



Economic Policy Research Center

Monitoring of Administrative Burden to Small and Medium Enterprises in Georgia



Georgia Enterprise Growth Initiative



USAID
FROM THE AMERICAN PEOPLE

0179, Tbilisi, Georgia, Melikishvili str. 1/6
Tel: (995 32) 922551
E-mail: info@eprc.ge
<http://www.eprc.ge>

Monitoring of Administrative Burden to Small and Medium Enterprises in Georgia

**David Tchkaduaⁱ
Vladimer Ugulava
George Chiladze**

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Summary of Main Results:

The main conclusion of the first monitoring round is that, problems with administrative regulation of small and medium enterprises (SME) are more related with legislation, rather than with enforcement of regulations. Almost in every case, time and monetary costs of regulation fall within the bounds, which are stipulated by the laws. Transparency of inspections, as well as registration process and licensing also improved. Firms report that time and monetary costs associated with regulatory interference into businesses do not impede their operations and growth. On the other hand, businesses speak about the need to reduce regulatory burden, to further cut down number of agencies regulating business and to streamline procedures.

Further, it turns out that administrative burden has actually decreased compared to earlier periods. This can be attributed to several factors, namely: First monitoring was conducted shortly after the political shock in Georgia and since businesses were overregulated before, it is reasonable to assume that real costs of regulation started to adjust to equilibrium values after political changes took place. Other arguments are related to massive restructuring in government and possibly loose control of business from reorganizing government agencies. We do not neglect the seasonal factors too. So, whether the progress in administrative enforcement is short term or is sustainable in long run will be more apparent during following rounds of monitoring.

Although the law “On Controlling Entrepreneurial Activity” (LCEA) sets out procedures to alleviate excessive interference of controllers into the businesses and cut down number of controlling agencies as well, still in recent years many companies experienced frequent and costly inspections. Starting from 2004, some positive changes evolved. During the first monitoring period, businesses reported that, monetary payments, frequency of inspections, costs related to transparency of the process and time actually spent on inspections decreased indeed. Importantly, at its current level, monetary and time costs of inspections do not hamper development of SME sector. Majority of problems, which enterprises encountered during inspections were related to extensive paperwork and need of processing massive documentation. Some difficulties are also associated with frequent changes of inspection rules.

Positive changes are observed with licensing and permits. Time, which enterprises spent on getting a license or a permit, did not exceed legislated values. Businesses did not pay significant amounts of unofficial payments to licensing agencies and monetary payments for obtaining licenses was acceptable as well. However, still too many entrepreneurial activities are subject to regulation and companies have to apply to many different agencies in order to get a permit or a license. Important conclusion for policymakers is that, changes to current legislation are essential and this issue is first priority.

Bureaucracy and Corruption		
		Average
Fraction of time company management spent with administrative agencies	SCALE: 1) 0%; 2) 1% to 5%; 3) 6% to 10%; ... 6) More than 50%	2.31 (2.19 - 2.43) **
Fraction of revenues company pays to administrative agencies as unofficial payments	SCALE: 1) 0%; 2) up to 1%; 3) 1% to 2%; 4) 2% to 10% ... 6) More than 25%	3.19 (2.95 - 3.43) **
How often companies pay bureaucrats	SCALE: 1) Always; 2) As a rule 3) Often; 4) Sometimes; 5) Seldom; 6) Never	4.47 (4.34 - 4.61) **
Notes: Average values and 95% confidence intervals marked with ** are estimated in last column		

Other results indicate that, situation is slightly different with registration. Entities pay more during the registration than it is legislated by law. Entities, who hired private intermediary to do registration for them, on average pay more than those, who registered by themselves. But, on the other hand, self registering entities spent more time on the procedures. In opposite to these latter companies, firms who used intermediary consider that costs, which they bear on registration is somewhat impeding to them.

First monitoring took place while the old tax code of Georgia was in effect. From our analysis follows that, tax level and tax administration was one of the primary factors severely hindering business development. In particular, businesses regarded tax regulations as ambiguous and taxation legislation itself as unstable. Importantly, SME-s were most concerned with high tax rates. As results of general business environment assessment indicate, taxation issues were more problematic for small enterprises in Georgia, than any administrative interference. Although we are optimistic about new tax code, which drastically cut down tax burden, still there is more to do for government in terms of administration and the results of tax reform will be evident during next monitoring rounds. Other conclusions about business climate are that, in most cases firms are troubled with factors, which directly influence business operations, such as high prices on intermediate inputs (energy) and general macro economy and market strength. Judicial system is also far from perfection, as it is corrupt and not competent to properly handle corporate disputes.

Although there are number of studies concluding that excess administrative burden hinders business development, which is intuitively obvious, we did not find significant evidence of causal effect of regulatory volume on growth. We explain this by need to construct more comprehensive model for SME growth analysis in order to control for other variables directly affecting growth.

It is also interesting to note that, according to our results small and medium sector did not grow faster when total economy. This is opposite to the fact, that small business is the main driver of development in transition economies and there are also many studies leading to this latter conclusion.

Finally, with only few exceptions, there are no systematic differences in patterns of administrative costs of regulation across the three regions we analyzed.

Table below summarizes key measures of administrative costs of business regulation.

Inspections				
	OVERALL	TBILISI	KUTAISI	RUSTAVI
Average number of days spent on one inspection	5.89 (5.11 - 6.67)*	6.07 (5.15 - 6.99)*	5.8 (4.15 - 7.44)*	5.45 (3.22 - 7.68)*
Average number of company staff engaged in one inspection	2.17 (1.99 - 2.34)*	2.3 (2.09 - 2.51)*	1.91 (1.62 - 2.21)*	1.85 (1.4 - 2.3)*
Average Amount of Monetary Payments on Inspections	2.73	Scale: 1) - Up to 150 Gel; 2) - 150 to 300Gel; 3) - 300 to 500 Gel; 4) - 500 to 800 Gel; ... 10) - More than 3000 Gel		
Licenses and Permits				
	Permits		Licenses	
Average number of days needed for official procedures to obtain one License/Permit	10.2 (6.25 - 14.15) *		14.9 (11.15 - 18.81) *	
Average total amount (in Lari, including unofficial payments) paid by one company for all Licenses/Permits	299.1 (201.6 - 396.5)*		273 (212.64 - 333.36)*	
Need for unofficial payments for Licenses/Permits. Scale: 1 - Always, 2 - Sometimes, 3- Never	2.57 ***		2.92 ***	
Total amount paid for Permits/Licenses. Scale: 1 - Acceptable, 2 - Relatively Impeding, 3 - Unacceptable	1.7 **		1.33 ***	
Registration				
	With Intermediary		Without Intermediary	
Average number of days needed to register a company	9.4 (7.7 - 11.1) *		13.8 (11.3 - 16.3) *	
Average total amount (in Lari, including unofficial payments) paid for Registration	(200GEL - 350GEL)***		(150GEL - 250GEL)***	
Total amount paid for Registration Scale: 1 - Acceptable, 2 - Relatively Impeding, 3 - Unacceptable	1.72 (1.11 - 2.33) ***		1.27 (1.07 - 1.47) ***	
Taxation				
Scale: 1 - Not problem at all; 2- Relatively not problematic; 3- Relatively problematic; 4- Very problematic				
	OVERALL	TBILISI	KUTAISI	RUSTAVI
Unstable Tax Legislation	2.8 (2.67 - 2.92)***	2.79 (2.62 - 2.95)***	2.81 (2.51 - 3.11)***	2.87 (2.63 - 3.11)***
High Tax Rates	3.3 (3.19 - 3.41)***	3.36 (3.22 - 3.5)***	3.15 (2.9 - 3.41)***	3.28 (3.05 - 3.5)***
Tax Inspections	2.01 (1.89 - 2.14)***	1.83 (1.67 - 1.98)***	2.1 (1.81 - 2.39)***	2.45 (2.16 - 2.74)***
Unequal Competition from Informal (Shadow) Sector of Economy	2.55 (2.4 - 2.7)***	2.43 (2.23 - 2.63)***	2.65 (2.3 - 3.0)***	2.8 (2.49 - 3.11)***
Note: *** 0.01 significance, ** 0.05 significance, * 0.1 significance				

Objectives of Monitoring

In recent years legislative attempts to improve administrative regulation of businesses in Georgia have been timid and by large failed to bear practical results. Small and medium enterprises were overregulated by numerous agencies, whose functions often overlapped and businesses carried high real costs of regulation. Change of political power in

Georgia, which took place in late 2003, supported the expectations that government would be forcing reforms towards freer, more efficient and less corrupt market economy. Nevertheless, how new government succeeds in deregulation and enforcement has yet to be evaluated.

Economic Policy Research Center (EPRC), with the support of USAID – Georgian Enterprise Growth Initiative (GEGI), is conducting monitoring of business regulation in order to assess the success of government deregulation efforts. The monitoring will be implemented in several rounds, where benchmark level and progress of administrative deregulation will be assessed. The rationale behind monitoring administrative costs of business regulation is to hold government accountable for its reforms and proper enforcement, as well as pressure authorities towards further de-bureaucratization and transparency.

Our initiative is to conduct surveys of small businesses in center, as well as in regions, to (i) evaluate a baseline level of regulatory burden on businesses in licensing, permits, registration, certification, inspections and other state interference; (ii) periodically monitor against benchmark the progress of regulatory enforcement and administrative deregulation aimed at reducing administrative barriers; (iii) test several hypothesis on the impact of excess regulation on the business development in Georgia.

To our knowledge, this is the first study for Georgia of this kind, where all factors related to administrative regulation of businesses are quantitatively assessed.

Survey Questionnaire:

Questionnaire includes structured questions on all four types of business regulation in Georgia, which are: registration, licenses and permits, certification and inspections. In addition, our interest in the project goes beyond simply monitoring regulatory enforcement. It extends to analyzing dynamics of small business development and testing causal effects of regulation on this sector of the economy. Therefore, some complementary blocks were also included in the questionnaire. These include: background questions and questions related to assessment of business environment, as well as companies' perceptions about factors, which impede business development. In total, questionnaire includes twelve clusters and ninety one questions.

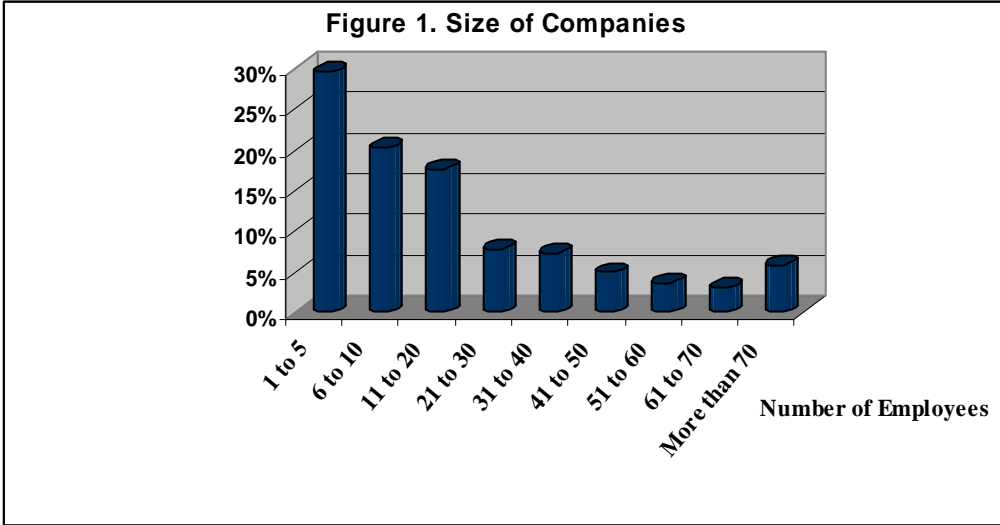
Sample:

Survey included three Georgian cities, namely Tbilisi, Kutaisi and Rustavi. The size of the sample was set at 500 enterprises. The respondents were randomly selected from a population of small and medium businesses, which were active by August, 2004 in Georgia. To determine the whole population, which comprises 3518 companies excluding individual enterprises, we consulted database of the Department of Statistics of Georgia. Number of employees and type of industry, in which company was engaged, were specified in the database as well.

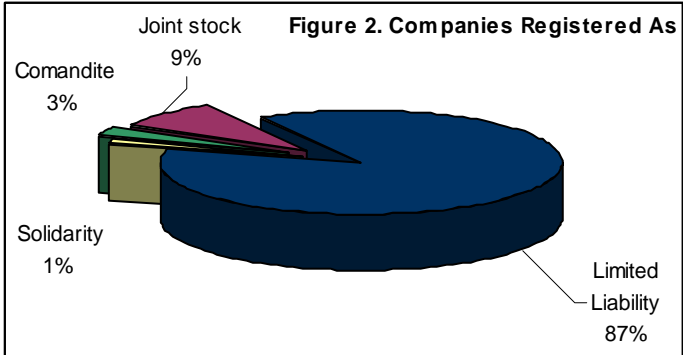
In order to form a sample, companies were grouped according to their location and optimal weights were assigned to companies to account for number of enterprises in each location, size of the company, date of registration and industry type.

In result, the sample includes 295 SME-s active in Tbilisi, 110 in Kutaisi and 95 in Rustavi respectively. 60 percent of survey participants are medium size and 40 percent are small companies. 22.4 % of companies in the sample are newly registered (i.e. registered since June, 2003) companies. As for industry composition, roughly 12 percent come from manufacturing, 18 percent from retail trade, 6 % from wholesale trade, 5% from transportation, 5% from construction

business, 6% from hotel and restaurant businesses, 8% are medical services companies and rest come from other services sectors. Sample distribution by company size is given in Figure 1.



Majority of companies in our sample are companies with limited liability (87%) and joint stock companies (9%). Others are proprietorships (Figure 2).



I. Inspections:

Business inspections are regulated by the law “On Controlling Entrepreneurial Activity” (LCEA), which was enacted by the parliament of Georgia in June, 2001 with the aim to alleviate excessive interference of controllers into the businesses. The procedure set out by the law is that any unplanned inspection should be substantiated and controllers have to go through application for court approval to carry out inspection. There are certain exceptions to the law, which concern planned inspections by Tax authorities, Chamber of Control and several other agencies. After the law “On Controlling Entrepreneurial Activity” was enacted, the number of controlling agencies was also cut down and register for controlling agencies was set up at The Ministry of Justice.

First we analyze subjective perceptions of businessmen about the costs associated with inspections. Because first monitoring period follows the political and structural changes in government, and expectations about positive changes in governance were very optimistic too, we could expect that situation with regulation improves. Indeed, with only few exceptions, businesses report that inspections are less costly to them in this monitored period. In some cases, SME assessment is that monetary payments, inspection frequency and costs related to the transparency and time actually

decreased. In majority of instances businessmen speak about improvements and that situation with inspections has changed indeed.

The progress on behalf of government in enforcing administrative regulation may in fact be the result of changes in governance. On the other hand, it can also be argued that administrative structure of governance itself was in process of adjusting to political changes and that improvement with regulation bear short-term nature. Other arguments are related to businesses themselves, and it may be the issue, that it's enterprises, who less frequently violate the laws and regulations, so that fewer fines can be imposed on them. But important conclusion is that, other things constant, monitoring results indicate on substantial and positive changes in enforcement. Whether this is short term shock or long sustainable changes, however, will be more apparent during following rounds of monitoring.

When we test perceptions of SME-s about the time spent on inspections, we get that in all three regions businesses think they spent less time on all inspections compared to previous half year period. The estimated parameter, which is mean scaled time costs of inspections, is less than 3 (indication, that inspection time is at same level compared to previous period) with 99% confidence. All relevant estimated parameters are given in the Table I.1.

Table I. 1: Real Costs of Inspections by All Agencies

Scale		OVERALL	TBILISI	KUTAISI	RUSTAVI
	Time Spent on All Inspections	2.58 ↓***	2.67 ↓***	2.36 ↓***	2.42 ↓***
1 - Significantly Decreased					
2 - Decreased	Number of Inspections	2.53 ↓***	2.56 ↓***	2.23 ↓***	2.61 ↓**
3 - The Same					
4 - Increased	Payments During Inspections	2.56 ↓***	2.64 ↓***	1.88 ↓***	2.77 ---
5 - Significantly Increased					
	Transparency of Process	2.33 ↓***	2.32 ↓***	1.96 ↓***	2.67 ↓*

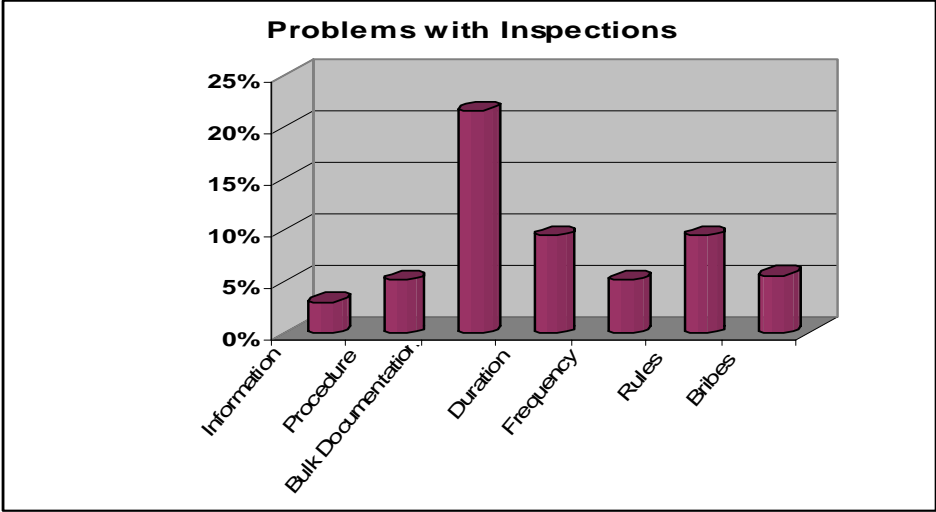
Notes: *** Indicates 0.01 significance, ** - 0.05 significance, * - 0.1 significance level

As shown in Table I.1, in both cities of Tbilisi and Kutaisi, when asked whether the number of all inspections changed, SME-s report that inspections are less frequent compared with second half of 2003. In Rustavi, we can infer with 95% confidence that mean scaled number of all inspections is not at same level as it was in the previous period, but we can not reject null at 99% level of confidence.

This result may be indicating two facts. First, we should have expected reduction of time costs of inspections following the enactment of LCEA, since the law induces limitations on the length of inspections, as well as on the number of inspections agencies can conduct. On the other hand, we doubt that LCEA was properly enforced before new government gained the political power, so that inspection costs of businesses still have to adjust to the long-run equilibrium. Second, during the first half of 2004, many governmental agencies conducted massive restructuring and this may have been a cause of loose control from inspecting bodies. There could have been seasonal effects too, so we expect to get more accurate picture during the next rounds of monitoring.

The dynamics of monetary costs of inspections exhibit slightly different pattern across the regions. In Rustavi, we can not reject the hypothesis that cost of inspections stays at the same level at any reasonable significance level, whereas in Kutaisi, respondents report that monetary payments during inspections decreased, in particular we accept hypothesis that payments slightly decreased. Based on Tbilisi interviews, with 99% level of confidence we infer that the situation improved and that costs are not same as they were in previous monitored period.

It can also be concluded, that inspection process became more transparent compared to earlier periods. When analyzing data in Kutaisi region, we accept hypothesis that level of transparency increased. In Rustavi, when we scale perceptions of businesses about the inspection process, we reject hypothesis about no changes in the level of transparency with 90% confidence, but at 95 % level we can not be confident of positive changes in this parameter.



Among the problems, which enterprises encountered during inspections (Figure above), amount of different kind of documents requested during the process, seems to be the major one. Businesses also name frequent changes of inspection rules, as well as duration of inspections among the problems. In fact, 22% of all respondents, who reported that at least one agency conducted inspection in their companies, relate difficulties with massive paperwork, and 9% with inspection rules and inspection duration. Six percent of all respondents report that they had to pay bribes to inspectors. Least problematic issue with inspections seems to be availability and access to information about the conditions of conducting inspections. This is confirmed in Table I.2 below, where upper bounds of 99% confidence intervals for true values of parameter are smaller than 2.

Scale	OVERALL	TBILISI	KUTAISI	RUSTAVI
Getting Information Was:				
1 - Considerably Easy	Evaluate the level of difficulty of getting reliable information on the conditions of inspection from inspecting agencies	1.61 ***	1.55 ***	1.88
2 - Relatively Easy				
3 - Relatively Difficult				
4 - Considerably Difficult				
	1.65 ***			

Note: *** Indicates 0.01 level of significance for true mean to be less than 2

Next we turn to direct estimation of actual inspection costs. We asked respondents to indicate total sum of payments to inspecting agencies during the first half of 2004, including official and informal payments. We estimate this parameter to establish a baseline for the following rounds. We also asked businesses to evaluate how impeding to their business operations are those payments. The results are as follows: interestingly, businesses pay more on inspections in Tbilisi than in other cities. This can be explained by the fact, that business is wealthier here to attract more interest from regulators, as well as administrative bodies themselves may be considered stronger to exert regulatory power. Based on statistical test, we accept that on average SME-s paid from 300 to 500 Lari on inspections in this monitored period and with 99% confidence level, we reject the hypothesis that the amount paid on inspections is impeding to Georgian small and medium businesses. Results are summarized in the table below.

Table I. 3: Monetary Costs of Inspections

Scale		Scale	
1) Up to 150Gel	Amount of Monetary Payments on Inspections	2.73	How impeding to your business is this amount
2) 150 to 300 Gel			
3) 300 to 500 Gel			
4) 500 to 800 Gel ...			
... 10) More than 3000 Gel			
			1.48 ***

As for time costs of inspections, on average one inspection took roughly 6 days and two persons were involved in inspection (Table I. 4).

Table I. 4: Time Costs of Inspections

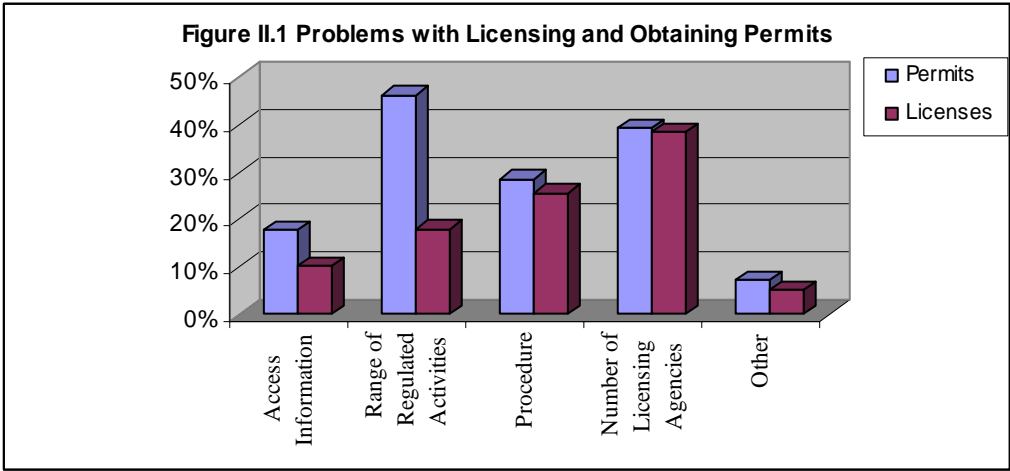
	OVERALL	TBILISI	KUTAISI	RUSTAVI
Average number of days spent on one inspection	5.89 (5.11 - 6.67)**	6.07 (5.15 - 6.99)**	5.8 (4.15 - 7.44)**	5.45 (3.22 - 7.68)**
Number of days spent on all inspections by average company	11.5			
Average number of company staff engaged in one inspection	2.17 (1.99 - 2.34)**	2.3 (2.09 - 2.51)**	1.91 (1.62 - 2.21)**	1.85 (1.4 - 2.3)**

Note: ** denotes 95% confidence intervals

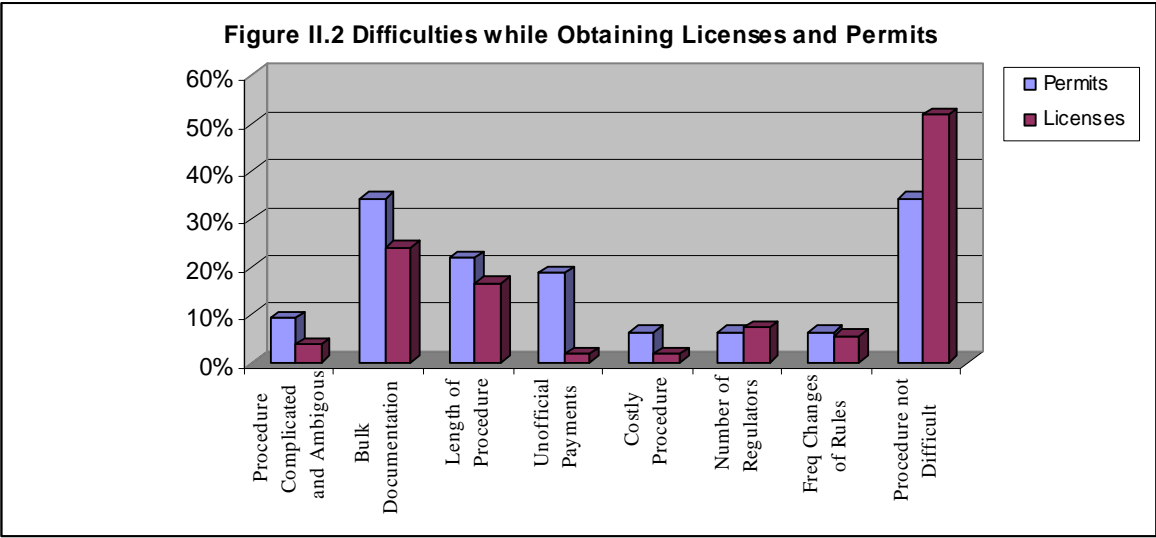
II. Licenses and Permits:

One interesting finding is that businesses encounter more difficulties with legislation than with enforcement of laws on Licensing and Permits (Figures II.1 and II.2). Licensing and Permits are regulated by the law of Georgia “On Issuing Licenses and Permits for Entrepreneurial Activities”, which lists around forty different activities, which are subject to licensing and even more for various kinds of permits. These numbers, in our opinion, are far too large and impeding for entrepreneurial activities. Monitoring results indicate the same. SME-s were asked to respond to different factors, which would improve process of licensing on the one hand, and to factors, which were most troublesome while actually obtaining licenses and permits. 46% of all companies, which obtained at least one permit in monitored period,

and 18% of companies, who had experience with licensing in this period, argue that cutting down the number of activities currently subject to licensing or permits will best improve business regulation. Note that this argument is related to regulation itself, not to administrative enforcement.



Among the problems, which companies encountered during licensing and obtaining permits, the major one is that companies have to process and submit massive documentation (34% and 24% of companies who obtained at least one permit or one license respectively in the monitored period). On the other hand, SME-s responded that procedure itself is rather clear and unambiguous. Requirement for paying unofficial payments was named by 19% of respondents in case of permits, and only by 2 % of companies in case of licensing. Time and monetary costs are perceived to be of moderate severity by businesses to impede their activities.



When it comes to enforcement of laws, we conclude on similar inference as it was the case with inspections. That is real costs of regulation are adjusting to long-run equilibrium values after the recent political shock.

Next paragraph is devoted to calculating actual time and monetary costs encountered by businesses while obtaining licenses and permits. In first monitoring period, Georgian small and medium businesses spent on average fifteen days to obtain one license and ten days to obtain one permit (Table II. 1). We note, that at 0.01 significance, these numbers fall into the range stipulated by the law. It is interesting to note, that in 21% of cases with permits and 25 % of cases with licenses, businesses report that they acquired fee-based services from state agencies in preparing laboratory and expertise results, different kinds of evaluation and other documentation.

Table II. 1: Real Costs of Licenses and Permits

		Permits	Licenses
Average number of days needed for official procedures to obtain one License/Permit		10.2 (6.25 - 14.15) *	14.9 (11.15 - 18.81) *
Average total amount (in Lari, including unofficial payments) paid by one company for all Licenses/Permits		299.1 (201.6 - 396.5)*	273 (212.64 - 333.36)*
Did you need to bear unofficial payments for Licenses/Permits?	SCALE 1 - Always 2 - Sometimes 3 - Never	2.57 ***	2.92 ***
How would you evaluate total amount paid for Permits/Licenses ?	SCALE 1 - Acceptable 2 - Relatively Impeding 3 - Unacceptable	1.7 **	1.33 ***

Notes: * denotes 90% confidence intervals, *** and ** mean 0.01 and 0.05 level of significance respectively

When we asked the enterprises whether they were required to bear unofficial payments to obtain License/Permit, they responded that, actually state licensing agencies did not require them to pay such payments. Also, businesses do not consider the payments for permits and licenses to be impeding at all at reasonable levels of significance. This is true with 95 % confidence with permits and with 99 % confidence with licenses, where population true scaled averages are less than 2 (Table II. 1).

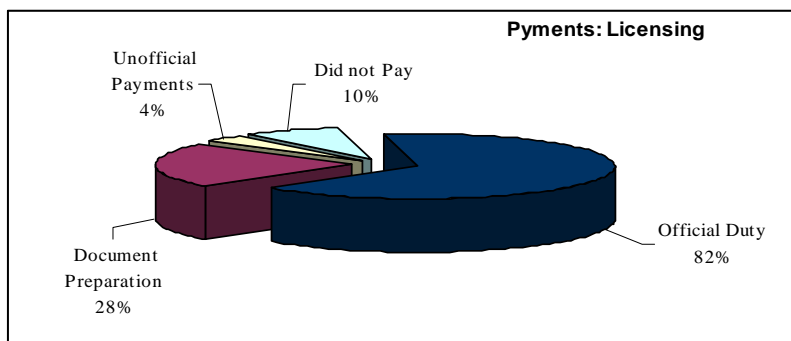
It is interesting to test perceptions of businesses about costs associated with licensing procedures and permits. This is particularly so, because we held first monitoring round and by testing perceptions we infer about dynamic changes in regulation. For both licenses and permits, we conclude that procedures of obtaining licenses and permits are relatively easy. With 99% confidence, we reject null hypothesis that procedure is relatively difficult and accept hypothesis that on average businesses consider them to be easy. When we compare time costs of licensing and permits in this period to the earlier period, we reject that costs stayed the same with 0.05 significance, but we can not reject original hypothesis at 0.01 level of significance. As for unofficial payments, we accept that payments were the same as in the previous half year period.

Table II. 2: Tests on SME perceptions about Licensing and Permits

SCALE		Permits	Licenses
1 - Considerably Easy; 2 - Relatively Easy; 3 - Relatively Difficult; 4 - Considerably Difficult	Evaluate Procedure: Licenses/Permits	2.34***	2.24***
1 - Significantly Decreased; 2 - Decreased; 3 - The Same; 4 - Increased; 5 - Significantly Increased	Evaluate Unofficial Payments Compared to Previous Period	2.94 ---	
	Evaluate Time Costs Compared to Previous Period	2.54**	

Notes: *** and ** mean 0.01 and 0.05 level of significance respectively

Interesting feature was revealed when businesses were asked to categorize payments they made during licensing. Ten percent of firms report, that they had no payment to make for obtaining license, what is considered to be direct violation of the law. Four percent of companies speak about the need for unofficial payments.



III. Registration:

From all newly registered companies (i.e. companies, which registered in this monitoring period), 26 percent did not actually deal with registration, but used private intermediary instead to register. As one would expect, entities hired intermediary when they wanted registration procedure to be less time consuming. Actually, when firms registered by themselves, on average they spent about 14 days on the procedure, while intermediaries registered firms in 9.5 days. This difference is significant at 98% confidence level. The simple explanation for this fact is that, private intermediaries have contacts with district courts and notaries to force the registration process to be faster. Quite naturally, payments for registration exhibit opposite pattern. On average, it cost entities less to register themselves than to hire intermediary. Intermediaries required on average from 200 to 350 lari for registration, while average entity paid from 150 to 250 lari when registering itself.

One note about violation of the law on “Fees for Registration” is due here. It turns out that entities pay for registration more than it is stipulated by law. Taking into account composition of firms in our sample, weighted average payment for registration should be around 174 lari. But from statistical tests we infer with 99% confidence, that registration cost average company more than 200 lari.

However, the only group which says that payment for registration is too much and it impedes business are companies, who paid intermediaries for registration (In fact, no test at any reasonable significance rejects this hypothesis for such group). On the other hand, companies who registered by themselves do not consider registration fee to be impeding at all. The conclusion is that, private intermediaries exert too much interest from the registration process (Table III. 1).

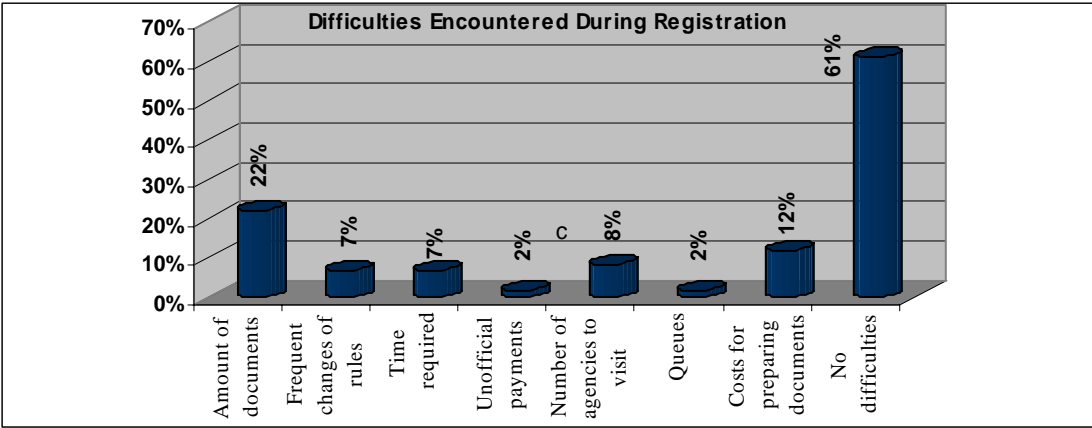
Table III. 1: Registration

		With Intermediary	Without Intermediary	Overall
Average number of days needed to register a company		9.4 (7.7 - 11.1) *	13.8 (11.3 - 16.3) *	12.7 (10.8 - 14.7) *
Average total amount (in Lari, including unofficial payments) paid for Registration		(200GEL - 350GEL)***	(150GEL - 250GEL)***	(200GEL - 250GEL)***
How would you evaluate total amount paid for Registration?	SCALE 1 - Acceptable 2 - Relatively Impeding 3 - Unacceptable	1.72 (1.11 - 2.33) ***	1.27 (1.07 - 1.47) ***	1.38 (1.18 - 1.58) ***

Notes: * denotes 90% confidence intervals, *** and ** mean 0.01 and 0.05 level of significance respectively

Next we turn to bureaucratic barriers in the process of registration. Firms were asked to respond how difficult they thought it was to acquire reliable information about procedures, required documents, costs, terms, etc. Neither

companies, who used intermediaries, nor those entities who registered by themselves, consider bureaucracy as a problem. Different bureaucratic factors are ranked by businesses in order of their difficulty in the figure depicted below. Again, 61% of all newly registered firms encountered no significant difficulties. Among the problems, businesses name that they have to deal with large amount of documentation (22% of all newly registered companies who did not use intermediary) and that they have to visit many administrative agencies during the registration (8% of companies).



IV. Certification:

Monitoring reveals some violations of authority on behalf of certification agencies. It appears that, 63 % and 61 % of all companies, who had mandatory and optional certification of their products/services correspondingly, did not have a choice of agency, which evaluated accordance of product standards. Consequently, such companies paid on average 58 Gel more for one certificate. Interestingly, during optional certification, companies can opt not to pay as much as they do for mandatory certificates (Table IV. 1).

Situation with administrative corruption and costs of certification follow similar pattern as it was case with other regulation mechanisms.

Market competitiveness and promotion seem to be main stimuli for optional certification. In fact, 46% of companies conducted optional certification to be more competitive on market, 23% to promote their products or services and other 15 % on demand of their dealers.

		Mandatory Certification	Optional Certification
Average number of days needed to obtain one certificate		6.2 (4.8 - 7.6) *	6.9
Average total amount (in Lari, including unofficial payments) paid for one certificate		187.8 (147.5 - 228.1) *	82.8 (60.1 - 105.5) *
Term duration (months) of one certificate		9.5 (7.4 - 11.5) *	5.8
Did you need to bear unofficial payments during certification?	SCALE 1 - Always 2 - In some cases 3 - Never	2.75 (2.57 - 2.93) ***	
How would you evaluate total amount paid for all certificates?	SCALE 1 - Acceptable 2 - Relatively Impeding 3 - Unacceptable	1.47 (1.22 - 1.72) ***	

Notes: * - 90% confidence interval, *** - 0.01 level of significance

V. Business Environment and Development:

V.1 Taxation

It is often argued that tax legislation in Georgia is one of the primary factors hindering business development. High tax level caused distortions to the economy at the same time forcing firms to succumb part of their businesses to informal sector.

In this section we try to assess what aspects of taxation are most problematic and what factors less. Are problems with tax regulation in Georgia related to tax legislation or to tax collection and enforcement of tax regulations? We tested several factors, some of them related to legislative issues, some to administrative enforcement.

We conclude that small and medium companies in Georgia consider that most of the problems follow from legislation. In particular, businesses regard tax regulations as unclear and taxation legislation itself as unstable. But above all, SME-s are severely hurt with high tax rates. In fact, labor taxes followed by profit tax and value added tax, are most hampering. They are named as most problematic issues respectively 73, 38 and 33 percent of time (Figure V. 1). Less problematic are issues, such as timely response from authorities to get clarification on tax matters and tax inspections. Obviously, these latter factors are connected to administrative enforcement. Businesses also think that informal sector of economy and unfair competition cause some problems to them.

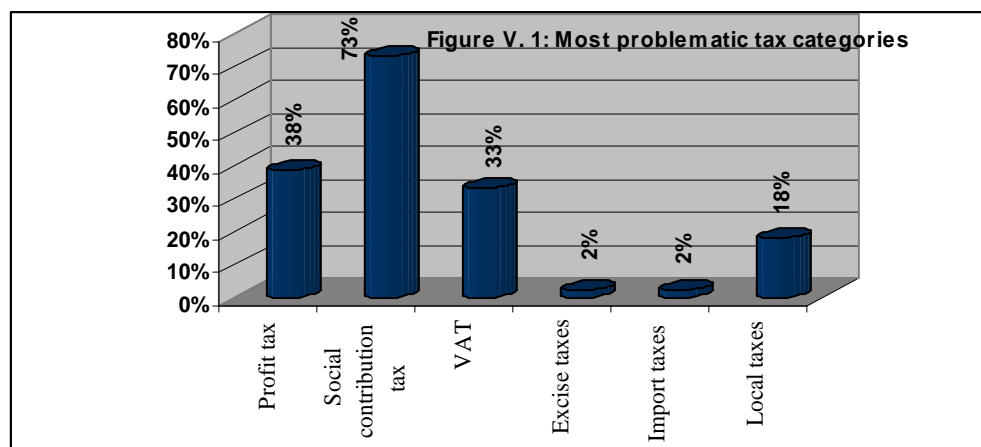
Table V.1: Assessing Taxation Aspects

Scale: 1 - Not problem at all; 2- Relatively not problematic; 3- Relatively problematic; 4- Very problematic

	OVERALL	TBILISI	KUTAISI	RUSTAVI
Unstable Tax Legislation	2.8 (2.67 - 2.92)***	2.79 (2.62 - 2.95)***	2.81 (2.51 - 3.11)***	2.87 (2.63 - 3.11)***
High Tax Rates	3.3 (3.19 - 3.41)***	3.36 (3.22 - 3.5)***	3.15 (2.9 - 3.41)***	3.28 (3.05 - 3.5)***
Clear Normative Regulation to Determine Tax Base	2.46 (2.33 - 2.6)***	2.4 (2.22 - 2.58)***	2.52 (2.2 - 2.85)***	2.56 (2.32 - 2.81)***
Response from Tax Authorities to get clarification on Tax Payments	2.09 (1.95 - 2.23)***	1.99 (1.81 - 2.17)***	2.01 (1.69 - 2.33)***	2.44 (2.14 - 2.74)***
Tax Inspections	2.01 (1.89 - 2.14)***	1.83 (1.67 - 1.98)***	2.1 (1.81 - 2.39)***	2.45 (2.16 - 2.74)***
Unequal Tax Treatment of Market participants due to Inconsistent Tax Regimes	2.33 (2.2 - 2.47)***	2.28 (2.11 - 2.46)***	2.39 (2.07 - 2.7)***	2.43 (2.12 - 2.74)***
Unequal Competition from Informal (Shadow) Sector of Economy	2.55 (2.4 - 2.7)***	2.43 (2.23 - 2.63)***	2.65 (2.3 - 3.0)***	2.8 (2.49 - 3.11)***

Note: *** denotes 99% confidence intervals

In addition, we tried to measure the volume of informal economy. Businesses were told that significant portion of activity of Georgian enterprises is not accounted in official statistics of the country and they were asked to evaluate percentage of total turnover of similar to them Georgian firms, which these firms conceal from what is officially declared. Although we are cautious of this assessment of informal volume of small and medium businesses, since firms are reluctant to give their estimates and our assessment may be downward biased, nevertheless, it is interesting to learn that, shadow economy volume is between 26 and 35 percent of total economy (99% confidence interval for the mean of respective r.v. is 5.7 to 7.2, where scaled values of 6 and 7 denote (26% -30%) and (31% - 35%) marks respectively).



V. 2 Barriers to Business Development

Next we compare different tools of administrative interference into businesses to each other. In addition to regulatory mechanisms, i.e. registration, licensing, certification and inspections, we also evaluate difficulties associated with taxation. Moreover, our analysis includes general factors related to business climate, such as corruption, infrastructure development, macroeconomic situation and market strength, political stability, crime issues and other factors.

Table V. 2: Assessing Business Regulation

	Scale: 1 - Very Easy; 3- Relatively Easy; 4- Relatively Difficult; 6- Very Difficult
Registration of Enterprises	2.68 (2.26 - 3.1)***
Obtaining Permits	3.05 (2.84 - 3.25)***
Licensing	3.21 (2.98 - 3.44)***
Certification	3.05 (2.84 - 3.26)***
Inspections	3.39 (3.22 - 3.55)***
Taxation	4.42 (4.24 - 4.59)***

Note: *** denotes 99% confidence intervals; Registration is evaluated on the basis of self-registered companies only

As it is shown in Table V.2, all types of business regulation procedures are relatively easy, while taxation is perceived by businesses as most troublesome issue.

Important implication, which follows from analysis of general factors of business environment, is that, firms mainly are concerned with factors directly related to their business operations. Again, tax level is among the factors, which most seriously hinder business development. But interestingly, average SME names shortage in energy supply and high prices on energy resources even more serious impediment to its business. One exception is that our respondent firms are not highly concerned with access to capital. Possible explanation for this fact is that, rate of expansion of small companies is not as high, and consequently they demand less financial resources, as compared to businesses of scale.

As noted earlier, legislation on business regulation is more problematic, than enforcement on the side of administrative agencies. With 99 % confidence, we conclude that average SME perceives that unstable legislation is more impeding to business development than administrative interference into the business and business regulation. Political situation, too, was named as one of the problematic factors. It is quite natural that this issue received such importance, since the study was conducted shortly after the political shock in Georgia, so that businesses were unclear and concerned about future government actions and its impact on their operations. So, this indicator may be biased and we expect it to be lower in the next monitoring rounds.

Other conclusions are that, opposite to many CIS countries, where similar studies have recently taken place, racket and criminal world is not a problem in Georgia.

Table V. 3: Business Climate

Do the following factors impede your business development?	Scale: 1 - Does not impede; 2- Relatively not impeding; 3- Relatively serious impediment; 4- Very serious impediment
Market strength	2.37 (2.25 - 2.50) ^{***}
Macroeconomic Situation	2.66 (2.55 - 2.78) ^{***}
Access to Financial Resources	2.65 (2.53 - 2.78) ^{***}
Tax Level and Administration	3.11 (3.01 - 3.21) ^{***}
Business Regulation	2.05 (1.93 - 2.16) ^{***}
Unequal Competition	2.71 (2.6 - 2.83) ^{***}
Level of Infrastructure Development	2.46 (2.34 - 2.58) ^{***}
Corruption	2.76 (2.62 - 2.9) ^{***}
Pressure from Criminal world	1.82 (1.68 - 1.95) ^{***}
Direct Interference of Administrative Agencies into the Business	2.04 (1.91 - 2.17) ^{***}
Unstable Legislation	2.84 (2.73 - 2.95) ^{***}
High Cost of Energy	3.2 (3.09 - 3.30) ^{***}
Political Instability	3.06 (2.94 - 3.18) ^{***}

Note: *** denotes 99% confidence intervals

Next we turn to business perceptions about how competent and just they think Georgian judicial system is in handling corporate cases. It is important to note, that dynamics and progress with judicial system exhibits similar pattern as it is with executive regulation. Firms were asked to rank how much they trusted, that judicial system is just and protects corporate and property rights of companies. They also were asked to compare current situation with the situation, which prevailed two years ago. When we compare respective test statistics, we conclude that situation has notably improved and that businesses perceive that now courts are more competent and fair in handling corporate disputes. Nevertheless, it does not mean that Georgian judiciary is ideal now (see table below). The system is still far from perfection, but what we argue is simply that Georgian judicial system was even more disastrous several years ago.

Subjective perceptions on various factors, related to the Georgian judicial system is evaluated in the table below.

Corporate Disputes and Judicial System	
Evaluate how often Georgian judicial system is:	Scale: 1 - Always; 2- As a rule; 3- Often; 4- Sometimes, 5- Seldom, 6 - Never
Just	4.18 (4.02 - 4.35)***
Fair and not corrupt	4.23 (4.06 - 4.4)***
Adequate to react in terms of time	4.28 (4.09 - 4.48)***
Costs of judicial services (lawyers, notaries) are adequate to companies	3.87 (3.66 - 4.09)***

Note: *** denotes 99% confidence intervals