum, what percentage would be spent for the following purposes?
 - To get connections to public services
 - To get licenses and permits
 - To deal with taxes and tax collection
 - To deal with customs and imports
 - To deal with the courts
 - To deal with health/fire inspectors
 - To influence the content of new laws, decrees, and regulations
 - Others
 - On average, what percentage of revenues do firms like yours pay in unofficial payments per annum to public officials?
 - How frequently do firms in your line of business have to pay some irregular “additional payments” for any of the following:
 - To get things done
 - To get connections to public services
 - To get licenses and permits
 - To deal with taxes and tax collection
 - To deal with customs and imports
 - To deal with the courts
 - To influence the content of new laws, decrees, and regulations
 - What percentage of the contract value is typically offered in unofficial payments when firms in your industry do business with the government?
 - What impact have the following forms of corruption had on your business:
 - Central Bank mishandling funds
 - Sale of parliamentary votes to private interests
 - Sale of Presidential decrees to private interests
 - Sale of decisions in the criminal courts
 - Sale of decisions in the commercial courts
 - Bribes to public officials to avoid regulations
 - Contributions to political parties by private interests
 - Patronage
-

SOURCE: <http://www.worldbank.org/beeps>.

Ukraine was not among the star performers – was in fact in about the middle of the pack – with no change from 1999-2000 to 2002. Significant percentages of firms expected to pay bribes for utility connections, licenses and permits, government contracts, and to tax, customs, health and safety, fire and building, environmental and judicial authorities. In Ukraine increases in bribe frequency were noted for utilities and the courts, but not in other sectors. The “bribe tax” was estimated at between 2 percent and 2.5 percent of annual firm revenues.

The Doing Business surveys that FIAS compiles each year for the IFC also provide some data. The methodology, which involves interviewing leading lawyers and accountants in Kyiv, was not appropriate to our purposes.

In addition to IFC and World Bank surveys are surveys by other organizations: a survey of 10 regions conducted in 2000 by ARD/Checchi under the USAID-sponsored Regulatory Reform Program; nationwide surveys conducted by Management Systems International (MSI) in 1999 and within BIZPRO in 2001 and 2004 (in partnership with the American Chamber of Commerce in Ukraine).³³

³³ See inter alia, "Regulatory Cost Assessment Survey," Brain for Ukraine for ARD/Checchi, May 2000.

Appendix B. Regulatory Reform Evolution and Overview

Regulatory policy in Ukraine and its regions is governed by the Law of Ukraine On Fundamentals of State Regulatory Policy in the Sphere of Economic Activity [Про засади державної регуляторної політики у сфері господарської діяльності”] (No. 1160-IV of September 11, 2003). This law is the latest legislation in a long chain of policy documents adopted since 1997 to develop consistent and simplified regulatory policy.

The first, the Presidential Decree on the State Committee of Ukraine on Entrepreneurship Development (No. 373/97), was enacted in 1997 and resulted in the establishment of what is now the State Committee on Regulatory Policy and Entrepreneurship (SCRPE).³⁴

The Presidential Decree on Eliminating Barriers that Restrain Development of Entrepreneurial Activities [Про усунення обмежень, що стримують розвиток підприємницької діяльності] (No. 79/98 of February 3, 1998) called for reducing government interference in business. Nicknamed the “deregulation act,” it called for simplifying business registration; reducing the number of business activities that needed to be licensed; reducing the number of inspections by different government agencies; and simplifying customs procedures. It obligated the Cabinet of Ministers and ministries to align laws and regulations with the policy of deregulation. SCRPE was to coordinate implementation of the decree. For the first two years, SCRPE reviewed 120 legal acts of different ministries and local governments. In about 60 percent of cases regulations were eliminated or modified.

Between 1998 and 2000, reforms were implemented to ease business operations (e.g., implementation of the simplified tax and reporting requirements for small businesses, regulating inspections, reducing number of business activities required licensing). These reforms reduced the costs of doing business. According to the study conducted by ARD/Checchi in 2000, the average cost for industrial enterprises to comply with regulations fell from US\$21,921 in 1997 to US\$5,795 in 2000. The most dramatic reduction in costs and

³⁴So named after reorganization in 1999,

time spent was in business registration (US\$480 and 24.1 days in 1998 to US\$158 and 11.6 days in 2000); licensing (US\$618.8 and 16 days in 1998 and US\$236.8 and 21 days in 2000); number of inspections and related inspections payments (US\$8,971 and 22.4 inspections per year in 1998 to US\$1,393 and 15.7 inspections in 2000). Declines continue as shown in Appendix A.

Each month SCRPE conducts and posts on its website analysis of the business climate. Each quarter it reports on the climate for entrepreneurship. These reports are based on complaints, information collected from local SCRPE offices, and media reports.

In January 2000, the president issued the Decree on Implementation of the Unified State Regulatory Policy in the Area of Entrepreneurship [Про запровадження єдиної державної регуляторної політики у сфері підприємництва] (No. 89/200 of January 22, 2000). The decree called for the development of a consistent state regulatory policy based on such principles as expediency, efficiency, consistency, stakeholder participation, and transparency. The decree prescribed cost-benefit analysis while drafting regulations and identifying their impact. It required the Cabinet of Ministers to draft a law on regulatory policy that incorporated the major principles of the decree within two months. In response, in May-July 2000, the Cabinet enacted a number of orders with instructions on how to rationalize, develop, and evaluate regulations. In 2004, some of these were replaced with regulations requiring a more elaborate methodology, among them the Cabinet of Ministers Resolution on the Approval of the Methodology for Regulatory Impact Analysis and Regulatory Impact Evaluation (No.308 of March 11, 2004).

Regulatory policy reform efforts culminated in late 2003 with adoption of the Law of Ukraine on Fundamentals of State Regulatory Policy in the Sphere of Economic Activity³⁵ [“Про засади державної регуляторної політики у сфері господарської діяльності”] (No. 1160-IV of September 11, 2003) promulgated January 1, 2004. The law systematically defined regulatory principles and directions. The most recent presidential decree—On Some Measure of Implementation of the State Regulatory Policy [Про деякі заходи щодо забезпечення здійснення державної регуляторної політики] (No. 305-2005 of June 1, 2005)—sets forth a strict and short timeframe within which all national and local regulations have to be revisited to align them with the new policy and deregulation requirements.

Regulatory Policy and Business Support Legislation

A number of laws and policy documents promote small business development in Ukraine. The Program of Small Entrepreneurship Development adopted by the Cabinet of Ministers in 1997 (Cabinet of Ministers Decree No. 86 of January 29, 1997) reviewed business registration

³⁵ According to SCRPE, ARD/Checchi provided assistance in drafting this law. According to BIZPRO, their legal advisors also provided advisory services for the preparation of this draft Law.

procedures. Adopted in 2000, the Law of Ukraine on State Support for Small Business [Про державну підтримку малого підприємництва] (No. 263-14) defines the principles of state support for small businesses. The law simplified taxation, accounting, and reporting for SMEs.

The Law of Ukraine on Entrepreneurship, enacted in 1991, was amended 30 times before it was superseded in 2004 by a new commercial code and other laws, including the Law of Ukraine on Registration Legal Entities and Individual Entities-Entrepreneurs [Про державну реєстрацію юридичних осіб та фізичних осіб – підприємців] (No. 755 of May 15, 2003). This law was then replaced by the Cabinet of Ministers' Order on the Rules of State Registration of the Subjects of Entrepreneurship Activities [Про порядок державної реєстрації суб'єктів підприємницької діяльності] (No. 740 of May 25, 1998).

No single piece of legislation explicitly discusses establishing one-stop shops for business registration, but a number of decrees and laws have called for simplifying registration and post-registration procedures (including limiting the number of documents necessary to open bank accounts and obtain an official corporate stamp).

Local and Municipal Implications

REGULATORY POLICY

In compliance with the national regulatory policy, local administrations and municipalities develop an annual plan for drafting, enacting, and amending regulations. Thus, in 2005 Kherson oblast plans to draft and implement 49 regulations, including 6 by the Oblast Administration, and 5 by the city of Kakhovka, one of which established a one-stop shop for permits. The SCRPE reviews the plans and approves the draft regulations.

In 2000, in response to the decree, SCRPE established public collegiums that consist of representatives of private sector and civil society organizations on the oblast and national levels. The collegiums play a consultative role. Their members are supposed to meet on a regular basis. Funding for their activities has to come from their own sources. In 2004, the committee attempted to revive these collegiums at all levels. The national collegium consists of 41 full and 5 accredited members. In 2004, members met about 10 times to discuss regulatory policy and business concerns.

SUPPORT FOR SMALL-SCALE ENTREPRENEURSHIP DEVELOPMENT

Ukraine laws On State Entrepreneurship Support (of October 19, 2000), On the National Program to Support Small Entrepreneurship Development in Ukraine (No. 2157 of December 21, 2000), and some other regulations and presidential decrees obligate each oblast to develop

two-year small business development programs in accordance with a methodology developed by the SCRPE and the Ministry of Economy and European Integration.

In developing the programs, oblast administrations work with think tanks and business representatives. The goal of the program is to promote small business development and establish favorable business environments by providing financial support, improving business development infrastructure, providing information services, and supporting innovative projects by small businesses. Programs are funded through state and local budgets, as well as implementing entities.

In addition, in response to the Presidential Decree On Measures to Support and Promote Entrepreneurship [Про заходи щодо забезпечення підтримки та дальшого розвитку підприємницької діяльності] (№ 906 of July 15, 2000), governments at the oblast and rayon levels were to establish coordinating councils on entrepreneurship development [координаційні ради (комітети, комісії) з питань розвитку підприємництва]. The councils consist of representatives of the executive branch of the local government, private sector, tax administration, the local branch of the Ministry of Interior, and the ombudsman for entrepreneurs' rights. The purpose of these councils is to discuss entrepreneurship development and implement regulatory policy.