

Main report
December 2008



CUTTING THE COST OF RED TAPE

for business growth in Rwanda



SBP

Promoting strategic partnerships
for business growth in Africa

This project was commissioned by the Rwandan Private Sector Federation, funded by the Deutsche Gesellschaft für Technische Zusammenarbeit (GtZ), and executed on behalf of the German Federal Ministry for Economic Cooperation and Development.

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The survey was conceptualised and carried out by SBP drawing on the comprehensive regulatory review methodology (CRR©) that it has developed. Albert Nsengiyumva, an independent consultant based in Kigali and Coordinator of the Rwanda Education and Research Network, managed the survey fieldwork and data collation.

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Our thanks are also due to the business executives and owners who gave their time to participate in the survey.



On behalf of

**Federal Ministry
for Economic Cooperation
and Development**

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Glossary

BDS	Business development services
CIT	Corporate Income Tax
CPI	Consumer Price Index
EAC	East African Community
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GtZ	Deutsche Gesellschaft für Technische Zusammenarbeit
ICT	Information and Communication Technology
MaGeRwa	Magasins Généraux du Rwanda
NSSF	National Social Security Fund
OECD	Organisation for Economic Co-Operation and Development
PAYE	Pay As You Earn
PSF	Private Sector Federation
RBP	Regulatory Best Practice
RBS	Rwanda Bureau of Standards
REMA	Rwanda Environment Management Authority
RIA	Regulatory Impact Assessment
RIEPA	Rwanda Investment and Export Promotion Agency
RRA	Rwanda Revenue Authority
RURA	Rwanda Utilities Regulatory Agency
RwF	Rwandan Franc
SME	Small and Medium Enterprise
VAT	Value Added Tax

Foreword

The Rwandan government is committed to building an enabling environment to drive economic growth and job creation. An appropriate regulatory and administrative environment that supports the expansion and diversification of private sector enterprises is a crucial component in this effort.

This pioneering study provides a strong evidence base for constructive engagement between the private sector and government, to support economic growth through targeted initiatives to reduce red tape and streamline administrative processes. It identifies regulations and administrative processes that businesses find most troublesome, and establishes the associated compliance costs in different economic sectors and employment size bands.

No study of this kind has previously been undertaken in Rwanda. Currently just over 27 000 businesses operate in the formal sector, as defined for the purposes of this study. The survey was based on a country-wide sample of more than 400 businesses operating in the formal economy, ranging from large corporations to small enterprises. Regulatory compliance imposes significant costs on these businesses and on the economy as a whole. Overall, red tape cost businesses in the formal sector at least RwF 55 billion in 2007. This equates to approximately three per cent of GDP. To put it differently, average annual costs per firm amount to more than RwF 2 million. Reducing these costs would free up resources for more productive activities and spur business growth.

From a practical perspective, the most important finding is that compliance costs associated with tax, importing and exporting together account for close to 90 per cent of regulatory costs for the firms surveyed. Major reductions in overall compliance costs can therefore be achieved by concentrating on these areas as priorities for reform.

The study was commissioned by the Rwandan Private Sector Federation, undertaken by SBP, funded by the Deutsche Gesellschaft für Technische Zusammenarbeit (GtZ) and executed on behalf of the German Federal Ministry for Economic Cooperation and Development.

Emmanuel Hategeka
Secretary General
Private Sector Federation

Chris Darroll
Chief Executive
SBP

Summary of the study

- The Rwandan government is committed to building an enabling environment to drive economic growth and job creation
- A regulatory and administrative environment that supports the growth and diversification of the private sector is a crucial component in this effort
- A business-friendly environment stimulates trade and attracts investment, accelerating growth and long-term development

Regulation and red tape

- ‘Red tape’ is a short-hand term for unnecessary or excessively complicated regulations and inefficient administrative processes – which not only create frustration but also increase compliance costs
- Current approaches to regulatory good practice do not advocate any hard and fast rules, such as ‘deregulation’ or even ‘less regulation’, but emphasise the importance of assessing the benefits and costs of existing regulations as well as any proposed new regulatory measures
- Better regulation aims to maximise benefits and to make it as easy as possible to comply with regulations by reducing negative impacts, streamlining administrative procedures and keeping the costs of compliance as low as possible
- A number of useful tools are available to help build a better regulatory environment, including regulatory reviews, compliance cost studies, detailed procedural audits, and regulatory impact analysis (RIA) for new regulatory proposals

The cost of complying with regulations

- Complying with regulations and adhering to administrative procedures necessarily entails costs for businesses
- These compliance costs include the value of time spent by business owners and staff on understanding the rules and complying with them; payments to service providers such as accountants, tax consultants and others who assist businesses to meet compliance requirements; and the costs to business caused by delays and inefficiencies on the part of government agencies
- Compliance costs can never be reduced to zero, but targeted initiatives to reduce red tape and streamline administrative processes can free up resources – both time and money – that businesses can use to grow their operations
- Compliance cost studies establish what it costs businesses to comply with regulations in specific regulatory areas, as well as in aggregate
- *Cutting the cost of red tape for business growth in Rwanda* is particularly useful because it establishes not only overall compliance costs but the relative compliance costs in various regulatory areas. It is therefore an extremely valuable tool to prioritise areas for closer scrutiny of the procedures involved in implementing these regulations, as a basis for reforms aimed at reducing the costs of compliance

Highlights of the study

- This regulatory survey, covering more than 400 businesses in the formal economy, is the first of its kind in Rwanda
- It pinpoints key regulatory areas and administrative or procedural processes contributing to the regulatory burden
- It uncovers the most troublesome regulations and administrative processes as identified by businesses themselves
- It calculates the costs of regulatory compliance for businesses of different sizes, and in different sectors
- It establishes a baseline, against which changes can be measured over time
- The study clearly demonstrates that regulations impose significant costs on individual businesses, and on the economy as whole
- It is estimated that there are just over 27 000 businesses in the formal sector, as defined for the purposes of this study. This figure excludes individually-owned businesses operating from collective sites such as markets
- An aggregate figure was calculated, drawing on estimated compliance costs in the following regulatory areas: business registration (initial, and annual), tax regulation, labour regulation, export, import, and doing business with government (tendering)
- Scaling up the results of the survey for the economy as a whole shows that, in 2007, Rwandan businesses incurred regulatory compliance costs *in the defined regulatory areas* of at least RwF 55 billion
- To put this figure in context, it is useful to note that RwF 55 billion is more than half of the Government's education budget for 2008 (RwF 103 billion), almost equal to the health budget (RwF 58 billion), and five times the budget provided for under 'Industry and Commerce' (RwF 11 billion)
- The aggregate cost equates to approximately 3 per cent of GDP. While this aggregate figure compares fairly favourably with the experience of other developing economies, the costs are borne by a relatively small number of businesses
- The average annual compliance costs per firm in the formal sector in Rwanda amount to more than RwF 2 million
- Big firms have the largest costs absolutely, but, in relation to their size, small firms bear the heaviest burden. For example, tax compliance costs per employee are almost seven times higher for micro firms than for larger firms
- Forty per cent of businesses cited regulatory requirements such as tax regulation, administrative procedures and public meetings as constraints on their growth
- The large majority of businesses believe that compliance costs have increased over the past three years, and expect that these costs will continue to rise

Key issues

- Compliance costs consume resources that could be more efficiently used by Rwandan businesses to develop and expand their activities and grow the economy as a whole
- Compliance costs associated with tax, importing and exporting together account for close to 90 per cent of regulatory costs of the firms concerned
- Major reductions in overall compliance costs can therefore be achieved by concentrating on these three areas as priorities for reform
- Over half the respondents said that tax-related regulations are the most time-consuming and troublesome
- The cost of complying with tax regulations also represents the largest component of compliance costs
- Delays at Customs and the Bureau of Standards account for the largest component of import and export compliance costs

Going forward

- It is important to reduce unnecessary compliance costs for business wherever possible
- Procedural audits are needed for closely targeted reforms, to observe and track direct business interactions with government departments and agencies step-by-step, so as to uncover blockages at the points where they occur. Procedural audits are essentially the responsibility of government
- The aim must be to simplify procedures, reduce the need for in-person interactions between businesses and the authorities, make requirements easier to understand, and reduce unnecessary delays
- Creative new approaches are needed to make it easier for businesses, large and small, to meet tax compliance requirements
- For example, VAT regulations and the impact on cash flow of VAT payment at the time of invoicing should be reviewed, particularly for smaller firms
- Administrative processes associated with importing and exporting should be reviewed to identify and remove unnecessary delays and streamline procedures
- Regulatory requirements in respect of work permits should be modified, to encourage skills transfer
- Regular dialogue is needed between high-level representatives of business and government to support the process of improving regulatory quality overall and in the different sectors

Section 1

Overview



Chapter 1

Introduction

Regulation and red tape

Regulation is central to the process of government. In the interests of good governance, it is self-evident that laws and regulations must be scrutinised and assessed not only in terms of their broad objectives but also their specific provisions, as instruments to achieve those objectives. It is perhaps less well-recognised – and certainly less established in practice – that it is equally important to monitor and assess the impacts of those regulations, including the costs of compliance and administration, and the efficiency and effectiveness of the ways in which they are implemented.

We have all experienced the frustration of spending hours standing in long queues to get official papers stamped or signed, and filling in complicated and confusing official forms. Standing in one of those queues, with our business on hold, it is hard not to think that regulations are a waste of time – simply ‘red tape’ and nothing more.

But there are many situations in which regulations are necessary and useful. We look to government to develop and enforce regulations so that we can be confident that the products we buy, from cars to cough medicine, are safe and meet essential quality standards. Similarly, tax regulations are necessary to ensure that the process of revenue collection is predictable, efficient and transparent; and import and export regulations are needed to support the development and expansion of local markets.

So when are regulations just ‘red tape,’ creating unnecessary complications and burdens? When are they essential? How can we tell the difference? Is there a way to reduce the amount of red tape faced by businesses without reducing the benefits that regulations can bring?

An essential first step towards answering these questions is to develop a clearer idea of how businesses currently experience regulatory costs and benefits, the impacts of regulation and the associated administrative processes. How much time and money do businesses actually spend on complying with regulations – standing in queues, filling in forms, and hiring external consultants? Where do the biggest compliance costs occur? Where are the most serious administrative bottlenecks or shortcomings?

Chapter 1

On this basis, it is possible to prioritise key areas where regulatory compliance costs are most problematic, and to review the associated administrative processes to identify opportunities for streamlining them and making them more efficient.

What does this study do?

This study draws on SBP's comprehensive regulatory review methodology, which encompasses the assessment of regulatory costs, and the identification of key administrative blockages and delays that contribute to these costs. The study was designed to:

- identify regulations and regulatory areas that Rwanda's formal sector firms find troublesome
- highlight key administrative and procedural problem areas contributing to the regulatory burden, as experienced by businesses
- create a credible baseline of quantified regulatory compliance costs for firms of different sizes and in different sectors, and
- encourage public debate and provide sound evidence to inform policy decisions about regulatory reform.

It is important to note that this study is based on *a survey of businesses*. The results reflect the experiences, cost estimates and perceptions of the business people interviewed. Validation interviews were undertaken with a number of government officials in the data analysis stage, but the primary voice throughout the survey is that of businesses of all sizes, operating in Rwanda.

Compliance cost studies go well beyond those surveys that report only on *perceptions*. In SBP's studies, businesses are asked to estimate the real costs of complying with regulations in terms of time, internal resources, and fees to external agencies and consultants, based on their experience over a defined period – usually the past 12 months. This highlights those regulations that businesses identify as particularly costly or troublesome to comply with; and it also establishes a baseline, against which changes can be measured over time. The methodology therefore provides a well-informed, evidence-based estimate of how much it costs in cash and resources (including staff time) for firms to comply with regulations.

It is also important to understand the extent to which the administration of regulatory provisions can raise compliance costs unnecessarily, or create negative experiences for business people. By analysing the types of regulations identified by businesses as particularly troublesome and costly at some level of detail, it is possible to identify administrative bottlenecks, delays, and other sources of frustration, as a basis for practical changes to ease the burden of compliance.

The survey surfaced a range of issues at the forefront of business peoples' minds when asked to identify the most significant factors that contribute to their compliance costs. These are listed in a series of boxes in Chapter 6 in rank order for a number of regulatory fields – tax, importing and exporting, and labour regulations. The findings

Diagnostic tools for regulatory reform

Tools developed to investigate regulatory and administrative areas that enhance or constrain business activity are designed to serve different purposes, and operate at different levels of specificity and detail.

The World Bank's **Doing Business** studies draw on expert informants, and focus on selected quantitative indicators for business regulations and administrative procedures, tracking performance across comparator countries and changes over time. *Doing Business: Rwanda 2008* and *Doing Business 2009* are valuable and informative resources which should be read in conjunction with SBP's compliance cost study. However, they do not provide the level of detail required to inform specific reforms.

Regulatory compliance cost studies involve a different methodology, focusing on information provided by businesses themselves. The methodology provides robust evidence on what it costs business to comply with regulations in general, as well as in specific regulatory areas. A comprehensive economy-wide study such as *Cutting the cost of red tape for business growth in Rwanda* also establishes the *relative* compliance costs in various regulatory areas. It is therefore an extremely valuable tool in prioritizing areas that require closer scrutiny of procedures and other factors involved in implementing these regulations, with a view to reforms consciously aimed at reducing the costs of compliance.

Procedural audits are needed for closely targeted reform, to observe and track direct business interactions with government departments and agencies step-by-step, so as to uncover blockages at the points where they occur. In effect this requires a methodology similar to a 'time and motion' study. Procedural audits of this kind are essentially the responsibility of government. For effective and committed reform, such audits must be 'owned' by the departments and agencies concerned.

Regulatory impact analysis (RIA) is used to analyse new regulatory proposals, the risks to be addressed by the regulation and the possible options for delivering the objectives. It makes transparent the expected costs and benefits of different options for different stakeholders – as well as the cost of enforcement for government. A properly conducted RIA systematically examines the likely impacts of proposed regulation, based on structured consultation with the range of stakeholder groups that are likely to be affected. It is a powerful tool for making well-informed regulatory decisions.

do not constitute procedural audits as such, but will certainly help government departments and agencies to focus on priority areas for closer investigation and reform.

Chapter 2

Red tape, better regulation and growth

Creating a business-friendly environment

There is no universal formula for growth¹; but if a country wants sustained growth, it needs to make itself more attractive to private business, among other things, to encourage domestic and foreign investment and make it easier for businesses of all sizes to operate. This may range from improving infrastructure, to developing more sophisticated industrial and trade policies, cutting red tape and raising regulatory quality. The guiding question should always be ‘Is this project going to make it easier for a business to start and to flourish?’

In this regard it is clearly important to understand regulatory costs and benefits, and the value of improving regulatory quality and reducing the burden of regulatory compliance – in other words, cutting the costs of all those unnecessary or unnecessarily complicated, cumbersome or inefficient regulations and administrative procedures that constitute ‘red tape’.

The broad scope of regulation

Broadly defined, regulations are rules and standards imposed by public authorities. Regulations include parliamentary legislation, rules, orders, standards, and codes of practice issued by different spheres of government using powers created by legislation; rules issued by other institutions to which government has delegated relevant powers; and rules imposed on bodies by their own governance structures (self-regulation).²

In the modern world, much regulation is made up of the rules put in place and the systems set up by governments to regulate or influence the activities of businesses.

The costs and benefits of regulation

This report focuses on the costs of regulation, but it is important to recognise that regulations create major benefits as well as costs. Regulations have a wide range of positive impacts on markets and existing social structures.

Why focus on understanding and quantifying regulatory costs, without paying the same attention to regulatory benefits? Wouldn't it be preferable to try to determine *net* regulatory costs?

It is sensible and appropriate to focus research effort and advocacy on regulatory costs for three main reasons:

- the benefits of regulation tend to be reasonably well understood and transparent – everybody can more or less see what they are and who they benefit; while regulatory costs are far less transparent and it is often not obvious who actually bears the cost
- it is relatively easy to give a monetary value to the costs of regulation, and specifically for compliance costs, while regulatory benefits are very diverse and not readily quantifiable, and
- real benefits can be brought about by reducing regulatory costs.

There has been a strong tendency in many countries for regulatory costs to increase steadily. The increasing complexity of modern economic activities, rapid technological advances and changing social relations have impelled governments everywhere to regulate more and more extensively. Among other things, voters' expectations can often bring persistent pressure to bear on governments to regulate so as to protect jobs, safeguard health and safety, protect pensions and savings, or increase fairness. While these are laudable objectives, it is crucial to understand the costs associated with achieving the intended benefits, and assess whether they are justified. A failure to understand these costs can create serious unintended consequences, with potentially negative impacts on particular social groups or economic sectors.

Groups with vested interests in particular regulatory issues can include government policy-makers; business owners and trade unions; producers, retailers, and consumers; and external interests such as international bodies, among others. Each group is likely to seek different benefits from a regulatory proposal and may be unaware of, or choose to overlook, the costs that will be incurred by other interests – including firms, and ultimately end users – as a result of compliance requirements and efficiency impacts.

Why it is important to cut red tape

The cumulative impact of the regulatory environment is an important factor in determining a country's overall economic and development prospects.

The survey results presented in this report clearly demonstrate that regulations impose significant costs on firms in Rwanda and on the economy as whole. In line

Chapter 2

with studies in other countries, this study shows that features of the regulatory environment discourage business growth and job creation in the formal economy.

The resources spent by businesses on regulatory compliance represent real time and money that could be employed in other, more productive ways.

International experience also confirms that high regulatory costs keep emerging enterprises out of the formal sector.³ Where compliance costs are high and the benefits of regulation are small or doubtful, informal enterprises have little incentive to formalise. The benefits of formalisation, such as more secure property rights, access to legal protection and access to finance, are perceived to be outweighed by the time and costs associated with regulatory compliance and the uncertainty that benefits will materialise. Easing the path to formalisation for small businesses is thus not only a matter of reducing regulatory costs, but also improving regulatory quality applicable to the smallest firms in the economy.

The socio-political costs of reforming the regulatory environment need not be high, as long as the focus is on reducing pure red tape costs. The rewards can be very large indeed, in the form of more streamlined and efficient systems, resources returned to the economy, and the creation of a more enabling environment for businesses of all sizes.

Raising regulatory quality in dialogue with business

The concept of 'regulatory best practice' (RBP) has gained increasing currency in countries at various levels of development.⁴ The approach, which aims to improve the way in which regulations are formulated and implemented, is directed toward making the regulatory environment as favourable as possible for trade, investment and growth, thus enabling the pursuit of socio-economic policy objectives such as reducing poverty, increasing employment and improving equity. The objective is to create an environment that is good for all business, from large corporations to small and medium enterprises, by ensuring that inappropriate legislation, regulations, and administrative requirements do not inhibit growth.

Regular, structured, and serious interaction between government and business is integral to regulatory best practice. Efforts to improve the regulatory environment need to tap into local and international businesses' knowledge and experience of operating in the country. This requires effective dialogue between government and business to identify mutual priorities and develop interventions that are capable of making a real impact.

Cooperative engagement mechanisms, such as working groups that provide for structured interaction between government and business on a regular basis, offer a useful model for such dialogue. Such structures should be positioned to attract high-level participants from both the public and private sectors. Business interests should be represented by broad sectoral or multi-sectoral associations rather than by individual firms.

Another useful mechanism for obtaining constructive input from business is Regulatory Impact Analysis (RIA). A properly conducted RIA examines the likely impacts of proposed regulation, based on systematic consultation with the range of stakeholder groups that are likely to be affected, including business. RIA thus channels business engagement along highly constructive lines, requiring business people to speak on the basis of evidence and for the business community as a whole as well as for specific sectors, rather than lobbying for the interests of individual firms.

Endnotes

- 1 No combination of institutions and policies is guaranteed to create long-term economic growth, but there is broad agreement on the main ingredients. These are discussed in Appendix 2.
- 2 N Lee, Developing and applying regulatory impact assessment methodologies in low and middle income countries, CRC working paper no 30, University of Manchester, October 2002.
- 3 The 'informal' sector in Rwanda has unusual and distinctive features, but there are nevertheless important qualitative differences between 'registration' at the local level and full participation in the formal economy.
- 4 See Appendix 2 for a fuller discussion of the core principles of RBP, and the regulatory management tools associated with this approach.

Chapter 3

Headline results

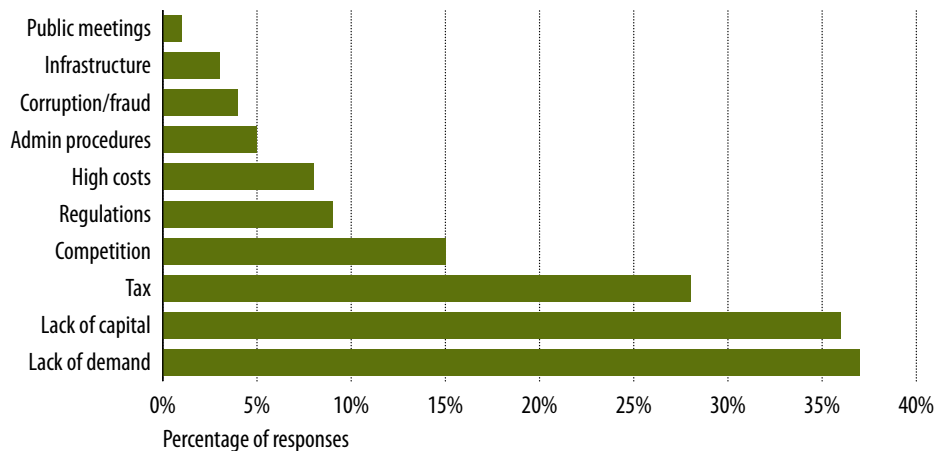
Constraints on growth and employment

At the outset, before addressing any regulatory issues, the survey asked business people to identify the three key factors that are most likely to discourage them from expanding their business, investing in new equipment or opening new branches.¹ The results are presented in figure 3.1.

The key challenges cited by the majority of respondents were 'lack of capital', 'lack of demand' and 'tax'. Competition, another key concern, was some way behind. 'Lack of demand' and 'lack of capital' are fairly common responses in surveys of this sort, particularly among smaller businesses. Small and micro-businesses may find initial entry to the market relatively easy – but then suffer the effects of competition owing to their failure to differentiate their products and services. The highly competitive nature of the lower end of the market, characterised by large numbers of businesses offering very similar goods, makes it difficult to attract customers – and this is often interpreted by the business as 'lack of demand.'

Similarly, lack of capital or difficulty in accessing finance is very often the main concern for small businesses, in any economy. The difficulties that small businesses face in establishing collateral to secure credit from formal lending institutions are well-recognised. Their limited access to capital and credit impacts severely on the ability of small businesses to expand, and this is certainly not a surprising response.

Figure 3.1: Factors discouraging business growth – top ten spontaneous responses from businesses



The fact that almost 30 per cent of respondents listed ‘tax’ as a key constraint on their ability to grow their businesses is striking. However, in identifying the key factors constraining business growth, they did not distinguish between *tax rates* on one hand, and the difficulty or burdensomeness of *tax compliance requirements* on the other. Thus, under ‘tax’ figure 3.1 shows all responses related to tax rates as well as tax compliance and administration.

However, in administering the questionnaire the distinction between the tax regime in general and tax compliance was probed explicitly at a later point in the sequence of questions.

Tax compliance issues feature again in the section immediately below, and are explored further in Chapters 6 and 7.

The most time-consuming and troublesome regulations

Turning specifically to regulatory issues, survey respondents were then asked to identify the three *regulations* that they found most time-consuming, troublesome and costly. These three choices were combined to provide the results illustrated in figure 3.2.

‘Tax’ emerged as the most problematic regulatory area by far and was cited in 53 per cent of the responses as the most time-consuming and troublesome regulation. Problems raised by respondents and incorporated under the broad ‘tax’ heading include compliance with VAT, requirements in respect of CIT and PAYE regulations, as well as preparation for tax audits.

In addition, interactions with the RRA were explicitly cited by just under ten per cent of respondents (further increasing the mentions of tax-related regulations).

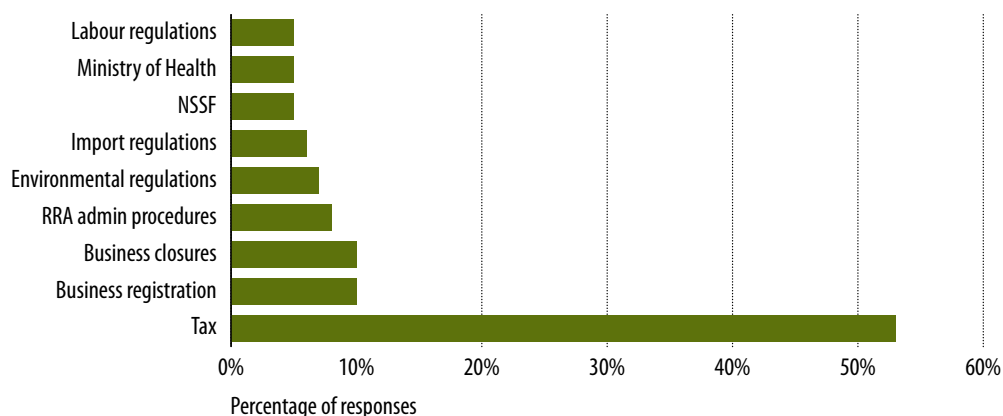
A large part of the perceived troubles associated with tax and related regulations centred on the costs of complying with tax paperwork and the need to visit the RRA

Chapter 3

offices in person – which, for many businesses, means that someone has to stand in a long queue every month.

Business registration and ‘business closure’ – that is, closure during business hours because of public commitments – were the second most likely types of regulatory requirements to be identified as troublesome and time-consuming, but at ten per cent each were significantly less prevalent among responses.

Figure 3.2: Most time-consuming and troublesome regulations (all firms)



What it costs businesses in Rwanda to comply with regulations

Compliance costs are of two types:

- Once-off costs, such as the costs associated with initial business registration
- Recurring costs, which arise on a regular basis (often annually). Compliance costs can be further broken down into those costs that affect *all* firms, such as those associated with annual registration, tax compliance and labour regulations, and costs that are *sector* or *activity specific*, such as compliance costs associated pharmaceuticals, or with exporting.

These costs will change from year to year, as regulatory requirements and administrative procedures evolve. The information provided here represents a baseline for compliance costs from mid 2007 to mid 2008.

To calculate the cost of regulations to the Rwandan economy, estimated values of the staff costs, the costs of external agents and other regulatory costs were obtained from the survey. For the purposes of this study, it was assumed that there are just over 27 000 firms operating in the formal sector.²

The averages for the combined costs for staff time, external agents and other regulatory costs were calculated for four size bands of firms according to the number of employees: 1–4; 5–49; 50–99; and 100+.

An aggregate figure was then calculated, drawing on estimated compliance costs in the following regulatory areas:

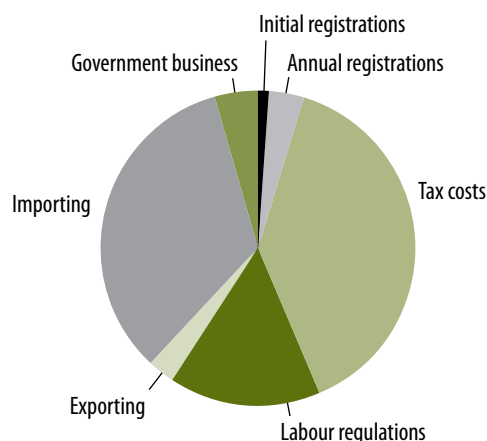
- Business registration (initial, and annual)
- Tax regulation
- Labour regulation
- Export requirements
- Import requirements
- Doing business with government (tendering).

‘Other’ regulatory costs identified by respondents (including the costs of business closures), but which were difficult to quantify for various reasons, were not included in the aggregate figure.³

Sector or activity specific costs were adjusted as appropriate. For example, for exporting, importing and government business, aggregate values were weighted by the probabilities of firms participating in these activities in each size group. A full account of the method followed is given in chapter 7.

Calculated on this basis, the overall total regulatory costs for the Rwandan economy amount to at least RwF 55 billion per annum. This is a minimum figure, as it does not reflect the full range of compliance costs, and pertains only to formal sector businesses.

Figure 3.3: Composition of regulatory costs to business



The aggregate figure equates to approximately three per cent of GDP⁴. In order to put this figure in context, it is useful to note that the amount of RwF 55 billion is more than half of the Government’s education budget for 2008 (RwF 103 billion). It is almost equal to the health budget (RwF 58 billion), and five times the budget provided for under ‘Industry and Commerce’ (RwF 11 billion).⁵

Another way to appreciate the overall significance of regulatory compliance costs is to say that the average annual cost per firm in the formal sector is RwF 2,024,416.⁶

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Table 3.1: Composition of regulatory compliance costs

	RwF	% of total compliance cost
Cost of undertaking initial registrations	727 924 294	1,3
Cost of undertaking annual registrations	1 951 872 366	3,6
Cost of complying with tax regulations	21 232 843 279	38,8
Cost of complying with labour regulations	8 509 666 367	15,5
Cost of complying with export requirements (including delays)	1 607 577 631	2,9
Cost of complying with import requirements (including delays)	18 390 119 156	33,6
Doing business with Government (tendering)	2 334 377 020	4,3
Total	54 754 380 112	100
Rwandan GDP	1 746 700 000 000	
%		3,1%

Endnotes

- 1 The question was open-ended and responses were spontaneous.
- 2 See chapter 7 for further details.
- 3 These 'additional regulations' are discussed in chapter 7.
- 4 Rwandan GDP is taken from the Ministry of Finance and Economic Planning publication 'Economic Performance Indicators 2006 and Outlook 2007'. In this publication an estimate of 2007 GDP is given. This is then converted to 2008 GDP using the CPI.
- 5 Ministry of Finance and Economic Planning, *Budget 2008*, 'State expenditure per sector and sub-sector 2008–2010'.
- 6 We arrive at this figure by dividing the total by 27 047 (that is, the number of formal sector firms).

Section 2

Understanding the costs of regulation



Chapter 4

Regulatory costs

The different kinds of regulatory costs

While regulations create benefits for consumers, producers, and society in general, they also give rise to various kinds of costs. The most important of these are compliance, administrative, efficiency, and non-compliance costs – as outlined in table 4.1.

These are not merely academic distinctions. Different types of regulatory costs have significant implications for firms, for consumers and for public policy generally. One way to understand the importance of different types of regulatory costs is to recognise that most regulations can involve various distinct sets of activities, as illustrated in the Box: *Regulatory costs: An illustration*.

Compliance costs

As shown in the example in the Box: *Regulatory costs: An illustration*, compliance costs are incurred in the process of finding out what a regulation requires a firm to do, time spent undertaking the necessary steps to comply, and then proving that these things have been done. Compliance costs include the value of time spent by business managers and staff on understanding the rules and applying them, together with payments to experts such as professional consultants, lawyers and accountants, who may be required to assist the firm in assessing compliance requirements and completing the necessary processes.¹

Both the private and public sectors incur compliance costs. Government departments, like businesses, have to abide by regulations. An example would be the need for government as an employer to ensure that regulations affecting the employment, health, and safety of its staff are observed.

Table 4.1: Main types of regulatory costs

Type of regulatory cost	Examples of activities involved	Who pays?
Compliance costs	Staff time required to complete and submit forms to prove compliance, plus fees paid to experts and service providers to assist in understanding and completing relevant requirements.	Firms, with costs often passed on to customers. Economy-wide knock-on effects.
Efficiency and opportunity costs	Administrative and procedural delays affect business activities. Cost of buying, installing and maintaining equipment required to be compliant with regulations. Regulations negatively affect choices about production techniques, number of people to be employed, and/or which markets to compete in. Businesses stay small or informal to avoid regulatory oversight or remain below regulatory thresholds.	Firms, their employees, suppliers and customers, local and foreign investors. Government loses revenue; and taxpayers may face higher rates as result of lost revenue. Economy-wide knock-on effects.
Non-compliance costs	Fines, cost of confiscated or destroyed stock, and/or cost of bribes as a result of attempts to evade regulatory compliance.	Entrepreneurs/businesses who don't comply. Employees of firms that don't meet minimum standards e.g. health and safety, labour protection. Government loses revenue; and taxpayers may face higher rates as result of lost revenue. Economy-wide knock-on effects.
Administrative costs	Government staff time to receive and assess required forms, undertake inspections, follow up with firms etc.	Government, taxpayers. Economy-wide knock-on effects.

Administrative costs

The administrative costs of regulation are the costs incurred by the public sector in developing, imposing, and enforcing regulation. Administrative costs may be quite small in relation to the benefits of a regulation, but they are still significant. For example, a study of the British VAT system found that administrative costs comprised 22 per cent of operating costs² (regulatory operating costs are comprised of administrative costs plus compliance costs).

Efficiency and opportunity costs

Opportunity costs are the costs of alternatives foregone in order to do something else, or the loss of benefits you could have received by pursuing an alternative action; for

Regulatory costs: an illustration

New fire-safety regulations and the different costs involved

A hypothetical new regulation requires companies with more than ten employees to ensure that their premises are fire-proofed to a certain regulatory standard. Ensuring building safety, and thus employee safety, is clearly an important social goal. However, the requirement to meet specific standards will undoubtedly create costs for firms. They will have to ensure that they have the required fire-exits, signage and hydrants, for example. These expenses may reduce their profits (with reduced tax revenue as an unintended consequence) and may have a negative impact on their plans to increase output or employment.

The new regulatory standards for fire-safety would require companies to engage in a range of activities entailing various costs:

Compliance costs (upfront) – All firms with more than ten employees will have to work out whether or not their premises meet the new fire-safety standards. Firms will need to gather information about how many exits and fire hydrants are needed, what signage is required, and whether there are any challenges created by the design of their premises or the building materials from which their work-place is constructed.

Efficiency costs – Firms may have to pay construction companies to put in new doors or external stairways and change the design of particular exits, as well as purchasing the required number of hydrants and appropriate signage. They may have to forfeit valuable work-space. All hydrants will need to be maintained in good working order and checked regularly.

Compliance costs (ongoing) – Firms will have to prove to the regulatory authority that they have complied with the regulation. Smaller firms would need to be able to prove that they do not employ more than 10 people and are therefore exempt from the regulation. Larger firms would have to submit proof that they already meet the standards, or that they are taking appropriate steps to do so. Firms may be required to make regular reports on their progress in complying with regulations.

Opportunity costs – Some firms may decide to stay small, or to reduce their staff complement to ten people, to avoid having to comply with the regulation. This is particularly likely if the firm discovers that the regulation will require major building work for example, or that particular materials used in the original construction of the building would need to be replaced at considerable cost.

Non-compliance costs – Some firms will decide to disobey the regulations because they do not have the time or skill to fill in the necessary forms, can't afford to comply, or calculate that their risk of being caught by the authorities is very small. These firms risk having to pay fines or bribes, or having to make the necessary changes in a hurry and without regard to their cash flow position if they are inspected.

Administrative costs – The regulatory authority will have to monitor and enforce the regulation. Officials will have to read and assess the reports sent in by companies, decide which companies to inspect, carry out these inspections, and take steps to enforce compliance where firms have not obeyed a regulation.

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example – to illustrate this very simply – the cost of keeping a heavy transport vehicle standing idle because of a delay at a customs point, when you could have been using the vehicle on profitable business.

Efficiency costs impact on the economic system as a whole. Essentially, they represent the negative impacts on economic growth and job creation when businesses:

- Choose to limit growth, innovation, or diversification in order to avoid specific types of regulation. For example, a business may stay small to remain below the VAT threshold
- Choose to use capital-intensive production methods or employ mostly casual staff in order to minimise the impact of employment/labour regulations, even when unemployment is high
- Are able to develop monopolies owing to high regulatory barriers to entry
- Choose not to invest in or trade with a particular country because of regulatory disincentives.

Opportunity costs and the efficiency costs of regulation may be difficult to measure, given that they represent the cost of actions not taken. They are however likely to be relatively high.³

It is important to appreciate the difference between efficiency and compliance costs as components in overall regulatory costs. For example, a decision to halve the number of times per year that companies have to report on the composition of their labour force will reduce compliance costs because it reduces administrative procedures for both government and business. However, it may also create an opening for firms to hire staff on short-term contracts, to avoid a regulatory threshold or keep a portion of the workforce ‘invisible’ for regulatory purposes. This could have efficiency costs. However, with evidence-based research about regulatory costs associated with different regulatory options, it should be feasible to distinguish reasonably clearly between changes that would impact on wider efficiency costs and benefits, and those that would simply reduce the costs of compliance. In effect, this is what a well-conducted RIA will show.

Non-compliance costs

A particularly heavy social and economic cost is imposed in developing countries by the ways in which regulation excludes the smallest businesses from participation in the formal sector of the economy, and therefore from access to secure premises and stable sources of finance. This is the most significant non-compliance cost of regulation. Other non-compliance costs that may be incurred by entrepreneurs or businesses that have failed to comply with particular regulations, in both the formal and informal sectors, include:

- Payment of bribes and/or penalties, including fines
- The time and cost of harassment by the police or other authorities
- The cost of confiscation of goods.

Other regulatory costs

Other types of regulatory costs include capital depreciation, transfer, and psychological costs. Analysis in this field is still at an early stage, and this study does not explore these types of regulatory costs. Nonetheless it is worth noting that these additional costs exist. A brief description of these additional regulatory costs is provided below:

- *Capital depreciation costs* – Regulation may result in incremental capital investment, for example for effluent purification equipment. In theory, the depreciation cost of these investments should be included in compliance costs. In practice, though, it is difficult to distinguish between investment made solely for regulatory compliance and other investment.
- *Transfer costs* – Wealth transfers from consumers to producers may occur as a result of regulations. A regulation restricting imports or imposing a minimum price would result in such a transfer, for example.
- *Psychological costs* – Regulations create anxiety and frustration as well as reassurance. Research suggests that fear of unintentionally transgressing regulations can be a significant source of stress for entrepreneurs and company employees. Efforts to achieve compliance, particularly where these are time-consuming and take resources away from other productive activities, are a further cause of stress. While psychological costs are difficult to measure, studies in developed countries show that many small business owners are willing to pay insurance premiums to avoid these psychological costs.⁴

Economy-wide impact of regulatory costs

Clearly, regulatory costs do have negative consequences, from the time lost through queuing or delays caused by overly bureaucratic procedures, to economy-wide impacts such as disincentives for firms to employ additional staff or for foreign companies to invest in the economy.

At first glance it might seem that because most regulatory costs are borne by firms, they stay with the firms. However, most firms faced with high regulatory costs will seek ways to compensate by shifting the burden to consumers in the form of higher prices. Thus, regulatory costs tend to be borne by society as a whole, in much the same way that taxes are.

People are very often well aware of the taxes they are paying and how the tax burden is distributed across society, but for regulatory costs the situation is rather different. A great deal of political energy and technical effort goes into deciding on tax rates and how tax costs are spread across high and low income citizens, and between businesses and households. Taxes are generally designed to be progressive and redistributive, so that people with lower incomes pay a lower level of income tax than those who are wealthier. By contrast, in most countries regulatory costs do not yet receive this kind of political and technical attention.

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When producers and retailers compensate for high regulatory costs by increasing their prices, all consumers are affected, regardless of their relative income levels. As a result, lower income consumers in fact bear a relatively heavier burden. By way of example – when an importer decides to increase the price of his fresh produce, to compensate for high costs and product spoiling incurred through long delays at the entry point, this has a disproportionate impact on the options of low income shoppers, when compared to wealthier customers.

Similarly, while businesses of all sizes are often subject to the same set of regulations, smaller businesses are likely to feel the impact of compliance costs on their bottom line more acutely. Small businesses are less likely to be able to pass on their regulatory costs to consumers. Given their position in a competitive market, they often have less power than larger firms over the prices they can charge – if they increase their prices, their customers are very likely to shop elsewhere.

Thus, the evidence shows that regulatory costs are regressive in that they place a larger burden on poorer people and smaller firms.

Political choices and regulatory reform

Regulatory issues are not purely technical matters, to be decided by an objective assessment of their socio-economic costs and benefits. The regulatory environment is strongly influenced by political choices. However, cutting compliance costs generally doesn't involve difficult political trade-offs.

Regulators often need to balance the goals of competition and market efficiency against socio-economic objectives such as the more equitable distribution of resources, or ensuring fair access to opportunities. This may require complex political choices and trade-offs. The government must weigh up the costs and benefits of the available regulatory options, assess the likely impact across a wide range of interest groups and activities, determine what compromises are worthwhile to achieve particular objectives, and persuade different constituencies to recognise the benefits of its approach.

Efficiency costs are often the result of conscious political choices. Compliance costs, by contrast generally aren't. Often, they may be unintended consequences, or arise from cumbersome administrative processes and overly complex official requirements. Reducing some of the compliance costs associated with regulation is not necessarily an easy process, but it can be relatively quick and non-controversial compared to lowering efficiency costs. Nobody ever won an election by promising to increase the number of forms that have to be filled in, and it is hard to imagine a politician losing popularity by reducing red tape.

Endnotes

- 1 If the firm would undertake an activity regardless of whether it was regulated or not, the costs involved should not be considered as regulatory compliance costs.

- 2 C Sandford, M Godwin, and P Hardwick, *Administrative and compliance costs of taxation*, Fiscal Publications, Birmingham, 1989.
- 3 They may be considerably higher than compliance costs. An estimation technique based on the effect of taxes on the prices of particular goods and resulting shifts of demand between goods, concluded that in the case of VAT in the United Kingdom, the efficiency costs of taxation were of the order of four times the compliance costs (G Bannock, Controlling regulation, *Economic Affairs*, June 2001).
- 4 R Woellner, C Coleman, M Mckerchar, M Walpole, J Zetler, 'Taxation or vexation – measuring the psychological costs of tax compliance', in C Evans, J Hasseldine, J Pope, *Tax Compliance Costs: A Festschrift for Cedric Sandford*, Sydney, 2001.

Chapter 5

Regulatory costs in a comparative context

Comparing regulatory costs

How do regulatory costs in Rwanda compare with those in other countries? This would seem to be a straightforward question, but there is really no simple answer. Comprehensive economy-wide compliance cost studies are still relatively rare, and relevant information is in short supply. But even where data exist, comparisons of regulatory environments and more specifically regulatory compliance costs should not be taken too literally, given the variations in socio-economic conditions and business cultures in different countries, as well as differences in method and scope among the various studies that have been conducted. So a word of caution is in order.

It is evident that the burden of different kinds of regulatory costs varies at different levels of economic development and state capacity. In developing countries, delays and expenses associated with red tape often characterise even essential business procedures such as company registration. The World Bank's 2007 *Doing Business* report, for example, noted that Burkina Faso had cut the number of procedures required for starting a business from 12 to 8, and the time required from 45 to 34 days. Despite this positive progress, the experience of setting up a business in Burkina Faso is still far more cumbersome than it would be in a highly developed country such as Canada, where starting a business requires two procedures and just three days.¹ The compliance costs of business registration are thus considerably higher for Burkina Faso – and many other developing countries – where aspiring entrepreneurs will need to spend more time filling in forms, visiting various government departments, and waiting for official responses. A common result in developing countries is reluctance among entrepreneurs to embark on the process of formalising their businesses – thus reducing the available tax base for government and limiting the businesses' potential for growth and employment creation.²

In developed countries, well-established systems, subject to regular review, are likely to ensure that basic regulatory tasks can be undertaken relatively quickly and simply. However, the 'higher-level' rules and regulations associated with a more

sophisticated level of development create difficulties of their own. For example, in a more developed economy it is likely that a business will face far more regulatory compliance costs associated with food product labelling regulations. There will also be more pressure from the public on industry to be environmentally responsible, and higher anti-pollution standards for companies to adhere to. In other words, the level of sophistication of an economy will generally determine the level of sophistication at which red tape becomes a major issue.

A further complication may arise where regulatory practice in particular areas is ‘imported’ into one country from another. Many ex-colonies, for example, are still dealing with the legacy of inappropriate laws introduced by foreign rule. In other cases, the apparent successes of a particular regulatory approach in one country may result in a second country attempting to adopt the approach for its own purposes, without fully weighing-up the relative merits and applicability to local circumstances. This can result in the attempted implementation of highly sophisticated regulations in a context which renders them inappropriate, unwieldy, and difficult to monitor or enforce.

In a very simplified way, table 5.1 illustrates the major regulatory challenges a country is likely to face in relation to its level of development.

Table 5.1: Economic development and regulatory issues

Stage of economic development	Typical state capacity	Examples of major regulatory cost issues
Most-developed economies	Strong central and local capacity.	Consumer protection. Environmental sustainability.
Emerging economies	Good in parts, slower and weaker local governments.	Regulation of bankruptcy, financial services, monopolies, labour market. Complexity of tax compliance.
Developing economies	Uneven, somewhat limited.	Enforcement of contracts, access to credit, occupational health and safety.
Least-developed economies	Often very limited, slow, may be considerable corruption problems.	Company registration and licensing. Inappropriate and unenforceable regulations.

Compliance cost surveys in other countries

Anecdotal evidence about the impact of red tape on national economies is relatively easy to come by. The extent to which such costs are accurately quantified, using representative business surveys is limited, however; although some developed economies publish regular reports on the rate of regulation and the costs to business of regulatory compliance.

Increasingly, impact assessments of specific regulations are being undertaken in many countries, particularly in the context of RIA, but studies assessing the impact

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of regulation as a whole, across the economy and on particular sectors, are still rare. Examples of countries that have implemented regular nation-wide compliance cost assessments include the UK, where the British Chamber of Commerce publishes annual compliance costs assessments and uses the information to lobby government for regulatory reform in specific areas. Business New Zealand publishes an annual survey of the cost of compliance for businesses across the economy. In Canada, the first comprehensive national study of compliance costs was conducted in 2005, to be repeated on a three yearly basis.

Given the limited number of countries engaged in economy-wide quantitative assessment of regulatory compliance costs, comparative information on a country-by-country basis is limited. The most comprehensive cross-country review of regulatory compliance costs was conducted by the OECD and published in 2001. The survey, based on a postal questionnaire, covered businesses with fewer than 500 employees in eight European countries, as well as Australia and New Zealand. Country sample sizes varied between 300 and 1 200. Only tax, employment, and environmental regulations were covered. Broadly speaking, however, the approach was similar to that used in the Rwanda survey. The overall results, with compliance costs expressed as a percentage of GDP, are shown in table 5.2.

Table 5.2: Estimated regulatory compliance costs in some developed countries as a percentage of GDP³

Australia	3
Austria	3,8
Belgium	1,8
Finland	1
Iceland	1,3
New Zealand	2,8
Norway	2,8
Portugal	5
Spain	5,6
Sweden	2,2
Average	3

Wide differences in response rates in the OECD survey, as well as cultural and socio-economic differences among countries, mean that the results are not fully comparable either among the participating OECD countries themselves or with the Rwandan survey. However, the regressive nature of compliance burdens was confirmed in all cases, with average costs per year being US\$4,600 per employee for firms with 1–9 employees, US\$1500 for firms with 20–49 employees and US\$900 for firms with 50–499 employees.

Tax compliance accounted for 43 per cent of costs, compliance with employment regulations made up 34 per cent, and environmental regulations 23 per cent. Among respondents, 61 per cent believed that regulatory compliance costs had increased in the two years before the survey.

Compliance cost surveys for developing and transition countries remain quite rare. A very small-scale survey in Bulgaria among firms with fewer than 100 employees suggested that compliance costs could be of the order of 5 per cent of GDP. A similar exercise in Jamaica put compliance costs for firms with fewer than ten employees at 3 per cent of GDP.⁴

In South Africa, a major study on regulatory compliance costs undertaken in 2004/5 showed that regulatory compliance cost South African businesses R79 billion in 2004, an amount equivalent to 6.5 per cent of GDP.⁵ The Presidency, National Treasury and SA Revenue Service were keenly interested in the detailed findings, which have since been incorporated into South Africa's policy reform agenda.

Despite comparability problems, three key messages emerge from these studies. First, in all countries studied, regulatory compliance costs tended to bear disproportionately on SMEs. Second, businesses in a range of countries perceived regulatory compliance costs to be increasing. Last, as a percentage of GDP, regulatory costs appeared to be higher in developing and transition countries than in advanced countries.

Rwanda's 3.1 per cent of GDP is interesting because it places the country in a position similar to the average for developed countries in the table above – though this is clearly higher than in some of the most developed OECD countries. Regulatory costs in Rwanda appear to be lower than in some other developing economies such as Bulgaria and South Africa. However, it is important to note that the aggregate total cost for Rwanda as estimated in the present study does not include all regulatory costs, and is based on a restricted definition of formal businesses. Actual costs for Rwandan businesses are undoubtedly somewhat higher in practice.

Endnotes

- 1 World Bank, *Doing Business 2007*.
- 2 SBP, *Counting the Cost of Red Tape for Business in South Africa*, 2005.
- 3 C Cordova-Novion and C De Young, 'Businesses' views on Red Tape: Administrative and regulatory burdens on small and medium-sized enterprises', OECD, Paris, 2001.
- 4 G Bannock, 'Regulatory compliance costs: an international perspective,' report commissioned by SBP, March 2005.
- 5 SBP, *Counting the Cost of Red Tape for Business in South Africa*, 2005. A five-year follow-up study will be conducted by SBP during 2009.

Section 3

The detailed findings



Chapter 6

Troublesome and time-consuming regulations

The efficiency costs of regulation

The efficiency costs of regulation are costs that arise where regulations change positive outcomes that would come about in the absence of regulation – in other words, that markets would otherwise create. An example would be a regulation that has the effect of discouraging a firm from hiring more workers. On the other hand, the social benefits of regulation are benefits that arise because regulation changes negative outcomes that would otherwise be caused by firms acting to maximise their own profits. An example of this would be the social benefit of reduced pollution when a law requires firms to pay to repair any damage caused by effluent they produce. Efficiency costs often have to be weighed against social benefits and specific policy objectives. However, some efficiency costs may come about as unintended consequences.

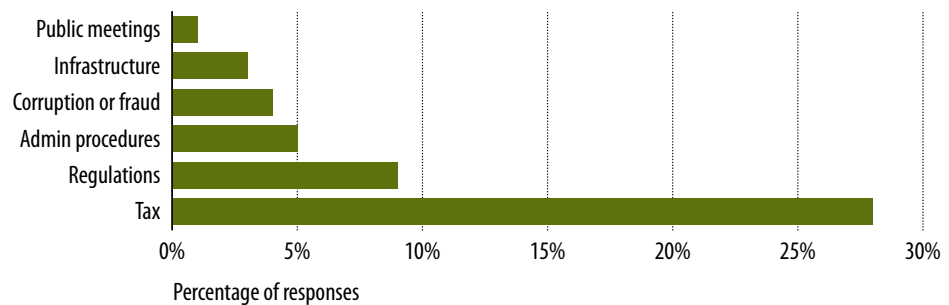
Efficiency costs can be very important. They create constraints on growth, employment, and investment, and are often the cause of higher prices for consumers. Some efficiency costs may constrain growth and development so seriously that a government will be willing to try to reduce them – and to fight the political battles required to make the necessary changes.

Efficiency costs are usually not easy to measure. Moreover, since they are often the result of conscious and specific political choices, they can be difficult to reduce in such cases. In some instances, it would not even be politically legitimate to try and reduce them without a clear change in the policies of a democratic government. But where efficiency costs arise as unintended consequences of regulation or administrative practice, it will generally be less controversial to reduce these costs once they are identified.

Key regulatory constraints on business growth

The survey questionnaire asked respondents at the outset to identify the three key factors most likely to discourage them from expanding their businesses, investing in new equipment or opening new branches. The question was open-ended and responses were unprompted¹. Among the key challenges identified in this way, a number were broadly related to regulatory and administrative issues. These spontaneous responses are shown in figure 6.1. In this context tax-related issues are clearly the most prominent concerns by far; but, as noted previously in chapter 3, these responses included both *tax rates* and *tax compliance requirements*. The distinction was made explicit only at a later stage in the questionnaire.

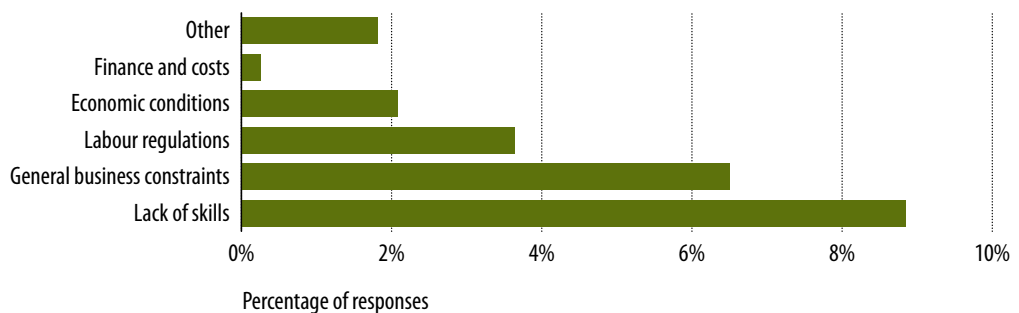
Figure 6.1: Regulatory/administrative factors discouraging business growth (spontaneous responses)



Key constraints on increasing employment

Respondents were asked to indicate the three factors that were most likely to discourage them from hiring more employees for their businesses.² The combined responses are presented in figure 6.2.

Figure 6.2: Constraints on increased employment



Twenty five per cent of respondents said that they had no need to increase employment. Looking below the surface, among other things this may be indicative of difficult market conditions under which businesses are unlikely to expand.

Doing business with government: delayed payments

A local supplier whose business is mainly with government ministries and organisations says that on average it takes about 10 months to receive payment.

In November 2007, he got a call from a high ranking ministry official. The official assured him that he would personally ensure prompt payment after the required service was delivered at a location some 140 kilometres from Kigali – but in fact it took a full year before payment was received. Reasons for the delay apparently included misunderstandings between various officials within the client ministry about the costs involved, a ‘wrongfully’ written delivery note prepared by the same ministry, failure to understand the extra costs for transport, and what appeared to be simply a reluctance pay on the part of the client.

In December 2008, the same businessman said that he currently had similar issues with three other ministries. In one case, where he had provided services earlier in 2008, and for which he could produce the supply order (*bon de commande*), he had been told that there were no funds available as yet since the money was to come from a third party organization.

A lack of skilled workers was highlighted as a key concern by a number of respondents. Concern about the skills deficit also emerged consistently in response to other questions in the survey, and is borne out by the findings of other recent research. A 2006 World Bank study found that less than one per cent of Rwanda’s population between 20 and 29 years of age was enrolled in higher education in 2000.³ According to the 2006 UNCTAD *Investment Policy Review*, ‘The general shortage of technical expertise and entrepreneurship is in good part responsible for the low level of national investment and the underdeveloped state of the manufacturing and services sectors. It also imposes constraints on the type of FDI that Rwanda can hope to attract in the medium term and delineates areas where foreign investment can contribute most in achieving national development goals.’

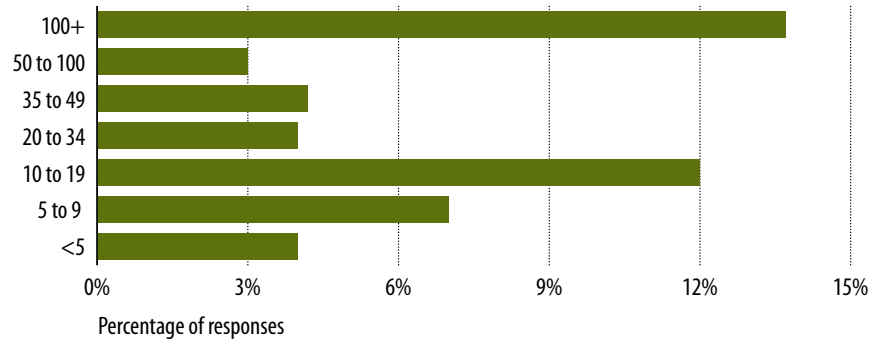
The survey findings suggest that while labour regulations are not the most important constraint on growth and expansion they are certainly a significant factor in limiting businesses’ propensity to increase labour absorption. Figure 6.3 was generated by combining mentions of ‘labour regulations’ as a constraint on expanding the business’s number of employees, and other mentions of regulations relating to employment more broadly. The figure shows the combined mentions by firms in employment size bands. It is clear that larger firms are more unwilling to increase employment as a result of regulations. This is probably attributable to the increase in compliance costs for labour regulations proportionate to the number of employees. Mentions of labour regulations as a constraint on increased employment increase markedly as firms expand from 5–9 employees, to 10–19 employees.

The pattern of these results looks significant. The very smallest firms are generally least affected by labour regulations. These firms are less complex and less visible and

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fall below the radar in terms of some aspects of labour legislation. As firms expand they become more affected by labour regulations.

Figure 6.3: Labour regulations as a constraint on increasing the number of employees, by firm size



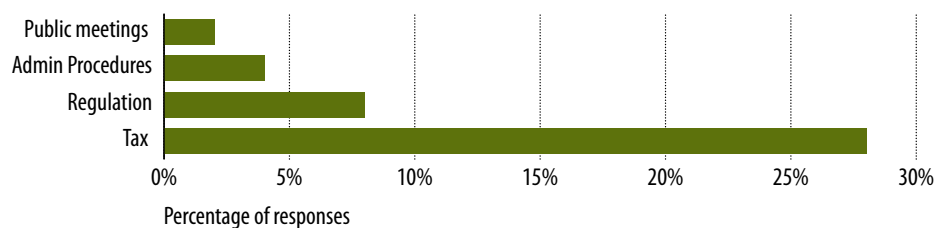
Analysis of these results by sector shows that industry, the financial sector and the agro-processing sector appeared most unwilling to increase employment as a result of labour regulations, whereas businesses in the professions, commerce and tourism sectors were least likely to cite labour regulations in their reasons for not increasing employment.

Business owners in the Northern and Southern provinces appeared to be more likely to be unwilling to increase employment as a result of labour-related regulations – approximately 15 per cent of respondents in each province reported that labour regulations were one of the top three reasons not to employ more staff, followed by ten per cent of respondents in the Western Province. By contrast, in the Eastern Province only seven per cent of respondents prioritised labour regulations as a deterrent to increasing employment.

State interface as a constraint on business growth

The scale and depth of the survey makes it possible to look in considerable detail at the interface between businesses and the state as a perceived constraint on growth. From the perspective of our respondents, regulatory requirements in respect of general regulations, tax requirements, administrative procedures and public meetings together accounted for just over 40 per cent of responses relating to constraints on growth. The results are illustrated in figure 6.4.

Figure 6.4: Constraints on growth at the state interface



Recent reforms to labour legislation

Rwanda has taken steps to liberalise regulations governing foreign workers. Investors welcome these, but still have a number of concerns.

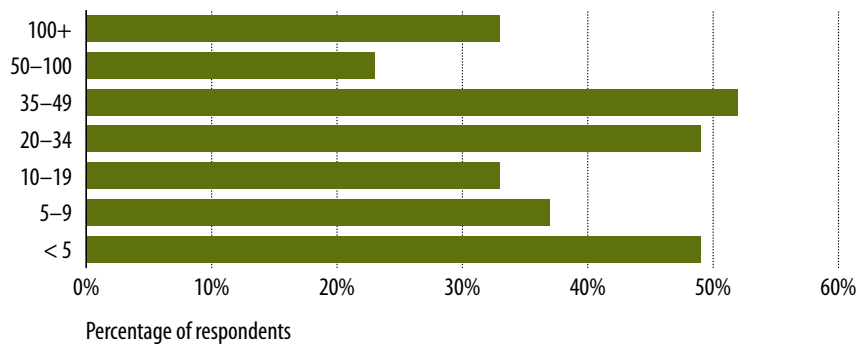
Companies are allowed to recruit expatriates for any category of skilled labour if they can demonstrate to the immigration authorities that a suitable Rwandan is not available. The expatriate worker must hold a university degree and professional experience commensurate with the position.

Work permits are issued for one year, and may be renewed up to three times. The Departments of Labour and of Immigration and Emigration work closely together and share information so that the acquisition of both residence and work permits is straightforward and efficient. RIEPA assists with the issue of work permits, securing required government approvals.

Investors' continuing concerns include the high cost of these permits: a residence permit and a work permit cost RwF 200,000 each. The need to renew permits annually also places an administrative burden on expatriates and employers. Limiting the number of renewals means that the foreign worker is limited to four year-long contracts at most, and at the end of the contractual period this may entail a loss of experience, skills, continuity and intellectual capital for the business.

Perceptions of the importance of the state interface as a constraint on growth vary by size of business, as shown in figure 6.5.

Figure 6.5: Constraints on growth – regulations and interactions with the state, by firm size



The constraints imposed by regulatory requirements, or interactions with the state, are very clearly most burdensome for businesses with less than 50 employees.

These constraints show a significant decrease among medium sized businesses with between 50 and 100 employees; but they increase again for the largest firms, which, by virtue of their size, are likely to be subject to a broader range of regulatory requirements.

Getting land title – a frustrating process

A businessman was given land in 11 October 2007. He wanted to develop it as soon as he had acquired all the necessary documents that would fully and officially transfer ownership to him. After acquiring the prerequisite topography report (*fiche cadastrale*) in November 2007, the would-be owner of the land wrote to the Lands Office in February 2008 requesting a land title. The Lands Office in turn requested a land title deed. This was provided in April 2008.

In June 2008, upon reviewing the land title deed the land titles registrar requested the district officials of the area to provide to him with a topography report. None of the officials he approached subsequently would respond to the businessman's enquiries as to progress. Fed up with waiting, the businessman decided to see the mayor himself about the issue. The mayor suggested that the businessman should work with his secretary on the matter till it was resolved. The two jointly then wrote a letter submitting the requested topography report to the Lands Office in September 2008.

Upon receiving the topography report, officials in the Lands Office claimed that the agreement between the businessman and the person who gave him the land had not been signed in front of the National Notary. The two had in fact gone to the National Notary to sign the agreement; but the National Notary now claimed that the agreement was not done according to the correct legal format. The Notary advised them to start all over again, using the correct legal format; return to the land titles registrar, and come back with the original title deed.

In December 2008, over a year after the land had been given to the businessman, he was still waiting for an appointment with the mayor to request the original title deed, so that he could return to the National Notary, and continue with a process that seemed to be interminable.

He had originally expected to develop the land two months after it was given to him. Understandably, after all of this, he was wondering whether he would ever be able to take possession of the land.

The results showed some variations by sector. Businesses in the agro-processing sector were most likely to identify regulatory requirements/the state interface as the most pressing constraint on growth and expansion (half of the total responses for this sector), while those in the financial and commerce sectors were least likely to do so. The tourism, services and professions sectors also reported relatively high levels of regulatory constraints on growth.

Firms in the Western Province were most likely to perceive the state interface as a constraint on growth (over half the responses) compared with other provinces. Kigali and the Eastern Province also reported relatively high levels of regulatory constraints on growth (over 40 per cent of responses). Businesses in the Northern Province were least likely to raise regulatory issues as a growth constraint.

Some small-scale studies could usefully investigate reasons for these regional and sectoral variations in greater depth.

The most time-consuming and troublesome regulations

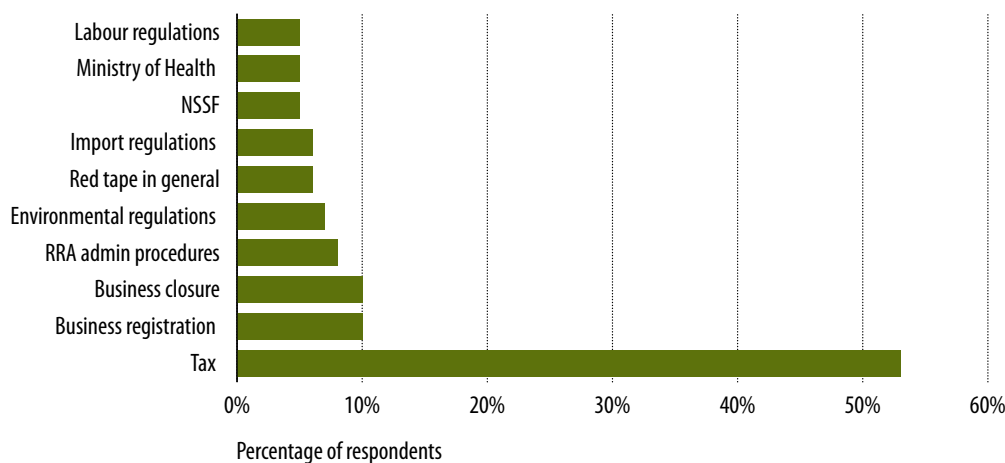
Not all regulations are equally unpopular. Efforts to reduce compliance costs need to take this into account and focus on areas in which the firms show most concern.

Respondents were asked to identify the three regulations that they found most time-consuming, troublesome and costly. These three choices were combined to provide the results illustrated in figure 6.6.

Tax was cited by 53 per cent of responses as the most time-consuming and troublesome regulation. Problems incorporated under the broad ‘tax’ heading include compliance with VAT, requirements in respect of CIT and PAYE regulations, as well as preparation for tax audits. A large part of the perceived troubles associated with tax and related regulations centred on the costs of complying with tax paperwork and the need to visit the Rwanda Revenue Authority offices in person. For many businesses, this means that someone has to stand in a long queue every month. Specific issues around tax compliance are addressed in detail in chapter 7.

Business registration and ‘business closure’ – that is, closure during business hours because of official requirements – were the second most likely requirements to be mentioned as time-consuming and troublesome, at ten per cent each.

Figure 6.6: Most time-consuming and troublesome regulations (all firms)



Other problematic areas identified by respondents included:

- Interactions with the RRA, noted by just under ten per cent of respondents (and further increasing the mentions of tax-related regulations)
- Environmental regulations, a broad category which included regulatory requirements under the Rwanda Environment Management Authority (REMA), including environmental impact assessments, and requirements in respect of ‘clean towns’
- Import regulations

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- Regulatory requirements in respect of the NSSF (National Social Security Fund)
- Regulations under the Ministry of Health
- Labour regulations, which included difficulties in securing work permits and dismissal of workers.

Small proportions of respondents also mentioned concerns in respect of bank declarations, regulations governing land and property, regulations administered by the Rwanda Bureau of Standards, tender requirements, and local level regulations.

However, even if mentioned by only a small number of businesses, it is important to note that for some businesses at least these regulations come to mind immediately as the most troublesome or time-consuming that they have to deal with.

Table 6.1 lists regulations perceived as most time-consuming, troublesome, and costly by all Rwandan firms, according to size of business (employee numbers). Tax compliance is clearly the main concern across businesses of all sizes. The smallest firms were more critical than others about business registration and business closure (for public meetings and so forth). The medium firms were most likely to criticise

Table 6.1: Rank order of most time-consuming and troublesome regulations, by number of employees

	Number of employees							Total (n254)
	< 5	5–9	10–19	20–34	35–49	50–100	100+	
	% of responses (multiple responses)							
Tax compliance	53	60	54	56	63	25	68	53
Business registration	13	17	11	11	5	4	–	11
Business closure (temporary interruptions)	17	3	7	–	16	13	–	10
Interacting with RRA	7	3	14	6	–	13	11	8
Import regulations	3	–	7	11	11	17	5	6
Red tape in general	6	6	7	6	–	8	11	6
NSSF	2	9	11	9	5	4	–	5
Ministry of Health regulations	7	3	–	–	11	8	–	5
Environmental regulations	–	6	4	3	21	8	5	4
Labour regulations (incl. work permits)	1	3	4	15	–	16	5	6
Other	1	6	4	6	–	8	–	3
Rwanda Bureau of Standards	–	3	4	3	5	8	5	3
Bank declarations	1	–	4	–	5	–	11	2
Land/property regulations	–	–	4	3	5	–	5	2
Regulations concerning government tenders	2	–	–	3	–	4	–	2
Local regulations	3	3	–	3	5	–	–	2

Troublesome and time-consuming regulations

environmental, business closure and import regulations. The larger firms tended to be more critical of import regulations, labour regulations, bank declarations and the RRA. It is worth noting that ‘red tape in general’, was mentioned as a problem both by the smaller firms, and larger businesses.⁴ Closer analysis shows that ‘red tape in general’ is particularly troublesome in the professional sector (which includes a considerable number of smaller firms – see table 6.2).

Analysis of the most time-consuming, troublesome and costly regulations across sectors again shows that in all sectors tax compliance is perceived as the most problematic type of regulation.

The sectors show some interesting variations in their criticism of other regulatory areas, as can be seen in table 6.2. Clearly, these are closely related to the nature of the sectors’ business activities – and as such should be flagged by the relevant government departments and other agencies with whom they interact.

For firms in the agro-processing and financial sectors, business closure was the only regulation mentioned with any frequency after tax. Businesses falling under the

Table 6.2: Rank order of most time-consuming and troublesome regulations, by sector

	Sector						
	Agro-processing	Financial	Professions	Commerce	Services	Tourism	Industry
	% of responses (multiple responses)						
Tax compliance	58	50	54	59	56	55	46
Business closure (temporary interruptions)	16	17	4	7	11	5	13
Interaction with RRA	5	33	4	7	10	5	11
Business registration	5	–	–	14	7	9	18
Labour regulations	–	–	–	–	2	14	4
Ministry of Health regulations	–	–	24	2	4	0	2
Red tape in general	5	–	16	5	5	9	4
Bank declarations	5	17	4	–	1	–	–
Import regulations	–	–	4	5	10	7	11
Work permit requirements	–	–	4	5	1	2	–
NSSF requirements	–	–	4	5	7	7	9
Environmental regulations	5	–	–	–	4	11	7
Interactions with Bureau of Standards	–	–	–	–	2	7	7
Government tenders regulations	–	–	4	5	1	–	–
Ministry of Agriculture regulations	5	–	–	–	–	–	–
Local regulations	–	–	4	–	2	–	5
Land/property regulations	–	–	–	–	1	5	4
Other regulations	–	–	–	5	4	7	2

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professions sector were most likely to note problems relating to regulations under the Ministry of Health – understandably, since that sector includes medical practitioners and pharmacists. ‘Red tape’ in general was also a key concern for this sector. Businesses in the commerce sector were most likely to be concerned with requirements for business registration. The biggest concerns for firms in the services sector were import regulations and requirements in respect of RRA. The tourism sector focused on labour regulations and environment – neither of which is surprising given the need for environmental impact assessments and eco-sensitive approaches in development of the tourism industry, and the large and often part-time labour force employed by tourism companies. Finally, the industrial sector was most likely to demonstrate concern in relation to business registration and closure and import regulations.

Analysing the responses by province, tax regulations were once again the main issue identified by firms across all provinces. Other key challenges were business registration (particularly in the Northern Province) and business closure (with a huge predominance in the Southern Province – where it is clearly a very significant problem), as shown in table 6.3. Import problems were mostly likely to be raised by firms in the Western Province (where a larger proportion of businesses identified themselves as being involved in import activities than in other provinces, with the exception of Kigali – see chapter 7). Firms in the Northern Province were more likely than those in other provinces to mention regulations falling under the Ministry of Health, and ‘clean town’ regulations.

Table 6.3: Rank order of most time-consuming and troublesome regulations, by province

	Kigali	Province				Total
		NP	EP	SP	WP	
% of responses (multiple responses)						
Tax compliance	55	44	55	44	65	53
Business registration	10	24	4	12	–	10
Business closure	4	16	19	40	–	10
Interactions with RRA	10	0	4	8	5	8
Import regulations	7	–	–	4	16	6
NSSF requirements	6	4	4	4	–	5
Ministry of Health regulations	2	12	8	8	5	5
Environmental regulations	6	–	–	4	5	4
Labour regulations	4	4	–	4	5	4
Bureau of Standards	2	–	8	–	5	3
Local regulations	2	–	4	4	–	2

All mentions of regulations relating to bank declarations, work permits, tenders, land/property regulations and regulations under the Ministry of Agriculture came from businesses in Kigali. Firms in Kigali were also more likely than firms in other provinces to report problems obtaining work permits and PAYE – reflecting the greater

concentration of larger businesses in Kigali. Kigali businesses were also much more likely to raise concerns about regulations governing dismissals and disputes.

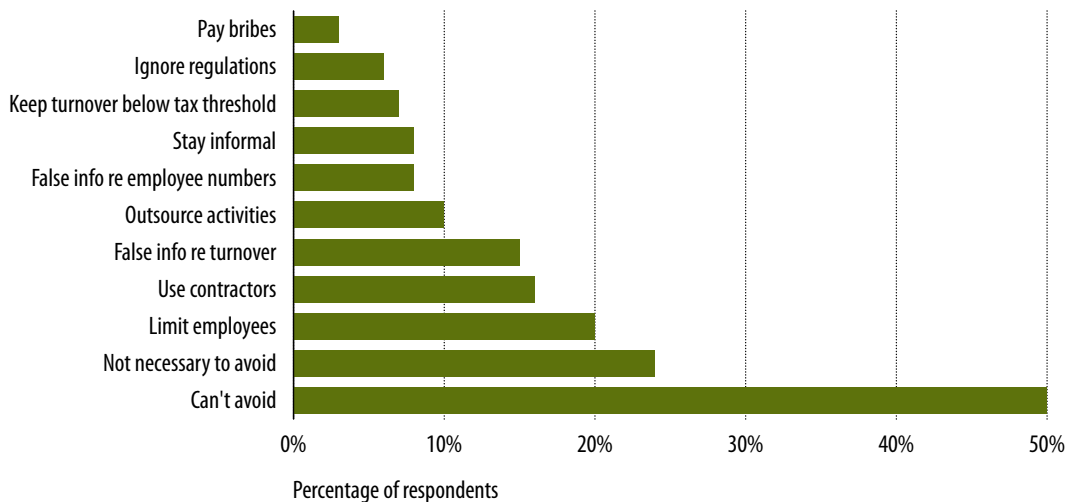
Avoiding regulation

A powerful way of understanding the nature and impact of the efficiency costs of regulation is to ask businesses what they might do to avoid the costs of regulation. Rather than asking respondents to answer for their own businesses, the survey asked respondents to identify things that might be done by businesses like theirs to avoid the cost of regulation. This allowed respondents to identify strategies for non-compliance without exposing their own businesses in any way.

About half the respondents did not think it was possible to avoid regulation. A quarter said it was not necessary to avoid regulations (the question allowed for multiple responses and there is likely to be some overlap across these responses). While the sincerity of this response cannot be guaranteed, it does seem to show that at least a considerable proportion of Rwandan businesses believe that the regulatory system is efficient in terms of monitoring and enforcing compliance. It also suggests that Rwandan business people tend to be (perhaps unusually) law-abiding. Among those who suggested that it was possible to find ways to avoid compliance, strategies did not necessarily involve disobeying regulations.

Significantly, respondents suggested that firms would stay small as a deliberate strategy to avoid particular labour and tax related regulations. As illustrated in figure 6.8, sixteen per cent of respondents said that businesses would use contractors rather than employing full time staff, 20 per cent said businesses would limit the number of their employees, and another 10 per cent said businesses would outsource activities in order to avoid complying with regulations. These responses are discussed more fully below.

Figure 6.7: Ways of avoiding regulatory costs (all firms)



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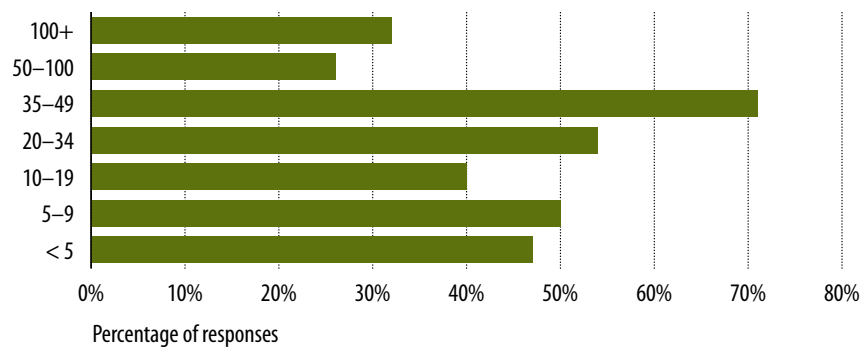
A striking finding was that only a very small number of respondents mentioned bribery as a possible way to reduce regulatory costs – only three per cent of respondents said that bribery was likely to be used as a tactic to avoid compliance. However, 23 per cent of respondents suggested that businesses might not disclose full information with regard to income and/or number of employees in order to avoid certain regulatory requirements.

In order to look in more detail at those responses that suggest that firms might limit their employee numbers to reduce regulatory compliance requirements, the following responses are combined in figure 6.8:

- employ fewer people/limit employee numbers/don't employ new staff
- use casual staff or contract workers
- outsource certain functions or activities.

As can be seen, while firms of all sizes frequently mention choices that would reduce employment, medium sized firms seem exceptionally open to reducing employment as a way of reducing exposure to regulatory costs. These firms are more likely to be exposed to regulatory inspections and labour regulation requirements than smaller enterprises, but less well equipped to manage these requirements (for example through establishment of a Human Resources department) than larger businesses.

Figure 6.8: Reduce employee numbers to avoid regulatory costs, responses by firm size



Businesses in the industry, tourism and financial sectors were more likely to suggest that businesses would reduce employment as a way of reducing exposure to regulatory costs (55–60 per cent of responses), while businesses in the commerce sector were least likely to suggest this possibility (30 per cent of responses).

Tax regulations

Issues contributing to high compliance costs as identified by businesses

Shown in rank order according to number of times mentioned by survey respondents

1. Long queues at RRA offices

- The requirement that taxes are paid at RRA offices in person creates a substantial time cost for businesses. Business owners must send a staff member every month to join the queue at the local RRA office. For smaller businesses, it is often the owner who must personally undertake the task. The time required to fulfil this requirement is greatly lengthened, according to respondents, as a result of inadequate staff numbers in RRA offices, and/or slow processing of customers by staff members.
- Businesses criticized RRA for inadequate staff training and poor communication with customers, as well as poor customer care. Respondents reported that the pace of processing customers is too slow, and that some RRA offices struggle to cope with the volume of people.
- While some businesses reported that the process is relatively easy, provided that the paperwork is done carefully and tax returns are submitted early, others pointed out that the required forms are often not available until later in the month, when there are long queues. In addition, many businesses noted that because they are only permitted one copy of the required forms, any mistake in completing the form means another trip to the RRA offices and another queue.

2. Time and transport costs associated with accessing RRA offices to make tax payments

- Businesses complained about the distances that they have to travel to reach RRA offices every month, which increases time and transport costs. This concern is particularly prevalent among firms outside Kigali.

3. Penalties incurred for late payment of taxes

- Penalties were a frequently mentioned concern, and could well account for the high compliance costs reported by some businesses. Businesses noted that penalties for late payment are extremely high, even if the delay is only a day or two. It was also said that in some cases the RRA contributes to the delay, but penalties are still imposed.

4. Multiple points of contact

- Businesses complained about the time required to interact with multiple departments in order to gather the required documents for tax compliance.

5. Communication from RRA

- Businesses complained about lack of feedback from the RRA on tax queries and long delays in settlement of queries and/or refunds.

6. Verification processes

- Businesses noted that they are required to undertake multiple verifications for RRA purposes, all of which take time, despite the fact that they pay their tax each month and their records are in good order. Some businesses reported that verification by RRA 'is done in a disproportionate manner,' and suggested that RRA needs to be more sensitive to the regulatory burden that standard procedures create for smaller firms.
- A number of businesses noted that they have to get a new tax clearance certificate every 3 months, which requires time-consuming in-person visits to the RRA.

7. Audits

- Preparation for tax audits involves a significant amount of time for businesses. Some businesses said that the uncertainty about when an audit will take place makes it difficult to prepare.

Import and export regulations

Issues contributing to high compliance costs as identified by businesses

Shown in rank order according to number of times mentioned by survey respondents

1. Time costs of in-person interaction with authorities

- Businesses involved in importing and exporting activities are required to collect documents in person from Customs.
- Businesses involved in importing complained about the number of documents required, which have to be obtained from different government offices. Another concern was the requirement that businesses must produce original invoices for imported goods – but as the originals are retained by the clearing agency, businesses spend time going back and forth between officials. It was also reported that the certifications required by Customs on some products are perceived as unnecessary by business.
- Businesses involved in exporting noted that the paperwork requirements are complicated and numerous. The requirement that initial paperwork must be obtained in person is costly in terms of their staff time, as this applies to every consignment exported. Exporters must also obtain signed clearance forms from the Rwanda Bureau of Standards, and customs officials must verify the contents and seal containers before the goods can be shipped.

2. Delays at Customs

- A large proportion of businesses involved in importing and exporting activities criticised the customs authorities for creating substantial delays in clearing and forwarding imported items, verifying contents of containers, and sealing containers for export.
- Respondents involved in importing specifically criticized MaGeRwa, and several spoke of poor service delivery and customer care at MaGeRwa and fractious relationships between customs staff and business people.
- These delays cost the businesses not only in terms of time, but also involve direct expenses – trucks and their drivers waiting at customs posts have to be paid for, businesses incur penalties for late deliveries, and in the case of fresh or perishable goods left standing at a border for several days as a result of customs delays, goods might be spoiled by the time they can be released to their delivery point.
- Some businesses said that the delays created by Customs in clearing and forwarding imported items were so severe that they sometimes lose their clients.
- Businesses complained about the lack of customer service when dealing with customs officials, described officials as being unhelpful, and reported that it is difficult to obtain the relevant information. There were also reports that customs offices lack appropriately qualified administrators who are able to answer queries.
- Businesses reported considerable levels of unpredictability in their interactions with officials, and complained about not being adequately notified about changes

to requirements – thereby incurring unnecessary delays that add to costs. There were also complaints that businesses were not informed of the period of validity before export certification expires.

- It was also reported that customs authorities do not always issue receipts to businesses.
3. **Duties and taxes**
- Many businesses noted that the compliance costs for importing activities are increased as a result of what they perceived to be very high customs duties and taxes on imported goods.
4. **Exemptions**
- Importing businesses spoke about difficulties and delays caused by lack of clarity regarding exempted goods, and suggested that there are differing interpretations in respect of such goods.
5. **Bureau of Standards**
- Some businesses reported that the Rwanda Bureau of Standards creates delays as a result of slow processing of imported and exported goods. Businesses said that delays in waiting for RBS to certify goods, and complicated procedures imposed by RBS, add to their compliance costs.
6. **Other issues**
- Exporters reported delays in obtaining the necessary certificates from the Ministry of Agriculture, and certificates of origin from the Ministry of Commerce.
 - Specific problems for importers included Rwanda's ban on plastic bags, which creates costs for importers whose products arrive wrapped in plastic (e.g. agricultural products) and have to be repackaged in order to be passed by Customs.
 - Businesses also mentioned a number of issues which do not relate specifically to domestic regulations, including costs experienced as a result of traffic congestion and consequent delays, and other problems at transit ports in neighbouring countries.

Labour regulations

Issues that contribute to high compliance costs, as identified by businesses

Shown in rank order according to number of times mentioned by survey respondents

1. Lack of information and/or poor understanding of labour regulations

- A very large proportion of respondents said that they lacked knowledge of/familiarity with labour laws and said that they would like more information and/or training on labour laws. There was also a significant degree of confusion regarding the application of the Labour Code.
- Some business people said that an easily accessible manual needs to be developed to provide businesses with clear information on labour regulations. In this regard it is worth noting that significant numbers of business people said that they were not aware of any labour laws applicable to their enterprises, despite those enterprises having at least one employee.
- Businesses also suggested that various provisions of the Labour Code required clarification and/or revision.

2. Administrative issues

- Businesses said that administrative efficiency in the implementation of labour laws needs to be improved, and that officials interacting with business should be better trained, with an improved understanding of the regulations.
- Several respondents also said that officials need to treat business people with appropriate respect, and to keep appointments.

3. Difficulties accessing work permits for foreign workers

- The process of applying for work permits for foreign workers was identified by a significant number of respondents as being characterised by delays. Others said that while the process itself was not necessarily difficult, the costs of the permits are very high.
- Businesses suggested that work permits should be valid for 3 years, rather than one year, given the time-consuming process involved in renewing them
- Businesses suggested that government should remove the requirement for a work permit for individuals from the East African Community.

4. Dismissal of employees

- Businesses noted that the regulations governing dismissals are onerous for employers. Several suggested that they were required to make substantial pay-outs to employees on dismissal. It was noted that legal fees associated with dismissal are often very high. Regulations governing redundancy and retrenchments were also raised as areas where businesses incurred significant compliance costs, including in the payment of 'terminal benefits'.
- Businesses said that labour regulations should make it easier for businesses to dismiss employees when the reasons are justifiable

- Businesses also called for the creation of a system for dispute settlement that allows disputes to be settled through mediation.
5. **NSSF**
 - Businesses said that NSSF contributions require time-consuming filling in of forms, and that payments are processed very slowly. There were also complaints about the level of contributions that businesses must pay to NSSF.
 6. **Employee insurance**
 - Businesses complained that regulations requiring them to insure their employees while at work create significant costs.
 7. **PAYE**
 - Businesses reported that the computation of PAYE contributions and the associated payment process for PAYE were very time-consuming.
 - Businesses suggested that PAYE could be paid quarterly, using a format in line with other RRA payments.
 8. **Contracts**
 - Businesses reported that regulations governing contracts with employees are very prescriptive and don't allow for flexibility at firm level.
 - Businesses suggested that regulation regarding employment contracts should be reviewed.
 - It was also suggested that labour contracts should be negotiated on a more flexible basis between the individual business and its employees.

Endnotes

- 1 The results are presented in chapter 3, figure 3.1.
- 2 Responses were open-ended and spontaneous.
- 3 Cited in UNCTAD *Investment Policy Review: Rwanda*, 2006, Advance Copy.
- 4 'Red tape in general' is not a helpful category for analytic purposes, but it does capture a set of responses expressing frustration at what is perceived as over-regulation, or the burdensome cumulative impacts of various regulations.

Chapter 7

The compliance costs of regulation

Different types of compliance costs

This chapter quantifies compliance costs for businesses in Rwanda in the period between mid-2007 and mid-2008.¹

As noted previously, there are two types of compliance costs: once-off costs, such as the costs associated with initial business registration, and recurring costs, which arise on a regular basis (often annually).

It is also important to bear in mind the further distinction between those compliance costs that affect *all* firms (for example, annual registration, tax compliance and labour regulations), and costs that affect only *some* firms, for example firms in a particular sector, or firms engaged in a specific activity such as exporting.

Calculating compliance costs in Rwanda

In order to calculate the cost of regulations to the Rwandan economy, estimated values of the staff costs, the costs of external agents and other regulatory costs were obtained from the survey.

For the purposes of this study, it was assumed that there are just over 27 000 firms operating in the formal sector in Rwanda, as explained in the Box: *Calculating the costs of regulation for Rwanda*.

The averages for the combined costs for staff time, external agents and other regulatory costs were calculated for four size bands of firms:

- 1–4 employees
- 5–49 employees
- 50–99 employees
- 100+ employees.

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An aggregate figure was then calculated, drawing on estimated compliance costs in the following regulatory areas:

- Business registration (initial, and annual)
- Tax regulation
- Labour regulation
- Export requirements
- Import requirements
- Doing business with government (tendering).

For the smaller size bands (1–4 and 5–49) median values were used for these estimates. This was so as to give less weight to outlying values that were not representative of the ‘typical’ firm. The smaller proportion of the population sampled in these categories meant that outliers would otherwise have had a disproportionate impact on aggregate costs.

For the larger size bands (50–99 and 100+) average values were used since the sample captured at least 20 per cent of the population in each of these size bands. The estimated costs were then multiplied by the number of firms in the Rwandan economy in each of these size categories.²

For exporting, importing and government business, aggregate values were weighted by the probabilities of firms participating in these activities in each size group. The cost of accessing tax incentives was also weighted by the number of firms in the sample participating in these schemes.

The total amount for ‘initial registrations’ assumed an entry rate of ten per cent of new firms each year evenly distributed across the size categories. The average values for initial registrations costs were calculated as the initial costs for those firms that began operating in the last five years. These values were adjusted by the Rwandan CPI.

As noted previously in Chapter 3, the total estimates do not take into account ‘other’ regulatory costs or the costs arising from business closures (i.e. interrupted business), which were difficult to quantify for various reasons.³

Nor do they include the prohibitive effect that high regulatory costs may have on the entry of new firms or entry into new activities. Thus for example, initial registration is relatively more expensive for firms with over 100 employees when compared to the costs for firms with 50–99 employees. Export costs on the other hand are relatively higher for smaller firms. These relatively higher costs may discourage firm entry by larger firms and entry into exporting by smaller firms. However, it would be very difficult to quantify these costs to the Rwandan economy, since they seek to measure the cost of lost opportunities, which are real enough but are not actually observed.

Overall total regulatory costs

Overall total regulatory costs for the Rwandan economy as calculated on this basis amount to at least Rwf 55 billion (as shown in table 7.1). This is a minimum figure

and does not reflect the full range of compliance costs (bearing in mind the exclusion of various sector- and activity-specific costs as noted above).

This amounts to approximately three per cent of GDP.⁴ In order to put this figure in context, RwF 55 billion is more than half of the Government's education budget for 2008 (103 billion RwF). It is almost equal to the health budget (58 billion), and five times the budget provided for under 'Industry and Commerce' (RwF 11 billion).⁵

Another way to appreciate the overall significance of regulatory compliance costs is to say that the average annual cost per firm in the formal sector is RwF 2,024,416.⁶

Activities related to importing – associated regulatory compliance costs and the costs of delays – make the highest relative contribution to overall costs. Tax compliance costs are the second largest contributor to aggregate administrative costs. For further details, see tables in the Box: *Regulatory costs by business size bands: The actual calculations*.

Methodological challenges: the possibilities of bias and error

Are the results likely to overestimate or underestimate the costs?

It is often assumed that studies of this type overestimate costs because it is in the interests of businesses to inflate their difficulties and complain about regulations. Furthermore, one has to acknowledge that some businesses, particularly smaller operations, may not actually comply with the regulations that they know apply to them and which they identify in their responses.

We cannot exclude the possibility of some degree of inflation for these reasons. However, when the detailed results were inspected it became evident that by far the larger source of bias was the tendency to overlook or not recall a variety of costs involved in compliance. For example, executives very frequently did not think of including their own time spent in supervising the operations involved in compliance, simply because it most often involves short slots of time here and there. And in the case of small businesses especially, it was observed that among many business owners the concept that 'time is money' was not widely appreciated. This is especially true where compliance requires personal visits to the relevant offices. In many cases, business people did not recognise the opportunity cost associated with these visits which take them away from their businesses for considerable periods of time. Again, in some cases, respondents tended to disregard the time and effort that they might spend complying with particular areas of regulation, such as health regulations, because so much more effort is directed toward more demanding areas, such as tax compliance. Other aspects of compliance costs, such as the costs of transport, messengers, phone calls, and paper, were also clearly under-reported.

On this basis, we are confident that the costs of compliance are, on balance, an under-estimate rather than an over-estimate.

Calculating the costs of regulation for Rwanda

The aggregate costs of regulation are presented in table 3.1. This box provides a systematic explanation of the calculations and the background workings.

The methodology used is both transparent and rigorous, and based on data collected in the survey and on the PSF's estimates of the number of firms in Rwanda.

Estimated costs of complying with regulations were obtained from businesses' responses in the survey. In calculating aggregate compliance costs, regulations were sorted into a number of broad groupings: initial registration; annual registration; tax costs; labour regulations; exporting; importing; doing business with government.

The total estimates do not take into account regulatory costs arising from 'other' miscellaneous regulations identified by firms or the costs of business closures, because these were very difficult to quantify.

Regulation groups were split into two types – those that affect all firms (annual regulations, tax costs and labour regulations), and those affecting only a subset of firms (initial registration, exporting, importing and doing business with government).

Businesses were asked a number of questions about the sources of their compliance costs for each group of regulations. In estimating the costs of compliance businesses were asked to distinguish between internal staff costs and the cost of external professional services and consultants. The costs of compliance with various components *within* a regulation group were obtained where appropriate. For example, estimates were obtained for compliance with the various types of tax (VAT, CIT and so on). More detailed or specific questions were also asked about other costs associated with various regulations, e.g. for exporting and importing, costs associated with delays arising from the regulatory process.

Average (or mean) and median (the middle of the distribution) costs for each sub-component of the regulation group were obtained for the sample as a whole, and across four size bands by number of employees: <5; 5–49; 50–99; 100+.

Estimates of the number of firms in each of the four size categories were obtained from the PSF's *Rwanda Business Operators' Census Report* of January 2008. This report finds that there are at least 72 994 businesses operating in Rwanda (this does not count all businesses – see report for more details). A breakdown by size category is given on p. 14 of the report. This was used to calculate the number of firms in each size category. An assumption was made that those businesses that did not state their size (2.1%) were evenly distributed across the size categories. The census included 45 947 individually-owned businesses operating from collective sites or multi-occupancy sites (such as markets). These firms were all assumed to be in the smallest size group of less than 5 employees, and furthermore were deemed to fall outside the 'formal' sector. They were not used to calculate total aggregate costs in the economy since these types of firms were not sampled. Thus the aggregate costs refer only to firms in the 'formal' sector. For the purposes of this study it is assumed that these number 27 047 – the figure obtained from the *Rwanda Business Operators' Census* less the number of businesses operating from collective sites. The aggregate costs thus underestimate the total compliance costs for the Rwandan economy.

For firms in the smaller two size categories (<5 and 5–49) *median* aggregate costs were used, when summing overall aggregate costs for each grouping. This was because the distribution from the census suggests that within these groups there are more firms towards the bottom of the size band. The use of the average (which is higher than the median) would thus skew the results upwards.

For firms in the larger size categories (50–99 and 100+) the *average* aggregate costs were used because we sampled comprehensively within these categories and thus were confident that the sample average was close to the population average.

For regulations that affect all firms, the aggregate values for each size group were multiplied by the number of firms within each group. For tax incentives, this sub-group was weighted by the number of firms applying.

For regulations that affect only some firms, the aggregate values for each size group were multiplied by the number of firms within each group that participated in each activity. Estimates of the number of firms in each size group that participated in each activity were obtained from our sample.

The proportion of firms exporting in the largest two and the smallest size categories was taken from the responses in our sample. The number of firms exporting in the 10–49 size group was calculated from data supplied by RIEPA and the *Business Operators' Census*. For all size categories these numbers were checked against both RIEPA data and the *Business Operators' Census*.

For each regulation type, these amounts were summed across size groups (these are the line estimates in table 3.1). These regulation types were then summed to obtain the total figure in table 3.1.

Recurring compliance costs: applicable to all firms

As table 7.6 illustrates, of the three main types of recurring compliance costs identified by businesses in the survey – annual registration, tax compliance and compliance with labour regulations – the cost associated with tax compliance is by far the highest. Compliance costs associated with VAT – both internal staff costs and the costs of external accountants, advisors and consultants – comprise the largest component of tax compliance costs. Administering CIT is also a significant tax compliance cost, as is the cost associated with preparing and undergoing audits.

Recurring compliance costs: not applicable to all firms

Some types of costs do not affect all firms. For example, only those firms that engage in regional and international trade (importing and exporting) require documents for these goods to clear customs. Companies that do business with government incur costs bidding for government contracts. They may also wait longer for payment from government clients compared to payments by clients in the private sector. These costs

Regulatory costs by business size bands: the actual calculations

The tables below provide the actual calculations. For each size group, column three is the product of column 1 and 2, i.e. (column 3) = (number of firms) x (cost per firm).

Table 7.1: Size group: <5 employees

	Median cost	No. of firms	Total
Initial registrations	68 150	2 108	143 673 830
Annual registrations	12 000	21 082	252 984 000
Tax costs	360 000	21 082	7 589 520 000
Labour regulations	35 000	21 082	737 870 000
Exporting	0	0	0
Importing	3 250 000	3 373	10 962 640 000
Government business	130 000	5 481	712 571 600

Table 7.2: Size group: 5–49 employees

	Median cost	No. of firms	Total
Initial registrations	599 000	569	340 771 100
Annual registrations	225 000	5 689	1 280 025 000
Tax costs	1 738 000	5 689	9 887 482 000
Labour regulations	1 000 000	5 689	5 689 000 000
Exporting	15 000 000	57	853 350 000
Importing	1 400 000	2 560	3 595 448 000
Government business	200 000	2 845	572 150 857

Table 7.3: Size group: 50–99 employees

	Average cost	No. of firms	Total
Initial registrations	2 422 885	16	39 735 314
Annual registrations	1 163 702	164	190 847 046
Tax costs	7 678 155	164	1 259 217 392
Labour regulations	8 668 704	164	1 421 667 423
Exporting	5 104 333	31	162 021 409
Importing	19 754 832	110	2 159 861 632
Government business	1 671 029	108	179 549 228

Table 7.4: Size group: 100+ employees

	Average cost	No. of firms	Total
Initial registrations	18 191 433	11	203 744 050
Annual registrations	2 035 860	112	228 016 320
Tax costs	22 291 285	112	2 496 623 886
Labour regulations	5 902 937	112	661 128 944
Exporting	17 845 500	34	592 206 222
Importing	23 712 488	71	1 672 169 524
Government business	13 109 846	66	870 105 335

Table 7.5: Overall Total (as in table 3.1)

	RwF	% of total compliance cost
Cost of undertaking initial registrations	727 924 294	1,3
Cost of undertaking annual registrations	1 951 872 366	3,6
Cost of complying with tax regulations	21 232 843 279	38,8
Cost of complying with labour regulations	8 509 666 367	15,5
Cost of complying with export requirements (including delays)	1 607 577 631	2,9
Cost of complying with import requirements (including delays)	18 390 119 156	33,6
Doing business with Government (tendering)	2 334 377 020	4,3
Total	54 754 380 112	100
Rwandan GDP	1 746 700 000 000	
%		3,1%

are of course quantifiable only for those companies that engage in these activities. They may however impact on other companies not currently engaged in such activities, since high regulatory costs may in themselves prevent entry to particular types of activities. The average compliance costs associated with these activities, if the firm participates in the activity, are presented in table 7.7.

For firms that engage in importing and exporting, the burden of these compliance costs, together with costs associated with tax compliance, is very apparent. Figure 7.1 shows the proportion of total compliance costs per regulatory category for businesses that engage in importing, exporting, and tendering for and undertaking government contracts. The compliance costs associated with tax, importing and exporting together account for close to 90 per cent of the red tape costs for these firms. Export and import costs as indicated in the figure include the costs of delays that businesses carry as a result of administrative delays attributed to Customs or the RBS (including for example the hire cost of transport and drivers who are delayed at customs posts for several days, or the costs of damage to perishable goods as a result of lengthy delays).

The costs of business registration

Breakdown of the aggregate figure

	<5	5–49	50–99	100+
	Median		Mean	
Initial registration				
Initial registration costs – staff costs	25 600	321 000	1 895 385	9 045 933
Initial registration costs – external fees	42 550	278 000	527 500	9 145 500
Total initial registration costs per size group	68 150	599 000	2 422 885	18 191 433
Number of firms	2,108	569	16	11
Aggregate initial registration costs	143 673 830	340 771 100	39 735 314	203 744 050
Total aggregate initial registration costs	727 924 294			
Annual registration				
Annual registration – staff costs	12 000	100 000	356 559	335 860
Annual registration – external fees	0	125 000	807 143	1 700 000
Total annual registration costs per size group	12 000	225 000	1 163 702	2 035 860
Number of firms	21 082	5 689	164	112
Aggregate annual registration costs	252 984 000	1 280 025 000	190 847 046	228 016 320
Total aggregate annual registration costs	1 951 872 366			

Total initial and annual registration costs per size group correspond with the median or average costs that are used for each firm size category in the table above.

For firms in the smaller two size categories (<5 and 5–49) *median* aggregate costs were used, when summing overall aggregate costs for each grouping. This was because the distribution from the census suggests that within these groups there are more firms towards the bottom of the size band. The use of the average (which is higher than the median) would thus skew the results upwards.

For firms in the larger size categories (50–99 and 100+) the *average* aggregate costs were used because we sampled comprehensively within these categories and thus were confident that the sample average was close to the population average.

It is assumed that 10% of firms register initially each year. Annual registration costs apply for all firms.

Total costs per size category are multiplied by the number of firms in each size category to obtain aggregate costs for each size category which are then summed to obtain aggregate total costs. These are the amounts presented in table 3.1.

Table 7.6: Average annual recurring compliance costs

Recurring costs	Mean costs	Per employee cost
Annual registration		
Staff time and cost of forms etc	226 440	23 543
Fees paid to external consultants	409 740	29 234
Total <i>annual registration</i>	636 181	52 777
Tax compliance		
Tax compliance – VAT		
Staff time, forms etc	800 464	77 891
Fees paid to external consultants	1 438 325	100 839
Tax compliance – CIT		
Staff time, forms etc	965 072	54 857
Fees paid to external consultants	1 114 587	78 673
Other tax compliance costs		
Time and money spent by firms in accessing tax incentives	2 625 400	165 900
Time and money spent by firms preparing for tax audits	1 516 751	51 098
Compliance with District tax	122 486	9 729
Total <i>tax compliance</i>	8 583 085	538 986
Compliance with labour regulations		
Staff time, forms etc	528 441	35 726
Fees paid to external consultants	1 471 064	50 624
Total <i>labour regulations</i>	1 999 505	86 350
Overall total	11 218 771	678 113

Figure 7.1: Composition of compliance costs: firms engaging in cross-border trade and supplying to government

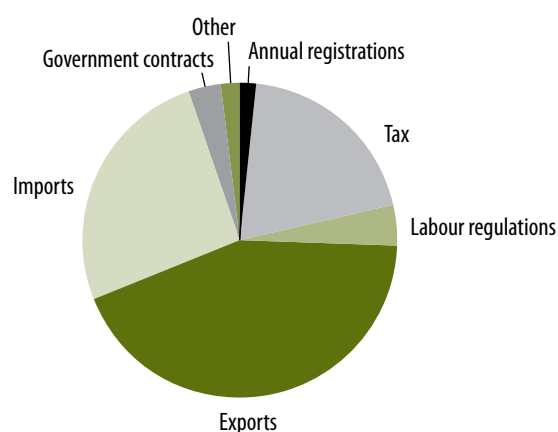


Table 7.7: Average compliance costs for activity specific regulations (not applicable to all firms)

	Mean costs	Per employee cost
Compliance with export regulations		
Staff time, permits, licenses etc	2 190 444	102 548
Fees paid to external consultants	3 947 000	227 127
Cost of delays caused by official administrative processes	13 500 000	864 414
Total	19 637 444	1 194 090
Compliance with import regulations		
Staff time, permits, licenses etc	2 364 295	65 992
Fees paid to external consultants	3 587 581	91 845
Cost of delays caused by official administrative processes	8 286 176	553 398
Total	14 238 052	711 235
Costs of tendering for government work		
Staff time and costs associated with bidding for government contracts	805 652	48 177
Staff time and costs of recovering outstanding government payments	1 512 765	42 675
Total	2 318 417	90 852
Labour regulations – dismissal costs		
Total	897 132	28 765
Costs of closing a business		
Staff time, costs associated with official procedures	10 500 000	451 232
Fees paid to external consultants	5 545 455	251 239
Total	16 045 455	702 471
Other		
Compliance costs specific to particular firms (including sector-specific requirements e.g. pharmaceuticals industry)	1 202 709	50 621
Total	1 202 709	50 621

Tax compliance

Compliance with tax regulations constitutes the largest compliance cost among Rwandan firms. These costs are also strongly regressive. Costs per employee decrease sharply as firm size increases. As figure 7.2 indicates, the total costs associated with complying with tax regulations are approximately 1.5 times higher per employee for firms with less than 20 employees, compared to firms with between 20 and 35 employees.

Comparing the average costs per employee for large firms (with over 100 employees) to micro firms (with less than 10 employees) shows that per employee compliance costs are almost seven times greater for micro firms.

Enduring long queues to pay tax

For many businesses in Rwanda paying tax is a time-consuming and frustrating procedure that often requires hiring dedicated staff members to deal with the paperwork and to make monthly visits to the nearest RRA offices. All tax returns must be submitted in person no later than the 15th of each month. A single form must be submitted and certified. The amount owing is then paid at the adjoining Ecobank office – either in cash or by certified cheque. Obtaining a certified cheque can itself be a time-consuming process.

At the mercy of individual bureaucrats

Anecdotal evidence indicates that for many businesses the experience of dealing with the RRA is dependent on the desk clerks with whom they interact.

One large, well established Kigali manufacturer reported being told by desk clerks that the information supplied in his company's tax return could not be correct, and that stated profits and turnover were wrongly reflected. Although this was not the case, the forms were then returned to the manufacturer to be 'corrected' – unnecessarily delaying the process and creating administrative hassles for the business.

It was also suggested that a lack of predictability makes the process harder than it needs to be – respondents reported that requirements and processes within the RRA offices changed from one visit to the next.

Figure 7.2: Cost of tax compliance

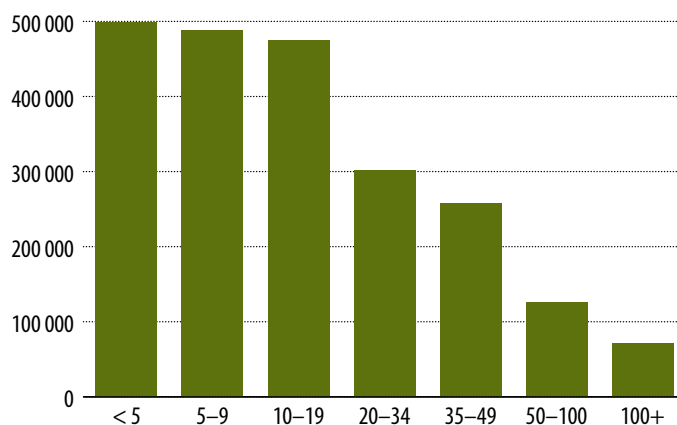


Table 7.8 shows the compliance costs associated with different aspects of tax compliance, and the compliance cost per employee in each case.

Tax: breakdown of the aggregate figure

	<5	5–49	50–99	100+
	Median		Mean	
VAT – staff costs	50 000	240 000	887 856	1 634 917
VAT – external fees	100 000	500 000	3 155 455	4 266 909
CIT – staff costs	80 000	300 000	992 127	2 392 384
CIT – external costs	100 000	500 000	1 629 000	2 185 000
Accessing incentives	0	90 000	943 333	2 650 000
Audit preparation	20 000	150 000	795 083	10 400 000
District level taxes	10 000	30 000	124 300	617 075
Total tax compliance costs per size group	360 000	1 738 000	7 678 155	22 291 285
Number of firms	21 082	5 689	164	112
Aggregate tax compliance costs	7 589 520 000	9 887 482 000	1 259 217 392	2 496 623 886
Total aggregate tax compliance costs		21 232 843 279		

Total tax compliance costs correspond with the median or average costs that are used for each firm size category in the table above.

For firms in the smaller two size categories (<5 and 5–49) *median* aggregate costs were used, when summing overall aggregate costs for each grouping. This was because the distribution from the census suggests that within these groups there are more firms towards the bottom of the size band. The use of the average (which is higher than the median) would thus skew the results upwards.

For firms in the larger size categories (50–99 and 100+) the *average* aggregate costs were used because we sampled comprehensively within these categories and thus were confident that the sample average was close to the population average.

All these costs except accessing tax incentives apply to all firms. The values for accessing tax incentives are weighted by the number of firms accessing these incentives when calculating total tax compliance cost.

These are then multiplied by the number of firms to obtain aggregate tax compliance costs per category.

Table 7.8: Tax compliance by type of activity

		Mean cost	Cost per employee
VAT	Internal compliance costs (staff time, costs of complying with official procedures)	800 464	77 891
	External compliance costs – fees paid to auditors, accountants etc	1 438 325	100 839
CIT	Internal compliance costs (staff time, costs of complying with official procedures)	965 072	54 857
	External compliance costs – fees paid to auditors, accountants etc	1 114 587	78 673
	Accessing incentives	2 625 400	165 900
	Audit preparation	1 516 751	51 098
	District level taxes	122 486	9 729
	Total	8 583 085	538 986

Accessing tax incentives

The survey results show that the process of accessing tax incentives is, on average, one of the largest tax related compliance costs that companies face – when expressed both as a mean and in terms of cost per employee. This is essentially a voluntary cost, and would be incurred only by firms who potentially qualify for such incentives and who choose to try to access these. Companies embark on the process of attempting to access tax incentives because they believe that the company will obtain a net benefit. However, it seems likely that if companies were fully aware of the magnitude of the associated costs prior to starting on this process, they might find that the benefits to be gained from tax incentives are not necessarily justified, at least in the short term, by the time and expense involved in accessing them.

The costs associated with accessing tax incentives are based on the information provided by the relatively small proportion of businesses in the sample that had been

Incentives for growth – but are they accessible?

Despite reforms in 1997 and 2005, the corporate and personal income tax code is still characterised by a complex and administratively burdensome structure of incentives. The income tax code of 2005 simplifies the rules for deductions for depreciation of capital assets. All assets are depreciated on a straight line basis, and rates track the actual useful life of the assets. The withholding tax rate on dividends, management fees and interest income has been harmonized at 15 per cent. The code introduces unilateral tax credits on foreign sourced income, a reduction in the corporate income tax rate of 2, 5 or 6 per cent for companies employing a large number of Rwandans (from 200 to more than 900), and a reduction in the corporate income tax rate of 2 or 5 per cent for companies exporting \$3–5 million a year or more than \$5 million a year, respectively.

Rwanda Mini-Diagnostic Analysis of the Investment Climate, FIAS, April 2005

or were currently involved in the process of accessing tax incentives. As noted above, application for tax incentives is essentially a voluntary process, and thus does not constitute a compulsory regulatory cost. However, the kinds of tax incentives under discussion are intended to encourage investment in particular areas, employment of local people, and/or export-led growth.

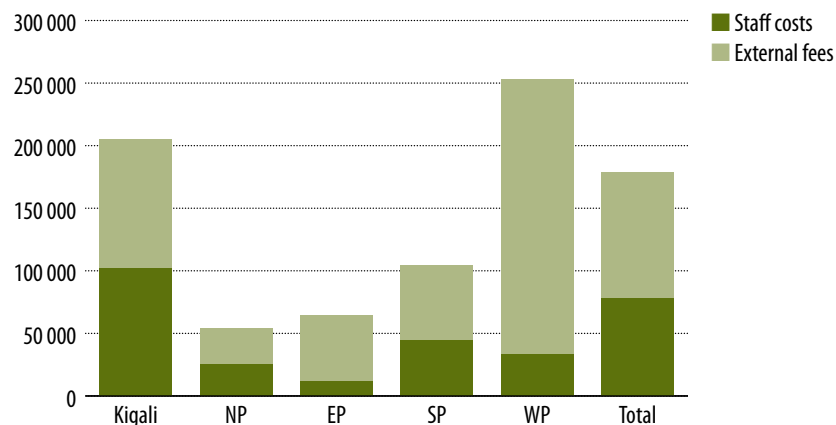
If companies find the costs of accessing the incentives overly burdensome in comparison to the benefits achieved, it suggests that the administration of these incentives requires comprehensive review.

VAT compliance

VAT-related compliance costs constituted the highest per employee cost among the compulsory tax costs. A high proportion of these costs were accounted for by external fees paid to agencies, accountants and professional consultants, contracted by businesses to assist them in completing VAT compliance requirements. The high proportion paid to external fees suggests that VAT regulations are either too complicated to be dealt with by the business internally, or that it is actually cheaper or more efficient to pay an external agent to take the necessary time to go through the full process. Either way, given the broad spectrum of firms covered by VAT regulations and the importance of ensuring an effective VAT system, it appears that a review of information requirements and payment processes should be prioritised.

VAT compliance costs in respect of direct staff costs (time spent making the necessary calculations, submitting forms and reports and recovering refunds) are highest in Kigali. The Western Province has the highest average level of external fees per employee. The highest total costs for VAT compliance were reported in Western Province and Kigali – where reported costs were more than twice the per employee cost for the next highest province (Southern Province). Given the extent to which administration and access issues appear to play a major role in the high tax compliance costs reported by surveyed businesses (particularly long queues requiring staff to spend long periods away from the office), further investigation into the reasons behind the large differences by province in reported compliance costs would be advisable.

Figure 7.3: Per employee VAT costs by province



At sector level, staff costs for VAT compliance are highest in the industry and financial sectors. External fees are the highest among the professions, making total compliance costs for VAT highest in this sector. This can be attributed to the fact that this sector includes business services, auditing and consulting, medical practices and pharmacies. These types of businesses are likely to add a lot of value per employee and thus incur relatively higher VAT fees. Furthermore, it should be noted that the time costs of employees in these types of businesses are likely to be high – making it worthwhile for companies such as these to buy-in outside professional assistance.

The regressive nature of VAT compliance is illustrated in figure 7.5. Staff costs are highest among the smaller firms. In many cases the owner is likely to be closely involved in compiling the necessary information for VAT returns, and enterprises are too small to justify the expense of contracting a third party to deal with tax compliance requirements. In contrast, we see that external fees are highest in the 10–19

Administration of the VAT system

Rwanda's VAT is administered by the RRA. VAT applies to locally and imported goods and services. Most goods and services are taxed at 18 per cent, while exports are taxed at zero per cent. A number of goods and services are exempt. Businesses are required to register for VAT if their turnover is above Rwf 20 million for any period of 12 months or Rwf 3.75 million in three consecutive months in the last quarter of the year. Other businesses may register on a voluntary basis. Investors seeking RIEPA incentives are required to register for VAT purposes. Returns must be filed monthly on an accruals basis. VAT must be paid in person – or through an agent – at a RRA office before the 15th of each month. Refunds can be claimed whenever input tax exceeds output tax without condition. The RRA is required to refund excess payments within 30 days or up to a maximum of three months if the claim must be investigated.

Paying VAT upfront leaves businesses out of pocket

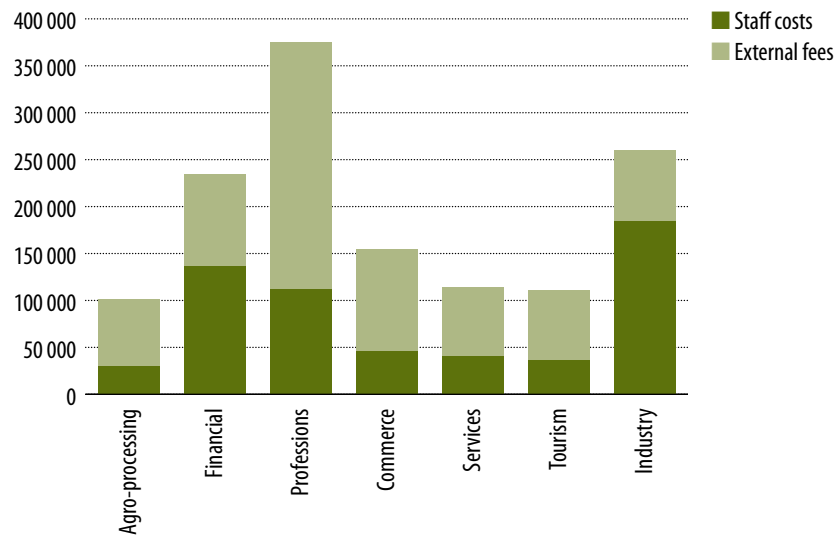
A number of businesses interviewed by SBP expressed frustration with what they termed 'paying VAT upfront'. Companies are required to pay VAT when they issue an invoice. However, they often experience a considerable delay between paying the VAT and receiving payment from their customers for the goods or services provided. For example, companies may allow a customer 30 days to pay. Payment for contract work may only be received at the end of the contract.

A medium-sized importer of computer parts, for example, told SBP that he had to pay approximately Rwf 20 million in VAT - and sometimes only received the full payment from his customers up to six months later. When combined with the costs of actually buying the equipment in the first instance, this forces his business to operate with very little working capital.

Chapter 7

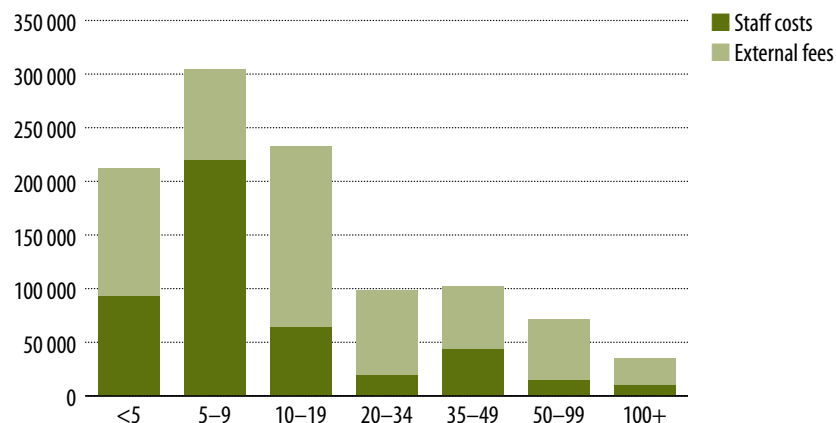
employee category. These businesses are unlikely to be large enough to employ someone to deal with tax compliance on a full-time basis, but being slightly larger are less likely to see the owner or senior managers directly involved in the process. They thus remain dependent on external experts, but experience lower per employee compliance costs than smaller businesses.

Figure 7.4: Per employee VAT costs by sector



The total costs associated with VAT compliance decline sharply once firms reach 20 or more employees. The average employee cost for companies in the 10–19 employee band is more than twice that of those in the 20–34 employee band, as can be seen in figure 7.5.

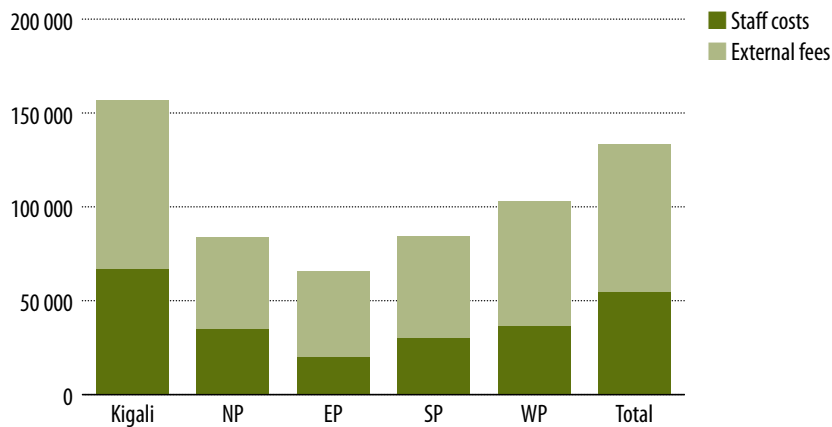
Figure 7.5: Per employee VAT costs by firm size



Corporate Income Tax compliance

The survey results show a sharp distinction between the Corporate Income Tax costs for companies in Kigali and those in the rest of the country. For companies in Kigali, the staff cost associated with CIT administration is almost twice that of companies in the next most costly province (Western Province) – reflecting the concentration of larger businesses in Kigali. The average costs of external consultants are larger than internal staff costs across all provinces; and again are largest in Kigali, followed by the Western Province.

Figure 7.6: Per employee CIT costs by province



The costs of CIT are largest in the financial and professional sectors.

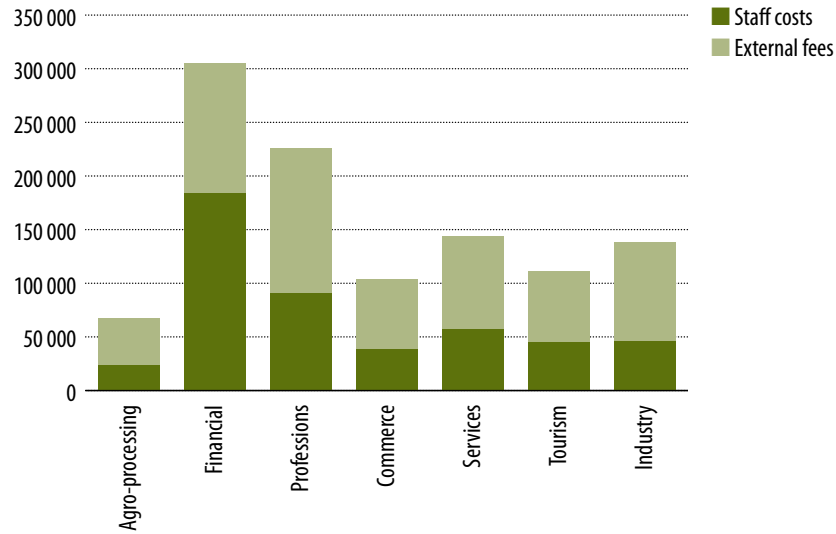
Administration of CIT

Corporate income tax is levied on business profits received by enterprises. These profits include rent from houses or buildings incorporated as assets. Rwanda’s standard corporate tax rate is 30 per cent. All registered businesses, cooperative societies, partnerships or de facto companies and associations that perform business activities and realise profits must pay CIT. Businesses file income tax returns annually but are required to make anticipatory payments on a quarterly basis, with the amount due equal to one quarter of the total income tax paid in the previous year. Although these anticipatory payments are deducted from the end-year tax due, excess payments, rather than being reimbursed, are credited towards future obligations. Winners of public tenders face a deduction of three per cent of the value of invoice as an anticipatory payment on future income tax. These measures have the potential to impact negatively on company cash flow.

However, the 2006 *Investment Policy Review* suggests that corporate taxation in Rwanda does not appear to place an excessive burden on investors or to be uncompetitive relative to a number of comparator countries, and can qualified as ‘average’.

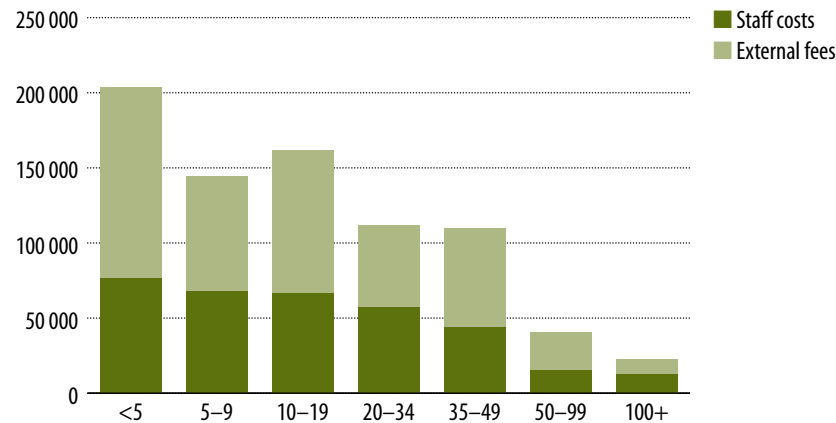
UNCTAD Investment Policy Review: Rwanda, 2006, Advance Copy

Figure 7.7: Per employee CIT costs by sector



The costs associated with CIT compliance are highly regressive. As with VAT compliance costs, there is a large reduction in CIT compliance costs once a firm reaches 20 or more employees. Total compliance costs per employee are almost one-and-a-half times higher for firms in the 10–19 employee band compared to those with 20–34 employees. There is a further drop in compliance costs once firms reach 50 employees. The average compliance cost per employee for businesses in the 50–99 employment band is less than half that for the 35–49 band.

Figure 7.8: Per employee CIT costs by firm size



Tax Audits

Preparation for tax audits and the process of undergoing them constitute a significant part of the tax compliance burden for businesses in the survey. Most firms undergo tax audits once a year. The exception was the Southern Province, where the typical firm reported being audited twice a year.

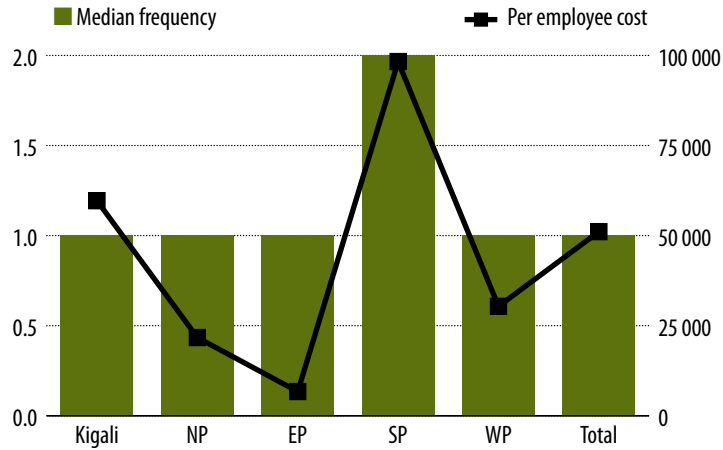
Annual tax commitments⁷

A medium sized private limited company described the company's tax commitments in an average year. The company, a registered consultancy firm, had been operating in Kigali for three years. The onerous nature of the requirements becomes clear when one considers that tax and National Social Security Fund (NSSF) contributions require collection and completion of the relevant forms in person at the relevant tax office, and payment, again in person, at the relevant bank – requiring a considerable amount of time to be spent in government offices rather than running ones' business.

	Tax payment	Deadline
1	Payment first deposit – tax on company profits	30/09
2	Payment VAT, professional/business tax, Municipal tax – August	15/09
3	Payment VAT, professional/business tax, Municipal tax – September	15/10
4	Declaration of social security for 3rd trimester, Municipal tax + payment	30/10
5	Payment VAT, Professional/business tax, Municipal tax – October	15/11
6	Payment VAT, Professional/business tax, Municipal tax – November	15/12
7	Payment second deposit – tax on company profits	30/12
8	Payment VAT, Professional/business tax, Municipal tax – December	15/01
9	Payment VAT, Professional/business tax, Municipal tax – January	15/02
10	Payment VAT, Professional/business tax, Municipal tax – February	15/03
11	Payment current annual vehicle tax – axle + annual license plate registration tax	30/03
12	Payment License (for trade)	30/03
13	Payment property tax and tax on income from renting and letting	30/03
14	Payment 3rd deposit – tax on company profits	30/03
15	Declaration of social security for 1st trimester, Municipal tax + payment	30/03
16	Payment VAT, Professional/business tax, Municipal tax – March	15/04
17	Payment VAT, Professional/business tax, Municipal tax – April	15/05
18	Payment VAT, Professional/business tax. Municipal tax – May	15/06
19	Payment 4th deposit for tax on company profits	30/06
20	Declaration of social security for 2nd trimester Municipal tax + payment	15/07
21	Payment VAT, Professional/business tax, Municipal tax – June	15/07
22	Payment VAT, Professional/business tax, Municipal tax – July	15/08
23	Payment VAT, Professional/business tax, Municipal tax – August	15/09

Businesses in the financial sector were more likely to report being audited twice a year than businesses in the other economic sectors. Again, the higher frequency of audits was correlated with higher costs for this sector. The services and tourism sectors reported the next highest audit compliance costs, as shown in figure 7.10.

Figure 7.9: Frequency and cost of tax audits by province



There was no significant reported difference in audit frequency across size categories, but the costs associated with audits do differ markedly. Businesses with between 10 and 35 employees reported the highest per employee costs. These costs fell significantly for larger businesses. Businesses with more than 50 employees report audit compliance costs almost seven times smaller per employee than those in the 10–35 size range.

Figure 7.10: Cost of tax audits by sector

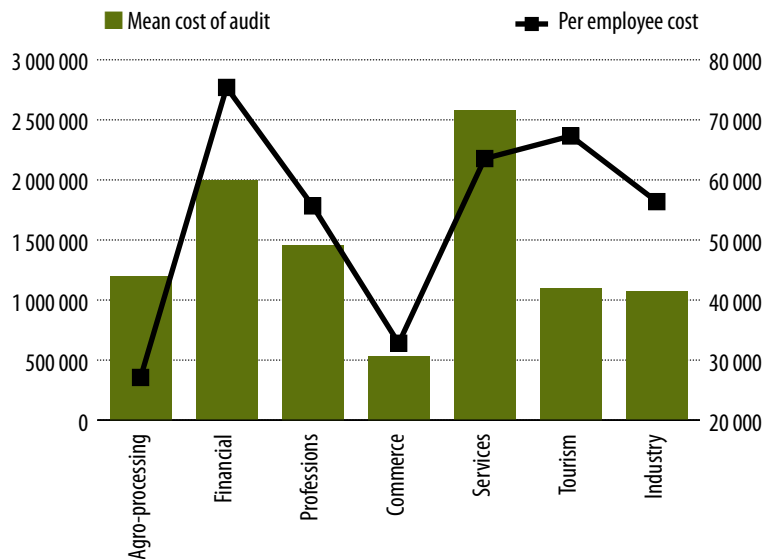
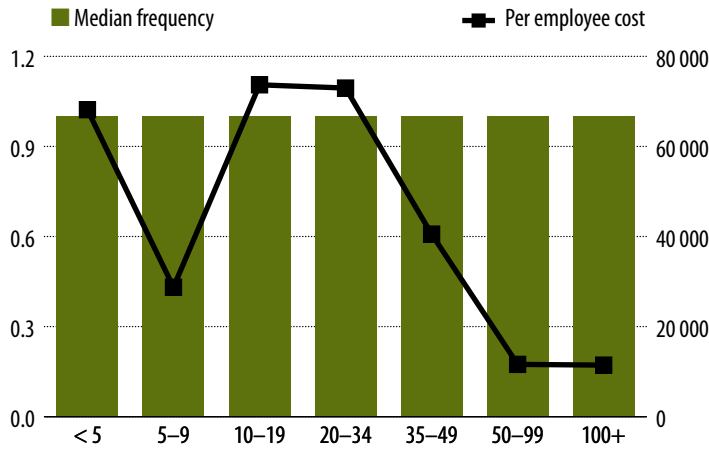


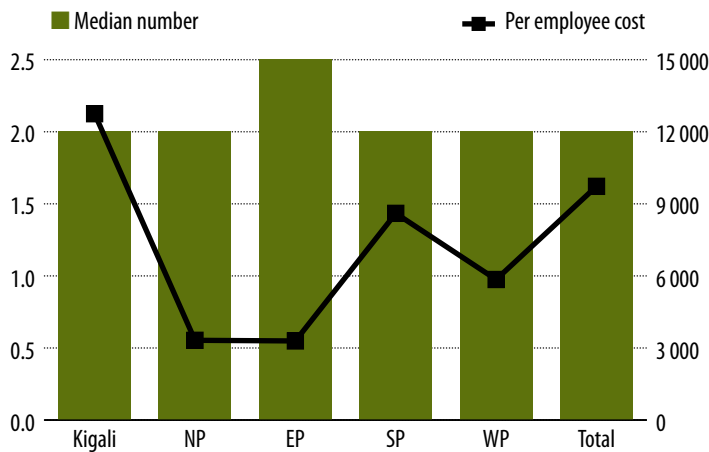
Figure 7.11: Frequency and cost of tax audits by firm size



District level taxes

Rwanda also collects taxes at the district level. Most businesses reported that they are required to comply with two district level taxes. The costs of complying with these taxes are significantly lower than for complying with VAT or CIT. However the pattern of higher compliance costs for businesses in Kigali (evident in relation to national level taxes) was repeated for district level taxes, as seen in figure 7.12.

Figure 7.12: Number and cost of district level taxes by province



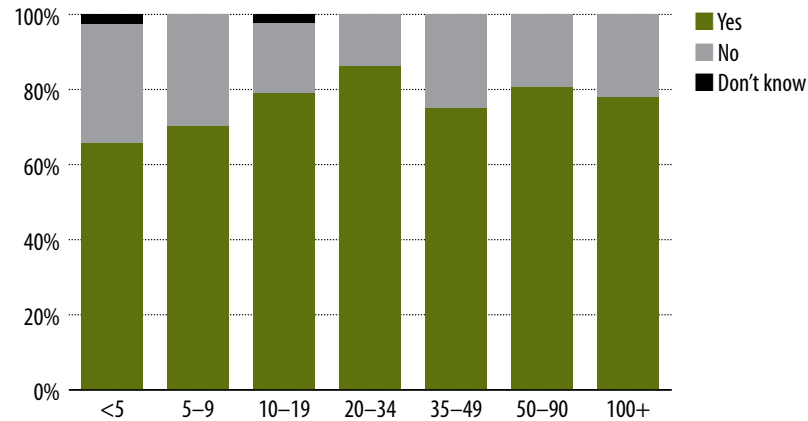
Accessing information about tax compliance requirements

One reason why firms may find it difficult and costly to comply with regulations is a lack of information. While over 70 per cent of respondents said that it was easy to get information about tax regulations, it is worth noting that smaller firms were more likely than larger firms to mention difficulties in accessing appropriate information about tax compliance requirements.

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The RRA has posted information about tax compliance on its website. This makes it easier for larger firms with internet access to obtain the appropriate information, but the service may not cater to the needs of smaller firms, many of which do not have internet access (and often do not even have access to an electricity supply). Almost 30 per cent of firms with fewer than 5 employees said that they did not find it easy to access information.

Figure 7.13: Ease of access to information about tax regulations by firm size



What would make it easier to comply with tax regulations?

Companies were asked about the changes they would propose to make it easier for businesses like theirs to comply with tax regulations. Understandably, most firms suggested a reduction in tax rates. However, in relation to administrative procedures the common theme emerging from many of the answers was for a simplification of these procedures, greater flexibility, and better access to the RRA to make payments easier.

Suggestions included the following:

- It should be possible to use *any* bank to deposit taxes
- It should be possible to pay through electronic transfer
- Businesses should have flexibility of payment (such as paying in instalments or making annual payments)
- The RRA should have more offices and/or satellite offices to make it more accessible (this response was particularly prevalent for businesses outside Kigali)⁸
- The RRA should improve customer services
- Penalties for late payment should be reduced, or at least applied on a sliding scale according to the length of the delay, and deadlines should be pushed back in cases where late payments are the result of queries or delays on the RRA's side
- There should be a single location where all taxes can be paid, rather than having to visit several offices, and the same office should handle tax registration, declarations and payment
- Information about tax regulations and changes to regulations should be communicated more effectively
- Tax verification processes should be done on an annual basis.

Firms in the agro-processing, industrial, professional and tourism sectors were most likely to emphasise the need to simplify and improve the payment process. The need to open more RRA offices was a prevalent response in the professional sector. Firms in the industry sector were more likely than those in other sectors to say that the number of taxes they had to pay should be reduced.

Firms in the 10–19 employee band were most likely call for tax concessions for SMEs. As noted earlier, the costs of tax compliance are disproportionately high for these firms, and drop off dramatically for larger businesses. It is likely that businesses in the 10–19 employee size band, while being particularly burdened by tax compliance, have also moved beyond a focus on ‘survival’ and are looking to expand – hence the perceived importance of tax concessions for these businesses. For the largest firms (those with over 100 employees) the importance of simplifying the collection process was the primary concern.

Regulations governing cross-border trade

Improved regulations governing cross-border trade and greater regional integration are central components of Rwanda’s Vision 2020.

Accessing the international market is essential for Rwanda to achieve sustained high levels of economic growth. The Rwandan domestic market is limited by the size of the population and by the relatively limited purchasing power within the country. There are thus limited domestic opportunities for company growth beyond a certain size. In contrast, the regional and international markets provide opportunities for businesses to break domestic market constraints and thus expand in size and/or become more specialized. Potentially this can facilitate faster growth and the creation of more and better-paid jobs.

Figure 7.14: Proposed changes in the tax administration process by province

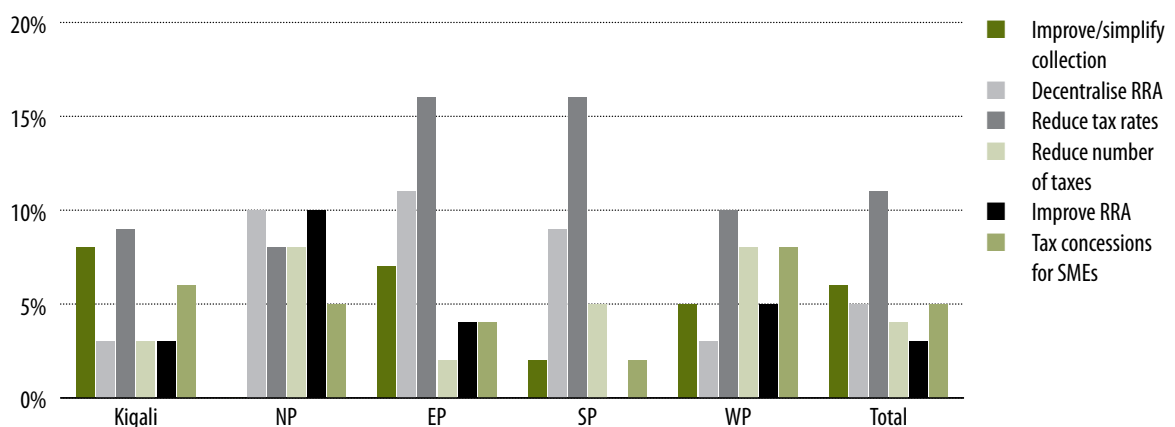
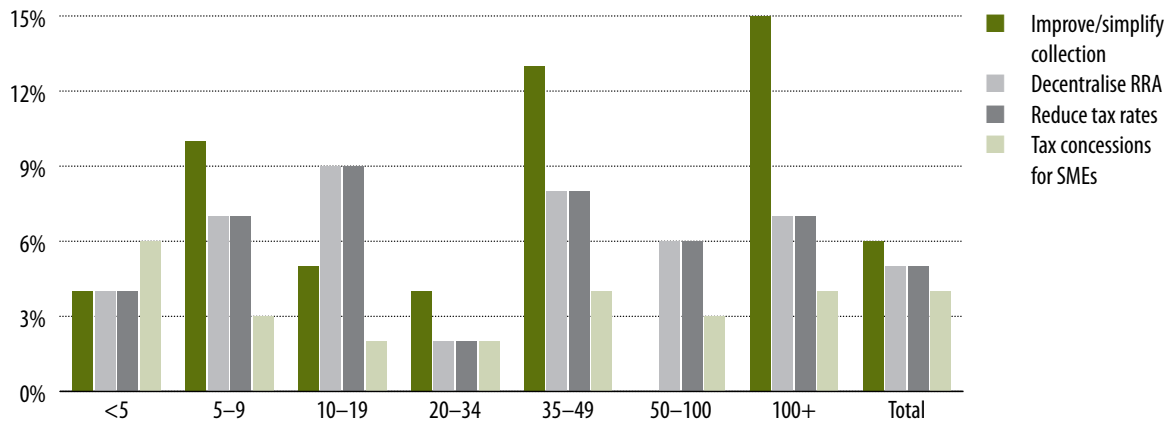


Figure 7.15: Proposed changes in tax administration process by firm size



Openness to imports can also be an important contributor to growth and the alleviation of poverty. Imports may allow for cheaper intermediate inputs into the production process, and import competition will help to keep domestic prices down, thus benefiting consumers.

Vision 2020 seeks to transform Rwanda into a middle income country through policies that promote an open, liberal trade regime, minimizing barriers to trade and adopting policies to promote exports.

Despite the government’s commitment to growing Rwanda’s import and export markets, the country’s geographic location and the nature of existing transportation infrastructure inevitably contribute to high costs for both importers and exporters, exacerbated by high fuel costs.

Exporting and importing processes also require considerable interactions with government regulations and agencies – which can have a significant impact on the viability and profitability of such activities. A review of the regulatory processes governing imports and exports potentially offers an opportunity to reduce unnecessary red tape and encourage more entrants to the export market.

Respondents who are engaged in importing and exporting activities report very significant compliance costs associated with these activities. The bulk of these costs appear to be incurred as a result of delays in shipments⁹, although a significant proportion is also due to the staff time spent on obtaining the relevant documentation, as well as fees paid to external consultants and agents. These costs are larger for exporting than for importing – which has serious implications for the potential growth path of the Rwandan economy.

Regulations governing exports

As is the case in many countries, within and outside of Africa, participation in the export market is confined to a small minority of larger firms. Only nine per cent of firms surveyed said that they currently export goods or services, while 81 per cent do

Limited export capacity and high dependence on imports

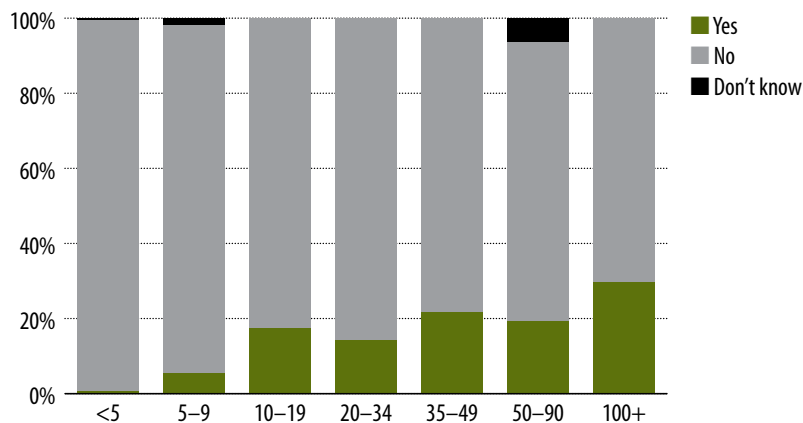
Rwanda's 2006 *Investment Policy Review* notes the country's limited export capacity, and the dependence of the formal sector on imported goods. The government has committed itself to pursuing an open, liberal trade regime, minimising barriers to trade and implementing policies to promote competitive enterprises, exports and entrepreneurship. Vision 2020 identifies the need for development of non-traditional exports and reversal of the anti-export bias in public policies. Coffee, tea and tourism have been identified as priority sectors for export development – together projected to generate \$306 million in exports by 2010.

Rwanda's government has also prioritised regional economic integration and cooperation. The country is a member of several sub-regional economic organisations, including the East African Community – one of the success stories of regional integration in Africa. The EAC aims to establish a European Union-style common market and monetary union. Its expansion in June 2007 to include Rwanda and Burundi brought its total coverage to 115 million people. The EAC prioritises cooperation in areas of transport and communication, trade and industry, security, immigration and the promotion of investment in the region. Efforts are being made to ease travel restrictions within the EAC, harmonise tariffs, increase cooperation among security forces, improve communications and share electrical power. Trade within the region is robust. A double taxation accord has been agreed, tax reform measures have been put in place to reduce reliance on external budget support, currencies are treated as exchangeable, and members of the Community can apply for an East African passport.

not (ten per cent 'do not know').

The small base of exporters is largely explained by the size and types of enterprises currently operating in Rwanda (mainly smaller, less sophisticated businesses), but it may also be indicative of particular challenges faced by exporters. As would be expected, the survey found that large and medium firms are more involved in export activities than small firms.

Figure 7.16: Export activities by firm size



Export compliance costs: breakdown of the aggregate figure

	<5	5–49	50–99	100+
		Median		Mean
Export regulations – staff time	0	300 000	2 226 000	3 513 000
Export regulations – external fees	0	1 200 000	2 018 333	1 832 500
Costs associated with delays	0	13 500 000	860 000	12 500 000
Total export regulations per size group	0	15 000 000	5 104 333	17 845 500
Number of firms	0	57	31	34
Aggregate total export regulation costs	0	853 350 000	162 021 409	592 206 222
Total aggregate export regulation costs		1,607,577,631		

Total export regulation costs per size group correspond with the median or average costs that are used for each firm size category in the table above and include the cost associated with regulatory delays.

For firms in the smaller two size categories (<5 and 5–49) *median* aggregate costs were used, when summing overall aggregate costs for each grouping. This was because the distribution from the census suggests that within these groups there are more firms towards the bottom of the size band. The use of the average (which is higher than the median) would thus skew the results upwards.

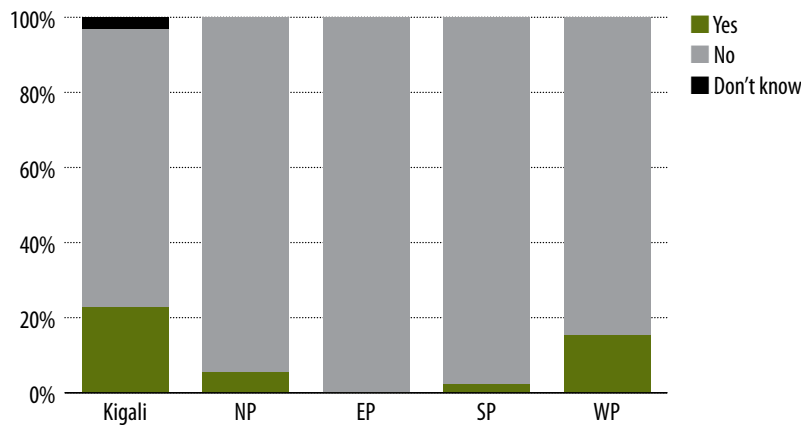
For firms in the larger size categories (50–99 and 100+) the *average* aggregate costs were used because we sampled comprehensively within these categories and thus were confident that the sample average was close to the population average.

These costs apply only to firms that export. The proportion of firms exporting in the largest two and the smallest size categories was taken from the responses in our sample. The number of firms exporting in the 10–49 size group was calculated from data supplied by RIEPA and the *Business Operators' Census*. For all size categories these numbers were checked against both RIEPA data and the *Business Operators' Census*.

Total costs per size category are multiplied by the number of firms in each size category exporting to obtain aggregate costs for each size category which are then summed to obtain aggregate total costs. These are the amounts presented in table 3.1.

Figure 7.17 shows the percentage of firms involved in export activities by province. The Western Province and Kigali are most active in export activities. The majority of medium to large firms are located in these provinces. None of the businesses surveyed in the Eastern Province were involved in exporting activities.

Figure 7.17: Export activities by province



Analysis by sector shows that the industry sector (20 per cent of firms), agro-processing (18 per cent of firms) and tourism (18 per cent of firms) were more likely to undertake export activities than other sectors. In respect of the tourism sector, this indicates the increasing integration of Rwanda into a regional tourism market, with many tourism companies operating across borders. Established agro-processing businesses, dominated by coffee and tea producers, also reflect a relatively high figure for exports.

Customs and RBS costs for an exporter

A large tea producer notes that exporters are required to obtain one document collected in person – at a cost of RwF 7 500 for the document and customs seal – from Customs and a signed clearance form from the Rwanda Bureau of Standards (RBS).

This particular tea producer exports on average two truck-loads of tea a week. The company has experienced costly delays in its dealings with both Customs and the RBS. The company estimates that the person nominated from the office to deal with Customs and RBS spends roughly 80% of their time dealing with administrative procedures for exporting. This costs the company approximately RwF 1 million per month, when taking into account how the person’s skills could be otherwise employed and the costs of transport for repeated in-person visits to the Customs and RBS offices.

The company notes that while meeting the standards required by RBS is, in itself, neither difficult nor challenging, the time spent dealing with RBS is costly and frustrating. Getting the required signatures from RBS representatives can take up to two days – delaying the departure of the trucks. These delays are compounded when the company has to wait for customs officials to seal the containers and verify the contents. Because the company rents the trucks and pays a daily rate, each day lost due to unnecessary delays is costly – the company estimates that an additional 3 days waiting for a consignment to be cleared for export can cost RwF 2 to 3 million.

Documents, departments and time

The survey found that, in order to export a consignment of goods, firms need to obtain an average of four documents, and contact three government departments/agencies. On average, it takes just over a week for the exporting firms to collect the necessary documents to export a consignment – assuming no delays in processing the documents.

It should be noted that the average of four documents required for exporting a consignment of goods, as reported by firms in the survey, is considerably less than the figure cited by the World Bank's *Doing Business Rwanda 2008* – which reports that nine documents are required by exporters. It is possible that the export process has been streamlined since the World Bank collected its data. It is however much more likely that businesses surveyed for this study did not list all the documents required as separate documents, or were not fully aware of all the documents required.

Respondents to SBP's survey noted that on average it takes just over a week to complete the necessary documentation (also considerably less than the 17 days listed in the *Doing Business* study).¹⁰

Export regulation costs

Table 7.9 gives an overview of the annual costs incurred by firms in complying with export regulations for 2007. Delays experienced at points of entry and exit constituted the largest proportion of these costs (RwF 13 500 000), followed by the cost of fees for external consultants/agencies (RwF 3 947 000). The costs in staff time, including senior management time, in dealing with export requirements were estimated at RwF 2 190 444.

Table 7.9: Export regulatory compliance costs (RwF)

	Average cost	Per employee cost
Costs of staff time, permits etc	2 190 444	102 548
Fees paid to external consultants/agencies	3 947 000	227 127
Cost of delays caused by administrative processes	13 500 000	864 414
Total	19 637 444	1 194 090

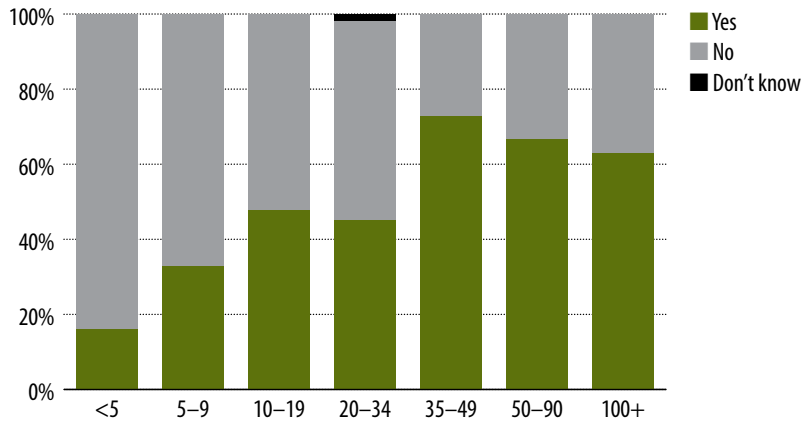
Regulations governing imports

Import activities are much more common among Rwandan businesses than exporting. The survey found that just over a third of businesses are engaged in import activities (36 per cent). This is unsurprising, given Rwanda's relatively small manufacturing base and a heavy reliance on imported goods.

Medium to large firms are more likely to be engaged in importing than 'smaller' firms, as illustrated in figure 7.18, although surveyed businesses across all sizes indicated some importing activity. These findings highlight the high proportion of

imported content in the Rwandan market, and underline the importance of reducing compliance costs associated with importing wherever possible.

Figure 7.18: Import activities by number of employees



Firms in Kigali are more involved by far with import activities when compared to the other provinces, as shown in figure 7.19. The significant drop-off in importation by businesses outside Kigali is indicative of the centralisation of the Rwandan economy around Kigali, and the low level of sophistication of many businesses in the provinces. For example, the survey found that less than five per cent of businesses in Eastern Province import. Combined with the findings that none of the businesses surveyed in this province were engaged in exporting activities, the low level of market sophistication among these businesses is apparent.

Figure 7.19: Import activities by province

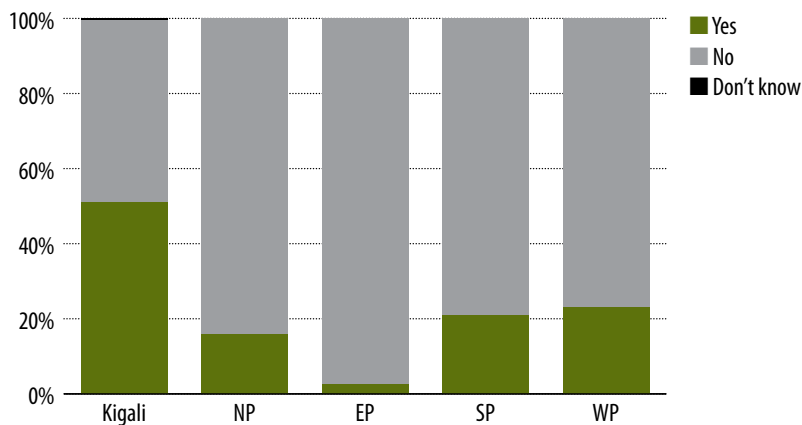
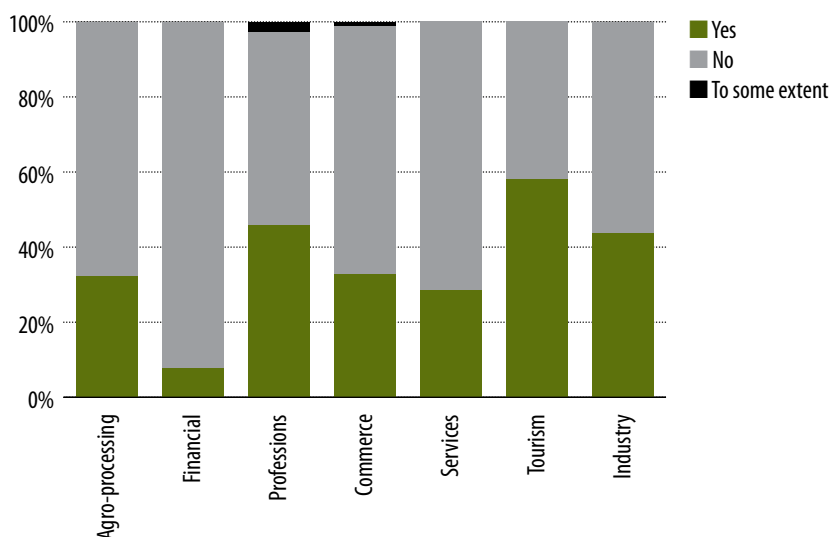


Figure 7.20 shows that the tourism sector is most active with imports when compared to other sectors. As noted above, the tourism sector is at the forefront of regional integration – where tourism products are often offered across borders (for example, safaris

that incorporate gorilla trekking in Rwanda and game-viewing in Kenya). In addition, many tourism operators have to import vital equipment such as vehicles.¹¹

The financial industry is the least active with regard to import activities – understandably given the nature of this sector.

Figure 7.20: Import activities by sector



Documents, departments and time

The survey asked firms to think about regulatory requirements around importing a consignment of goods. Firms reported that on average they need to obtain three documents, and visit three government department/agencies to obtain these documents. It takes firms on average just less than a month to collect the necessary documents.

The number of documents listed by respondents in the survey as necessary for importing a consignment of goods is considerably less than the nine documents listed in the World Bank’s *Doing Business Rwanda 2008* study. While it has been noted that the importation process has been streamlined since the introduction of the ‘blue channel’ at Customs (see Box below), it seems likely that businesses surveyed for the present study did not list all the documents required as separate documents or were not fully aware of all the documents required.

Respondents noted that on average it takes just less than a month to complete the necessary documentation. This finding is supported by the *Doing Business* study, which found that document preparation requires an average of 25 days.¹²

Import regulatory compliance costs

As was the case with export related compliance costs, the largest proportion of import compliance costs is to be found in the delays at points of entry and exit (RwF 8 286 176 in 2007), as indicated in table 7.10. The cost of delays as calculated by respondents to the survey includes the cost of goods damaged or spoiled as a result of delays at Customs (e.g. perishable goods), lost orders as a result of late deliveries,

A new blue channel at Customs

The 2006 *Investment Policy Review* identified the physical handling of goods as a key weakness in imports and exports. All imports had to transit through a bonded warehouse owned jointly by the government, the central bank and private companies. The warehouse charges a fee of four per cent of the value of the goods, a one per cent fee for handling and warehousing services, and three per cent as a tax to the RRA. Insufficient capacity in the warehouse's own infrastructure was the main cause of delays in goods clearance.¹³

In an effort to reduce delays associated with importing of goods, Rwanda has recently opened a pre-clearance or 'blue channel' at Customs. The pre-clearance process is a quick release procedure that allows declarations to be submitted to Customs and processed before the arrival of the goods. The blue channel allows importers to have imported products delivered directly to their premises, so that they do not have to wait for clearance at the MaGeRwa bonded warehouses.

For an importer to benefit from the pre-clearance facility, the enterprise should meet following requirements:

- possess a permanent address in Rwanda;
- have up to date books of accounts;
- not have three or more statements of offences (PVs) within the last three years.

Interviews conducted with selected importers indicated that those businesses which make use of the blue channel have found it to be a great improvement, significantly reducing the types of delays experienced in the past when all goods had to pass through MaGeRwa. It is likely that as more businesses become familiar with the new channel, the compliance costs reported by businesses in this survey may see a significant decline. The current study thus presents a useful baseline measurement in this regard, against which the success of the new system can be measured after a defined period of time.

additional transport expenses as a result of trucks and drivers having to wait long periods for clearance, and so on.

Table 7.10: Import regulatory compliance costs (RwF)

	Average cost	Per employee cost
Costs of staff time, permits etc	2 364 295	65 992
Fees paid to external consultants/agencies	3 587 581	91 845
Cost of delays caused by administrative processes	8 286 176	553 398
Total	14 238 052	711 235

Addressing the key bottlenecks for imports

Companies were asked to identify the key bottlenecks/problem areas with regard to the administration of import regulations, and identify recommendations for reform. Open-ended spontaneous answers were recorded. A large proportion of businesses

Import compliance costs: breakdown of the aggregate figure

	<5	5–49	50–99	100+
	Median		Mean	
Import regulations – staff time	200 000	200 000	6 433 151	6 707 873
Import regulations – external fees	150 000	600 000	3 678 824	6 504 615
Costs associated with delays	2 900 000	600 000	9 642 857	10 500 000
Total import regulations per size group	3 250 000	1 400 000	19 754 832	23 712 488
Number of firms	3 373	2 560	110	71
Aggregate total import regulation costs	10 962 640 000	3 595 448 000	2 159 861 632	1 672 169 524
Total aggregate import regulation compliance costs		18 390 119 156		

Total import regulation costs per size group correspond with the median or average costs that are used for each firm size category in the table above and include the cost associated with regulatory delays.

For firms in the smaller two size categories (<5 and 5–49) *median* aggregate costs were used, when summing overall aggregate costs for each grouping. This was because the distribution from the census suggests that within these groups there are more firms towards the bottom of the size band. The use of the average (which is higher than the median) would thus skew the results upwards.

For firms in the larger size categories (50–99 and 100+) the *average* aggregate costs were used because we sampled comprehensively within these categories and thus were confident that the sample average was close to the population average.

These costs apply only to firms that import. The proportion of firms importing in each size category has been estimated from our sample.

Total costs per size category are multiplied by the number of firms in each size category importing to obtain aggregate costs for each size category which are then summed to obtain aggregate total costs. These are the amounts presented in table 3.1.

criticised the customs authorities for causing substantial delays in clearing and forwarding of imported items. Respondents specifically criticized MaGeRwa, and several spoke of poor service delivery and customer care, and fractious relationships between customs staff and business people. Significant delays were also reported in the verification process and declarations.

Several businesses called for the computerisation of MaGeRwa services, noting that the current system is far too slow to handle importing activities efficiently. It was also suggested that when there are good reasons for delays, customs officials should communicate these clearly to businesses, so that they can take the necessary steps to

avoid such delays in the future. Businesses suggested that customs authorities could make it easier for them to access the various documents they need for importing, and that some of the documents could be integrated in order to reduce the documentation required. They also called for a single point for collection of taxes and duties.

Labour regulations

The survey asked firms to think about the cost of complying with labour regulations.

As indicated in table 3.1, labour regulations constituted just over nine per cent of total compliance costs for businesses. These costs include obtaining work permits for

Labour regulation: breakdown of the aggregate figure

	<5 Median	5–49	50–99 Mean	100+
Labour regulations – staff costs	30 000	200 000	750 815	1 175 455
Labour regulations external fees	5 000	500 000	6 049 000	2 063 636
Dismissal costs	0	300 000	1 868 889	2 663 846
Total labour regulation costs per size group	35 000	1 000 000	8 668 704	5 902 937
Number of firms	21 082	5 689	164	112
Aggregate total labour regulation costs	737 870 000	5 689 000 000	1 421 667 423	661 128 944
Total aggregate labour regulation costs		8 509 666 367		

Total labour regulation costs per size group correspond with the median or average costs that are used for each firm size category in the table above.

For firms in the smaller two size categories (<5 and 5–49) *median* aggregate costs were used, when summing overall aggregate costs for each grouping. This was because the distribution from the census suggests that within these groups there are more firms towards the bottom of the size band. The use of the average (which is higher than the median) would thus skew the results upwards.

For firms in the larger size categories (50–99 and 100+) the *average* aggregate costs were used because we sampled comprehensively within these categories and thus were confident that the sample average was close to the population average.

These costs apply for all firms. Total costs per size category are multiplied by the number of firms in each size category to obtain aggregate costs for each size category which are then summed to obtain aggregate total costs. These are the amounts presented in table 3.1.

Frustration at the Rwanda Bureau of Standards

A large Kigali-based manufacturing company interviewed by SBP reported experiencing costly and frustrating delays in its interactions with the Rwandan Bureau of Standards (RBS). The company has been operating for many years in Rwanda and is familiar with the customs requirements for importing products. On one occasion, however, a container of products from Indonesia had passed through Customs without complaint, but was stopped by RBS as the name of the product was not correctly printed on the packaging. The importers were informed that because the product did not meet the required standards, it had to be shipped back to Indonesia at the importer's expense, where the labelling would have to be corrected to meet the requirements. This despite the fact that it was a sealed container with all the correct paperwork. The importers even offered to allow RBS to test a sample of the product to ensure that it met the standards.

The supplier acknowledged the error and gave an undertaking to make the necessary changes in future.

Despite this, it took two months - and extended negotiations with RBS - to get the container released. Our informant noted that, while the company is happy to comply with the required standards, RBS should show greater understanding towards the needs of business people - particularly when products meet the required standards set for neighbouring countries. By insisting on different requirements for packaging, the RBS effectively adds to the cost of importing goods into Rwanda. He also noted that since Rwanda's market is relatively small, suppliers, are more than likely to pass the costs of complying with RBS standards onto their customers.

foreign employees as well as complying with regulations covering dismissal, insurance and contracts.

Costs of doing business with government

The survey asked firms to think about the cost of doing business with government.

These costs obviously apply only to firms that do business with government. The proportion of firms doing business with government in each size category has been estimated from our sample.

As shown in table 3.1 the cost of doing business with government constituted 3.5 per cent of total compliance costs for businesses. These costs are comprised of meeting tendering requirements for government contracts and recovering payment from government.

Doing business with government: breakdown of the aggregate figure

	<5	5–49	50–99	100+
	Median		Mean	
Successfully bidding for government business	80 000	100 000	188 382	3 553 846
Costs associated with recovering payment from government	50 000	100 000	1 482 647	9 556 000
Total government business costs by size group	130 000	200 000	1 671 029	13 109 846
Number of firms	5 481	2 845	108	66
Aggregate total government business costs	712 571 600	572 150 857	179 549 228	870 105 335
Total aggregate costs of doing business with government		2 334 377 020		

Total government business costs per size group correspond with the median or average costs that are used for each firm size category in the table above.

For firms in the smaller two size categories (<5 and 5–49) *median* aggregate costs were used, when summing overall aggregate costs for each grouping. This was because the distribution from the census suggests that within these groups there are more firms towards the bottom of the size band. The use of the average (which is higher than the median) would thus skew the results upwards.

For firms in the larger size categories (50–99 and 100+) the *average* aggregate costs were used because we sampled comprehensively within these categories and thus were confident that the sample average was close to the population average.

These costs apply only to firms that do business with government. The proportion of firms doing business with government in each size category has been estimated from our sample.

Total costs per size category are multiplied by the number of firms in each size category doing business with government to obtain aggregate costs for each size category which are then summed to obtain aggregate total costs. These are the amounts presented in table 3.1.

Additional regulations

These ‘other’ costs are not included in the calculation of total compliance costs presented in table 3.1.

Respondents were asked to identify any additional national, provincial or local regulations and requirements which require time-consuming procedures or paperwork.

Local sanitary requirements (often referred to by respondents as ‘cleanliness’ and ‘town hygiene’) and public security obligations were the most frequently mentioned

Competition from illegal imports

Businesses participating in the study were asked to identify key problems they encountered when importing. Illegal importation and smuggling together were among the top four challenges identified.

The Rwanda Revenue Authority explained to SBP that the vast majority of illegally imported products are luxury goods such as wines, spirits and cigarettes. These types of goods are subject to relatively high tariffs and are thus attractive to unscrupulous business people wishing to avoid punitive tariffs and sell their products below market prices. RRA noted that they have established a specialised division to tackle the problem of illegal imports, and that they often receive tip-offs from the public that are of great assistance in combating smuggling.

The extent to which firms abiding by the regulations perceive that they are losing business to unscrupulous operators operating outside the law, clearly demonstrates that while regulations are crucial in providing a competitive market and protecting the quality of consumer products, effective enforcement is critical to realising these benefits.

‘other’ time-consuming and costly regulations – comprising 42 per cent and 27 per cent of responses respectively. These were followed by environmental regulations (15 per cent of responses). Other problematic regulations identified included requirements for businesses to close for certain periods, both on weekdays and over weekends, to attend public meetings and undertake community service (each between five and ten per cent of responses).

Table 7.11 lists the ‘other’ regulations perceived as most time-consuming, troublesome, and costly by all Rwandan firms, divided into employment size bands. Regulations associated with public sanitary requirements are predominant across all size bands, but are particularly worrisome for small and micro firms. Security regulations and local defence were also a major concern for small and micro businesses – but were much less of an issue for businesses with 35 or more employees. Firms with ten or more employees mentioned environmental regulations far more often than smaller firms. These include regulations in respect of environmental impact assessments, for example, and are likely to be far more relevant to larger firms seeking to develop new sites, for example. Community service was an issue for smaller firms, but did not feature as a concern among firms with 35 or more employees. Many of the smaller firms in the sample were retailers and service providers who rely heavily on passing trade over weekends – making closure for community service a more serious issue for them.

While the compliance costs of these ‘other regulations were not included in the aggregate estimate, they were calculated as a matter of interest. However, in the survey responses it was not always clear what specific activities or requirements were being referred to, as listed in table 7.12. Given this degree of uncertainty, as well as the wide variety of ‘other’ regulations mentioned by respondents, including sector-specific

regulations and regulations set at local and district level, average costs in respect of these regulations should be treated with some caution.

Table 7.11: ‘Other’ regulations – Rank order of most time-consuming and troublesome regulations

	Number of employees							Total
	< 5	5–9	10–19	20–34	35–49	50–100	100+	
	%	%	%	%	%	%	%	%
Local sanitary requirements	65	60	55	28	38	29	0	51
Public security requirements	46	37	35	17	0	12	15	32
Environmental regulations	6	7	30	22	31	24	31	15
Public meetings and related activities	21	10	15	11	8	18	8	16

Table 7.12: All firms – Compliance cost of ‘other’ regulations

	Mean	Median	Number of responses
Local sanitary requirements	141 239	18 000	85
Environmental regulations	1 750 018	350 000	22
Public security requirements	66 278	12 000	54
Public meetings and related activities	438 316	40 000	24
Developmental tax laws	21 600	24 000	5
NSSF ¹⁴	1 556 667	450 000	12
Health insurance and medical care	61 111	12 000	9
Education fund	7 000	6 000	5
Normal business costs	36 667	30 000	3
Insurance – undifferentiated	428 571	240 000	7
Other public authorities	3 833 750	815 000	8
Other	1 564 789	230 000	19
Total	15 844 276	13 823 000	

Cost of external services to deal with regulatory compliance

Regulations are often complex, and firms often need outside help in understanding and complying with them. Rwandan firms are no exception. Figure 7.21 presents the proportion of the total compliance costs for various types of activity, as paid to external agencies and consultants.

The extent to which businesses use external agencies to assist them in meeting their regulatory obligations is a useful indicator of the complexity of regulation, since business owners have felt it necessary to source expert advice and assistance to complete the necessary procedures. However, it is also likely to indicate the time-consuming nature of regulatory compliance – since even in the case of less complex

Interrupted business: down-time because of various official meetings

Businesses noted that the regulatory requirement to close their businesses on a regular basis creates significant costs in terms of down-time and lost business e.g. an afternoon every week for Gacaca, and attendance at local meetings or enabling staff to attend them. Some businesses noted that they are instructed to close their shops when there are meetings or visits involving district, local or higher government officials.

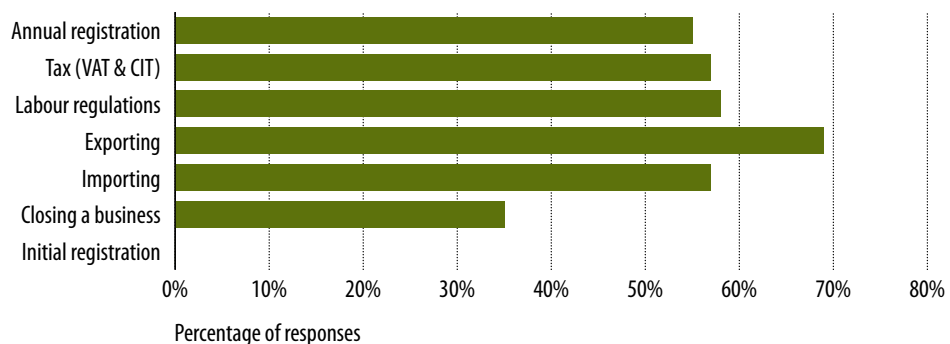
requirements, business owners might find that it is more cost-effective to pay an external person to spend the necessary time filling in forms, visiting different government agencies and waiting in queues, rather than doing it themselves or sending a member of their staff.

What is particularly striking is that in all cases, with the exception of initial registration and closing down a business, professional fees exceed internal staff costs incurred in complying with the regulations.

Rather oddly, perhaps, none of the respondents reported using external consultants for help with initial registration.

Participation in the export market requires the most external help, where almost 70 per cent of compliance costs are associated with external agency fees.

Figure 7.21: Professional fees as a percentage of total compliance costs



Endnotes

- 1 As noted in chapter 3, these costs will change from year to year, as regulatory requirements and administrative procedures evolve. The information provided by this study thus constitutes an important baseline against which future changes in compliance costs can be measured.
- 2 These estimates were obtained from the *Business Operators' Census Report* compiled by the PSF.
- 3 These 'additional regulation' are discussed further in chapter 7.

- 4 Rwandan GDP is taken from the Ministry of Finance and Economic Planning publication 'Economic Performance Indicators 2006 and Outlook 2007'. In this publication an estimate of 2007 GDP is given. This is then converted to 2008 GDP using the CPI.
- 5 Ministry of Finance and Economic Planning, *Budget 2008*, 'State expenditure per sector and sub-sector 2008–2010'.
- 6 We arrive at this figure by dividing the total by 27 047 (that is, the number of formal sector firms).
- 7 The list does not include district taxes, which are determined by the size of the company and district concerned.
- 8 The RRA currently operates across the four regions, with 12 sub-offices across the country.
- 9 According to information provided by the PSF, a study conducted in March 2008 of the time taken from arrival to removal of goods from customs control showed that there are delays at all stages of clearance processing, including customs operations, cargo handlers' operations, intervening operations, and clearing and forwarding agents' services. The mean time from arrival to release was 7 days, 2 hours and 2 minutes at land border posts; and 9 days, 1 hour and 47 minutes at the airport. From lodgment to release of goods it was 2 days, 23 hours and 37 minutes at border stations; and 3 days, 11 hours and 16 minutes at the airport. From release to the time when goods were removed from customs control it was 1 day, 2 hours and 8 minutes for border posts; and 15 hours and 16 minutes at the airport.
- 10 World Bank, *Doing Business Rwanda 2008*.
- 11 The questionnaire did not distinguish between the importation of necessary inputs for the business and importation as a function of the core business activity.
- 12 World Bank, *Doing Business Rwanda 2008*.
- 13 UNCTAD *Investment Policy Review: Rwanda*, 2006, Advance Copy.
- 14 Note that many respondents included NSSF under compliance requirements in respect of labour regulations but others, reflected here, included it under the 'other regulations' category.

Chapter 8

Variations in regulatory impacts

The regressive nature of compliance costs

Businesses of all sizes in the formal sector are often subject to the same sets of regulations, but smaller businesses are likely to feel the impact of compliance costs on their bottom line more acutely.

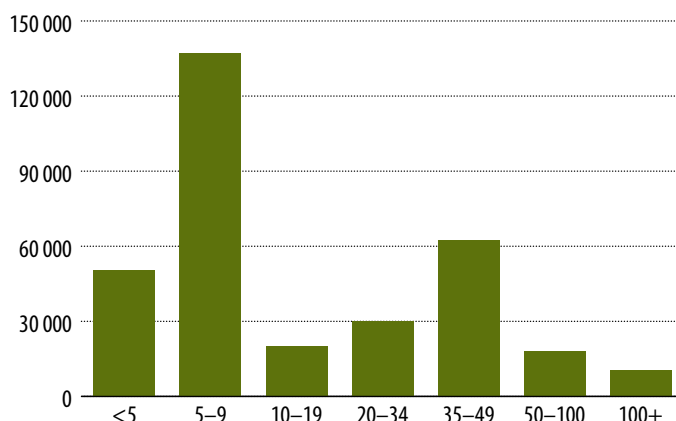
Regulatory compliance cost studies in other countries have shown that compliance costs are generally regressive, affecting smaller firms much more than larger firms. The survey results confirm that this is also the case in Rwanda.

There are economies of scale in regulatory compliance. Certain fixed basic costs, such as those for licensing or registration, are borne by all firms. Large businesses are better placed to absorb these costs, given their higher turnover. In addition, the burden of time and effort associated with meeting regulatory compliance requirements is more keenly felt in small firms, where the owner-manager is also often the book-keeper, form-filler, perhaps even the person who stands in the queue. Large firms are able to handle these compliance issues more easily by employing specialist staff at relatively lower costs to the overall salary structure of the business.

Annual licences and tax

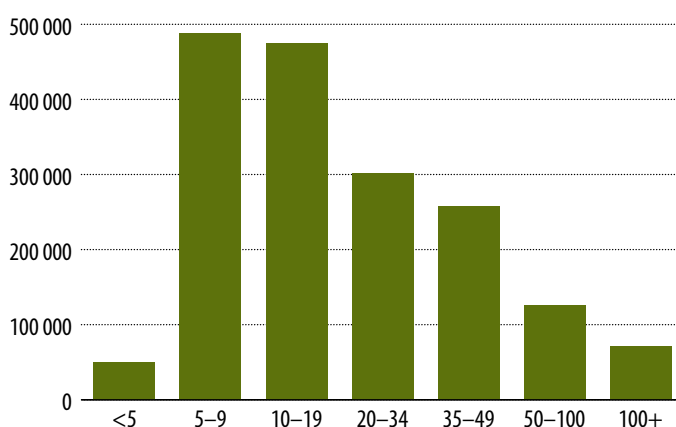
The regressive pattern of compliance costs is illustrated in figure 8.1, which shows the costs associated with obtaining annual registrations and licences for businesses of different sizes. Small businesses with 5–9 employees report much higher compliance costs per employee than businesses in other size bands – over twice that for firms with 35–49 employees, and twelve times the costs of the largest firms. However, it is important to note that in real terms, costs are much higher for the larger businesses.

Figure 8.1: Annual compliance costs for license renewal per employee



The regressive burden of tax compliance is also striking. Tax compliance costs are a relatively more important component of the regulatory burden for small firms than for larger ones. This is particularly significant in terms of lost business and the opportunity costs which smaller businesses carry in complying with tax regulations and making personal visits RRA offices.

Figure 8.2: Tax compliance costs per employee

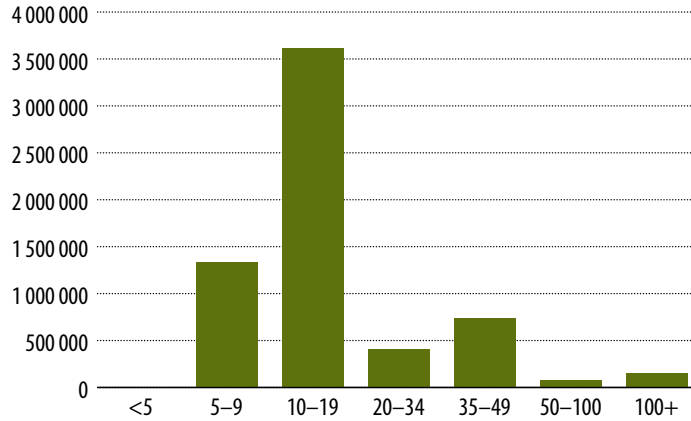


International trade, and doing business with government

The costs of engaging in international trade and providing supplies or services to government are less regressive. This is because the size of a firm is positively associated with exporting, importing and winning government contracts. Companies generally have to reach a certain size threshold in order to participate in these activities (and thus incur these costs). Smaller firms mostly do not engage in exporting activities; while the scale of importing activities tends to correspond with increasing firm size.

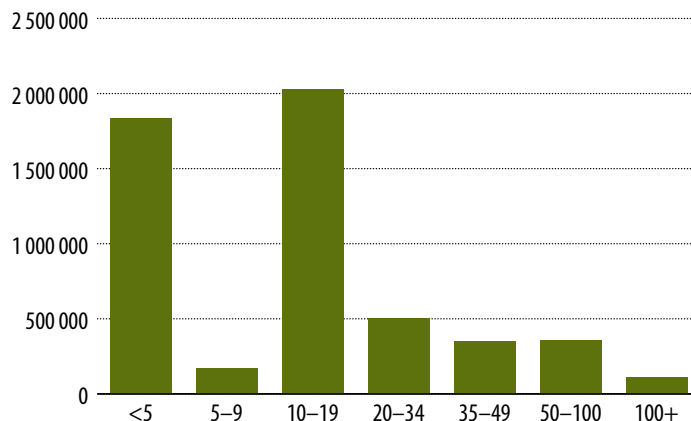
Thus the costs associated generally show an n-shape (since smaller firms are less likely to engage in these activities).

Figure 8.3: Compliance costs per employee – exporting



The compliance costs associated with exporting are very interesting. While micro-enterprises with fewer than five employees are unlikely to export at all, compliance costs are highest in the next two size bands. Businesses with 10–19 employees face considerably greater compliance costs than businesses in any other size band, and the second highest compliance costs are borne by small businesses with 5–9 employees. The finding that smaller businesses face far greater compliance costs per employee for exporting can be understood in terms of the costs of complying with paperwork and meeting RBS requirements. It probably also reflects the inability of smaller firms to carry the costs of delays created by administrative procedures. Clearly, this uncovers an important issue in the drive to expand exporting activities.

Figure 8.4: Compliance costs per employee – importing

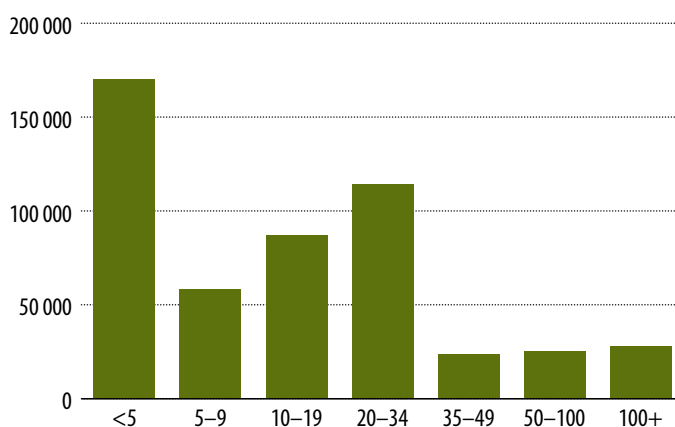


Similarly, compliance costs for importing are borne disproportionately by smaller businesses – micro enterprises with less than five employees and firms with

10–19 employees. While micro-enterprises are generally not involved in exporting activities, they do engage in *importing* goods – some of which may be fairly basic components in the production processes of these businesses. Given the high costs associated with importing reported by these businesses, it seems likely that the need to import key components squeezes the profit margins of the smallest firms very hard.

Figure 8.5 details the compliance costs of doing business with government. Significantly, these costs are considerably greater for micro-enterprises and other small enterprises. This can be understood in terms of the costs associated with complicated procurement procedures and the cost of the ‘man-hours’ involved in filling-in required documentation and meeting prescribed processes. Larger companies have established systems and structures within their organisations to cope with tendering procedures, and they report lower associated compliance costs.

Figure 8.5: Doing business with government: compliance costs per employee

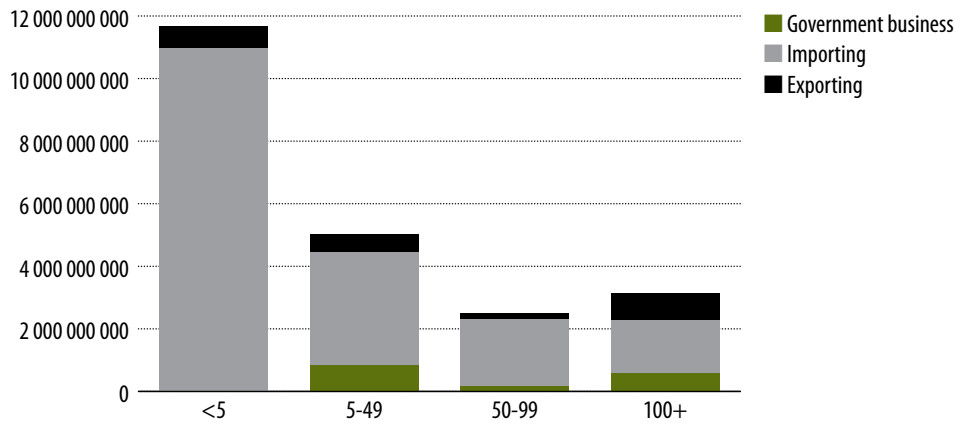


In calculating the aggregate costs for the economy represented by regulatory compliance in relation to exporting, importing, and doing business with government, it is necessary to take into account the number of firms in each category, and also to weight the results by the probability of firms in these categories engaging in these activities. Aggregate compliance costs are highest for firms in the smaller employee size bands. This is because all three of these activities, and particularly exporting, become more common once firms reach a certain size threshold.

The aggregate compliance costs associated with exporting in the 5–49 employee size band is of particular importance for a national growth strategy. These high costs are likely to prevent firms within this category from becoming successful exporters.

Figure 8.6 represents the aggregate compliance costs related to exporting, importing and doing business with government by firm size. Note that the figure *excludes* the costs of administrative delays associated with importing and exporting.

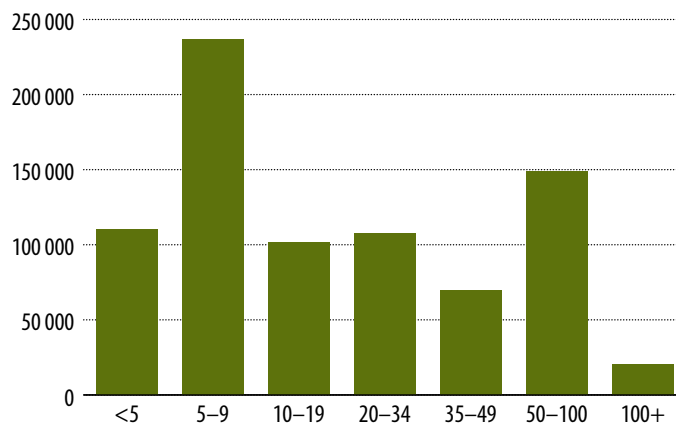
Figure 8.6: Importing, exporting, doing business with government: aggregate compliance costs per employee



Labour regulations

Figure 8.7 shows the contributions of labour regulations to total regulatory compliance costs by employment size band. The largest firms seem relatively untroubled by labour compliance costs – this probably reflects ‘economies of scale’ in dealing with labour regulations, with dedicated human resource staff members and structures to ensure compliance. However, the relatively high compliance costs for small businesses with 5–9 employees is striking. This may reflect a sharp increase in the compliance cost burden once firms grow large enough to be visible to the authorities, and have to formalise their human resource procedures and policies. Studies in other developing countries suggest the possibility that a significant proportion of businesses with fewer than 5 employees employ mainly family members and friends, and as a result may have a fairly informal approach to labour regulations.

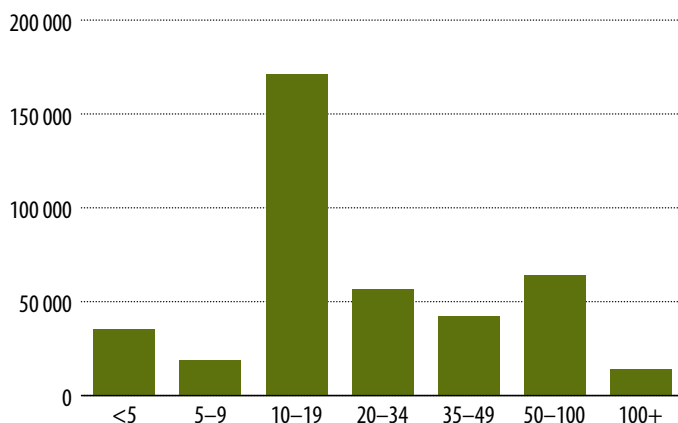
Figure 8.7: Labour regulations costs per employee



Total compliance costs per employee

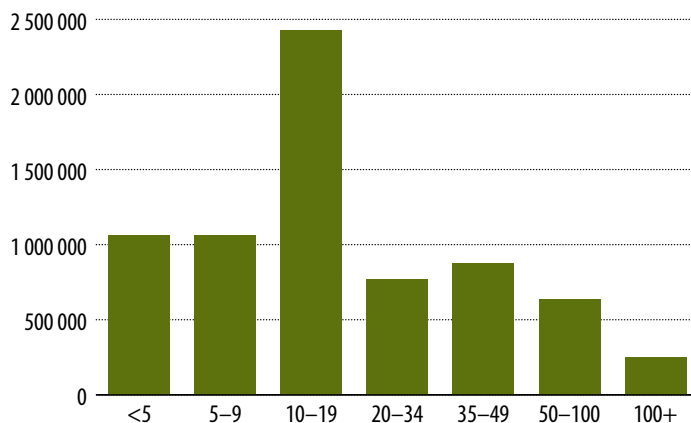
Over and above the costs dealt with in the preceding sections, respondents were asked to think about additional national level regulations that create compliance costs for their businesses, and to estimate the magnitude of these diverse costs. The results are presented in figure 8.8.

Figure 8.8: Other costs per employee



Finally, figure 8.9 shows the total compliance costs per employee as estimated by firms in the survey, by employee size bands.

Figure 8.9: Total costs per employee



Figures 8.1 to 8.9 tell a compelling story about the compliance costs for small businesses – especially those with 10–19 employees.

In most cases, the compliance costs per employee carried by smaller businesses are considerably greater than those borne by medium and large businesses – and in the case of initial registrations, tax compliance and ‘other’ costs, these differences are very large.

Compliance costs vary by location

The cost of regulation varies considerably depending on whether firms are located within or outside Kigali. Reported regulatory compliance costs in respect of export and import activities are higher for firms outside Kigali. In most other cases, the regulatory compliance costs reported by firms are higher in Kigali (both for the mean and per employee values).

Compliance costs vary by sector

The costs of complying with various types of regulation differ significantly among the sectors. This is driven by a number of factors including the size of firms within the sector, their geographical location, and importantly the interface between the type of activities engaged in by the sector and government regulation.

The cost estimates were standardized by the number of permanent employees and, in the case of exporting, importing and doing business with government, weighted by the number of firms participating in these activities. The figures give an indication of the average cost across all firms.

The impact that the costs associated with exporting, importing and government business may have in preventing or deterring companies from engaging in these activities was not factored into the estimates, given the difficulty of trying to calculate this (as noted earlier); but it should be borne in mind.

For the financial, tourism and professions sectors, regulatory compliance costs associated with tax make up the bulk of their compliance costs (between 60 and 70 per cent). Tax compliance also constitutes the largest proportion of costs for the commerce sector (close to 40 per cent).

In the services and industry sectors import compliance costs constitute the highest proportion of overall costs. The services sector includes various transport services such as bus services, airfreight, passenger airlines and courier services. Many of these operators need to deal with border control and customs on a regular basis. In addition, many of these businesses are likely to rely on high-value imported inputs such as vehicles, parts and computer equipment. As noted earlier, the manufacturing sector, which is a large component of the 'industry' sector, is also highly dependent on imported inputs, including raw material, machinery and electrical products.

In the agro-processing sector approximately 20 per cent of firms are exporters. Costs related to exporting are the largest category of compliance costs, and costs associated with delays in export shipments are the most burdensome. The high costs associated with exporting may possibly prevent other firms from entering the export market. These high export costs could have significant negative consequences, given the importance of agriculture for Rwanda's GDP and employment. They clearly constitute a barrier to both regional and international trade.

For agro-processing, the second largest group of costs is associated with tax compliance. Labour regulations also represent a large proportion of reported compliance

costs in this sector. While the costs associated with dismissing workers in the agro-processing sector are relatively low, firms reported generally high proportions of spending on external advisors – possibly suggesting a lack of capacity within businesses in the sector to deal with regulatory requirements in respect of labour issues, and/or a more complex labour regulatory framework governing the sector.

The fact that different types of regulatory costs constitute significantly different proportions of the overall compliance costs in the various sectors strongly suggests that more detailed sector-specific regulatory reviews may be advisable.

Perceptions of trends in regulatory costs

Respondents were asked whether they believed the costs of complying with regulations had increased or decreased for their businesses over the past three years. Figure 8.10 shows that 77 per cent of respondents said that compliance costs had increased over the past three years; 19 per cent felt that compliance costs had remained the same; and only four per cent felt that compliance costs had decreased over the period. Just under 70 per cent of respondents in Kigali felt that that compliance costs had increased over the past three years. The figure was higher for respondents in other provinces, with 80 to 90 per cent saying that compliance costs had increased. These are of course only perceptions, not hard data; but they are an important reflection of business people’s experience and their feelings about the regulatory environment in which they operate.

Figure 8.10: Perceived changes in compliance costs over past 3 years

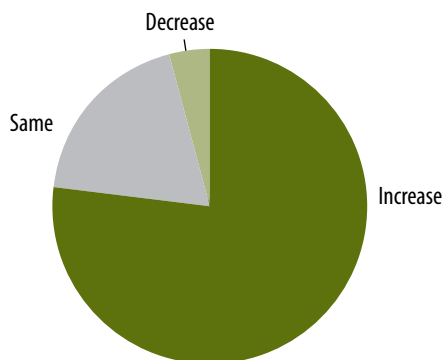
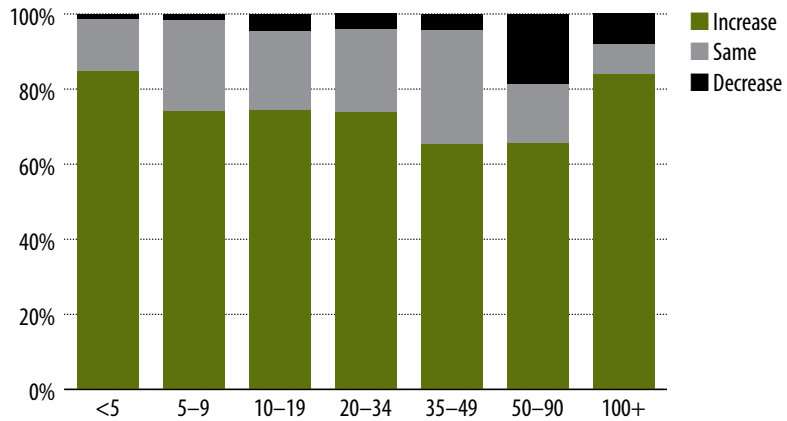


Figure 8.11 shows that firms of all sizes said that compliance costs had increased over the past three years. These findings are most notable amongst the smallest firms (less than 5 employees) and amongst the largest firms (more than 100 employees) where over 80 per cent of respondents felt that compliance costs had increased. By contrast, almost 20 per cent of respondents with 50–100 employees said that compliance costs had *decreased* over the 3 year period.

Figure 8.11: Perceived changes in compliance costs over past 3 years, by firm size



Respondents were also asked whether they expected the costs of complying with government regulations to increase, decrease, or stay the same over the next three years. The results are shown in figure 8.12. The large majority of respondents (71 per cent) expect compliance costs to increase, whereas 14 per cent expect no changes and 15 per cent expect a decrease.

Figure 8.12: Expected increase and decrease in compliance costs over next 3 years

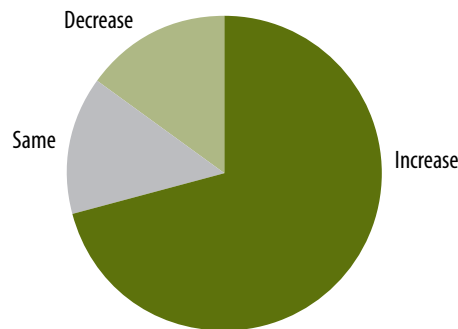
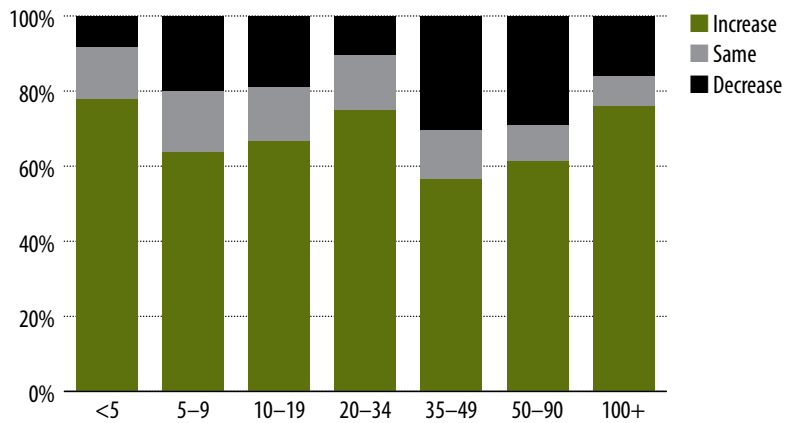


Figure 8.13 shows that expected increases in compliance costs are greatest among micro and large firms – presumably drawing on their experience of increases over the past three years, as shown in figure 8.11.

Figure 8.13: Expected change of compliance cost over next 3 years by firm size



Visible and effective efforts by the Rwandan government to reduce the burden of regulatory compliance and streamline administrative procedures thus have the potential to make a very positive impact on perceptions of the business environment on the part of both domestic and foreign investors and Rwandan entrepreneurs.

Section 4

Regulatory reform: issues and priorities



Chapter 9

Discussion and conclusion

Government initiatives to support business

The Rwandan government has made a firm commitment to building an enabling environment to drive economic growth and job creation, so as to reduce dependence on external aid while transforming Rwanda into a middle income country. A regulatory and administrative environment that supports the growth and diversification of the private sector is a crucial component in this effort. Targeted initiatives to reduce red tape and streamline administrative processes thus present an opportunity to accelerate growth and long-term development.

This must be seen in the context of Rwanda's Vision 2020 goals. These are, in the short term, to promote macroeconomic stability and wealth creation, with high levels of savings and private investment; in the medium term, to transform from an agrarian to a knowledge-based economy; and in the longer term, to create a productive middle class and foster entrepreneurship.

Business reforms led by President Kagame have already made Rwanda one of sub-Saharan Africa's top five performers, according to the World Bank's *Doing Business 2009* global report.

Good governance for sustainable development

'Rwanda is committed to establishing new management methods and strategies that we believe will spur the pace of good governance and sustainable development. A stable, transparent and predictable framework for business remains an important component of our government policy.'

H.E. President Paul Kagame, speaking at the *High Level Forum on Implementation of ICT Policy and Regulatory Reform*: a meeting organised by Comesa, the Economic Commission for Africa and the Government of Rwanda, September 2005.

Businesses' perceptions of positive support by government

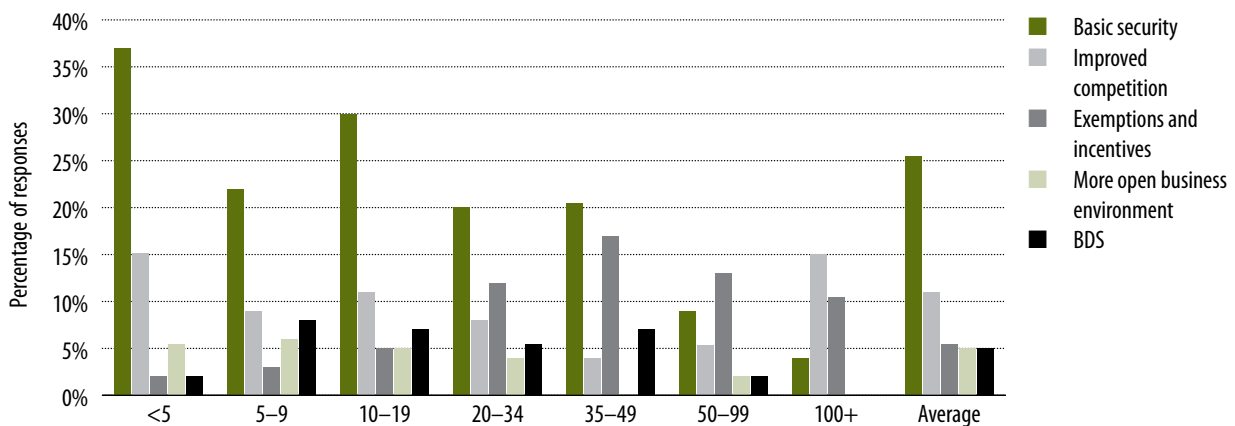
Respondents to the survey were asked to identify the most important thing that government has done in recent years to make it easier for businesses like theirs to operate. 'Improved security' was the spontaneous answer given by a quarter of the respondents (26 per cent), followed by greater competition in the economy and a more open business environment, tariff exemptions and incentives, the provision of business development services, and the development of RIEPA.

The top five government initiatives identified by respondents are shown in figure 9.1 analysed by firm size. The provision of security was much more significant for micro to medium firms than for larger businesses. Tariff exemptions and incentives were more likely to be recognised as a benefit by medium and large firms, which are better placed to access such initiatives.

Importantly, some government initiatives were identified only by large firms, with the result that they did not feature prominently in the sample as a whole. For example, 19 per cent of firms with 100 or more employees mentioned increased foreign direct investment. The largest firms, as well as businesses with 20–34 employees, were also more likely to mention RIEPA as an important initiative (12 per cent of businesses in each of the two size bands).

The smallest firms were least aware of government initiatives. Eleven per cent of businesses with less than five employees said that they were not aware of anything government had done to ease business operations (against a sample average of six per cent for this response).

Figure 9.1: Most important recent initiatives by government to ease business operations



The perceived importance of government initiatives varied considerably by province. Improvements in basic security were mentioned by two thirds of respondents (65 per cent) in the Western Province, about one third in the Southern Province (37 per cent), but only 17 per cent of respondents in Kigali. Eighteen per cent of respondents in the Northern Province mentioned improvements to infrastructure – compared to very small proportions in the other provinces. Thirteen per cent of

Working toward a single information portal: the Rwanda Development Board

The Rwanda Development Board (RDB) is a new umbrella agency¹ tasked with assisting entrepreneurs in various ways, including speeding up the process of registering and starting a business. The RDB will promote local and foreign direct investment by providing investment guidelines, analysing project proposals and following up on government initiatives.

Seven major foreign exchange-generating agencies will be merged to form the RDB. These include the Office of Rwanda Tourism and National Parks (ORTPN), Rwanda Commercial Registration Services Agency (RCRSA), Rwanda Investment and Export Promotion Agency (RIEPA), Rwanda Information Technology Authority (RITA), the Centre for Support to Small and Medium Enterprise in Rwanda (CAPMER), the Human Resource and Institutional Capacity Development Agency (HIDA) and the Privatisation Secretariat.

The RDB will be supervised by the President's office and headed by a Chief Executive Officer who will also chair its board and management.

The creation of the RDB is seen as crucial in helping Rwanda to secure investment, alongside the work being done to improve the business climate.

respondents in the Eastern Province, and nine per cent in Kigali, listed improved administration as a very important improvement.

Businesses' priorities for regulatory reform

Respondents were asked to identify the *single* most important thing that government could do to make it easier to comply with the regulations affecting their businesses.

Improvements in the **regulation and administration of taxes** comprised by far the most common set of responses – mentioned by 44 per cent of respondents. Comments included the need to reduce tax rates, stabilise taxes, and improve tax administration and collection processes – including arrangements for electronic payments, and easier access to RRA offices or alternative payment options, such as local banks.

The importance of easing tax compliance was ranked most highly among the micro-firms, where it was mentioned by more than half the respondents (53 per cent). It was also a priority issue for the small and medium firms in the sample. It was listed by 40 per cent or more of respondents in all size categories, with the exception of the largest firms (100+ employees), where it was mentioned by only a quarter of respondents. The importance of easing tax compliance was most strongly emphasised in the Southern and Western Provinces (mentioned by 56 and 53 per cent of respondents respectively).

Improvements to **import and export regulations** were prioritised by 20 per cent of businesses with 50–100 employees (against a sample average of four per cent).

Chapter 9

One fifth of all firms mentioned **general regulatory issues** – including reduction of compliance costs and red tape, improvements in respect of sector-specific regulations, improved information on regulatory requirements, improved administrative procedures, faster processing times and reduction in the cost of official documents. General regulatory issues were mentioned more often among the larger firms with 35 employees and above.

Other suggestions for regulatory improvements included simplification of tender processes, and changes to land ownership regulations.

Key issues in regulatory reform

Impediments to growth in the Rwandan economy arise from a range of factors, many of which are structural rather than regulatory issues. Lack of demand, lack of capital, high levels of competition, infrastructural challenges and skills shortages were identified by survey respondents as key constraints on expansion.

Businesses for the most part don't cite regulatory issues as the most important factor limiting their growth and profitability, but the survey results demonstrate that regulatory compliance requires a very considerable expenditure of businesses' resources. As seen in chapter 3, the staff time, administrative costs and consultants' fees involved in different aspects of regulatory compliance cost Rwandan businesses at least Rwf 55 billion during the 2007 financial year.

The survey results show very clearly that the burden of regulatory compliance acts as a disincentive to growth for individual firms. When firms were asked to identify the key constraints to business growth, regulatory requirements in respect of general regulations, tax requirements, administrative procedures and public meetings together accounted for just over 40 per cent of responses. Fourteen per cent of the largest firms surveyed (with more than 100 employees) specifically cited regulatory constraints as a factor discouraging them from increasing employment.

The implications for future economic growth and job creation are significant. Much will depend on whether businesses continue to operate under the burden of red tape, or are able to benefit from streamlined and efficient regulatory processes that enable them to deploy their resources more productively.

Businesses identify tax and customs procedures as priority issues

The priority regulatory concerns identified by business in the survey, and confirmed by the analysis of compliance costs, are **tax compliance**, and regulations and administrative procedures associated with **importing and exporting**.

The largest component of tax compliance costs is made up of costs associated with **VAT compliance** – both internal staff costs and the costs of external accountants, advisors and consultants. Complying with corporate income tax (CIT) is also a significant cost for businesses, as are costs associated with preparing for and undergoing audits.

A particularly problematic area for VAT compliance is the requirement that businesses pay VAT as soon as an invoice is issued, in advance of receiving payment from the recipient of goods or services. There is often a considerable delay between paying VAT and receiving payment from the customer, creating cash flow problems, particularly for smaller businesses.

A very significant component of tax compliance costs results from **administrative inefficiencies**. The administrative process for tax collection requires business people to make time-consuming, in-person payments at RRA offices – taking them away from their businesses to stand in long, slow-moving queues. Businesses also complain about a lack of predictability and consistency. They say that requirements and processes within the RRA offices can change from one visit to the next, sometimes depending on the particular official with whom one interacts. For businesses outside Kigali, it would appear that the transport and time costs involved in reaching RRA offices on a monthly basis present a significant burden.

These inefficiencies can be addressed by improving the interaction between the RRA and the tax payer and ensuring that procedures work effectively, without necessarily involving any changes in policy or the relevant regulations.

The RRA has already taken some steps to improve outreach, and has increased the number of decentralised offices in the provinces. There are also plans to implement online tax filing, which will certainly be of great benefit to many firms. Many of the larger businesses surveyed look forward to online filing saving their businesses considerable time and money by streamlining the compliance procedure. However, while online filing is likely to make a very positive difference for businesses with internet access, few of Rwanda's very numerous small businesses are likely to be able to access this benefit – hence the importance of other measures such as opening up payment options at local banks.

Given the strongly regressive costs of compliance² creative approaches will be needed to improve outreach to small businesses in particular, ensuring predictability and consistency in general, and minimising the time required to complete regulatory obligations as far as possible. According to the survey respondents, this could include relatively simple steps such as reducing the need for in-person visits as far as possible, seeing that the relevant forms are available well in advance, ensuring that staff members are trained to be helpful and courteous, and communicating changes to tax regulations clearly and effectively.

For businesses engaged in **importing and exporting activities**, compliance costs associated with these procedures, together with tax compliance, account for almost 90 per cent of the red tape costs identified by these firms. These findings are corroborated by recent research conducted on behalf of the Government of Rwanda, which found that regulatory requirements on import and export document preparation and customs clearance raise import costs by 12 per cent and export costs by 18 per cent, compared with what the costs would be if regional best practice were applied.³ Administrative inefficiencies are even more apparent as a factor in the high level of compliance costs for import and export activities. A large proportion of these costs arise from delays attributed to customs officials, or the RBS. A related concern

is the perceived lack of consistency and predictability in the application and enforcement of regulatory requirements. Recent studies confirm the severity of the problem – procedural obstacles have been found to account for up to half the time that goods are in transit, while the unpredictability of delays at each stage adds to the costs borne by businesses.⁴

The survey results suggest that a targeted review of procedures associated with import and export activities would be valuable. Key steps toward reducing the frustration and compliance burden for businesses would be to identify the reasons behind delays, with a strong message to customs staff about the need to improve the efficiency of the administrative processes.

Regulatory compliance is easier when appropriate information is readily available

Access to information needs to be easier, particularly for small firms. The extent to which firms admitted to a lack of understanding of applicable rules and regulations, and expressed concern at the wide range of these rules and the effort involved in keeping up with changes, points to the need for improved coordination among the various government departments and statutory bodies responsible for enforcing regulations. This includes improved communication at the industry and sub-sector level.

The regulatory burden affects businesses of all sizes

The argument for reducing compliance costs applies across the economy. Large businesses are key drivers of economic growth, but carry a heavy burden in terms of average compliance costs. These resources could potentially be more productively spent on expansion and diversification of activities. The economic rewards of reducing the compliance costs and administrative delays experienced by larger firms are likely to be reflected in making Rwandan products more competitive outside the country, and in the prices paid by Rwandan consumers.

Smaller businesses provide crucial entry points into the formal economy and can potentially absorb a large percentage of the working-age population into the labour force. The findings of the study clearly demonstrate that smaller firms experience a greater compliance cost burden in relation to their overall turnover. As with larger firms, simplifying and streamlining the compliance regime would release resources which could be spent more productively, not least on increasing employment. Furthermore, the costly administrative delays associated with exporting may well be a disincentive for smaller firms to explore business opportunities.

Regulations impact on skills transfer

Rwanda's skills deficit emerged as a key concern among businesses. The problem is borne out by the findings of other recent research.⁵ Experience in other countries shows the value of tapping into big business (including foreign-owned firms) as a positive source of skills transfer. This requires engaging with big business to find out what skills local industries require, while ensuring that the regulatory environment facilitates the entry of skilled foreigners, with mechanisms to encourage the transfer of skills.

While the process of acquiring work permits is straightforward, and there are strong intra-governmental relationships to facilitate the process,⁶ businesses complain about the high costs of work permits, the need for annual renewals, and the three year limit on renewals. The latter restriction may well entail a loss of experience, skills and intellectual capital for businesses at the end of the contractual period.

The regulatory environment impacts on formalisation and business growth

Many developing economies, more particularly those in sub-Saharan Africa, suffer from a 'missing middle'. The term refers to the lack of a core of growth-oriented small and medium businesses that, in a fully developed economy, fill the space between large firms on the one hand and micro-enterprises and survivalist and informal sector businesses on the other.

Locally-owned and growth-oriented SMEs are a crucial component in private sector growth and development. They act as sub-contractors to locally-owned and foreign-owned larger firms, and play an important role in developing locally based supply chains. A shortage of these SMEs requires big businesses to source their inputs and supplies from other countries, or from one another. This practice limits the integration of foreign-owned businesses in the local economy, and restricts the multiplier and spill-over benefits of big business activities for the local economy. This in turn limits the developmental impact of foreign investment – including wealth creation, employment opportunities, and improved local capacity – and can create significant tensions with local communities.

Developing the 'missing middle' requires low barriers to formalisation as well as sources of support for aspirant entrepreneurs. Recent studies have shown that the development of entrepreneurship and small-scale local business is weak in the African context. Part of the problem is the extent to which regulatory requirements (together with limited access to finance) have a disproportionately negative impact on micro and small enterprises. A FIAS study, for example, identified high taxes and high administrative costs associated with tax compliance, lack of information on formalising, and the high cost of obtaining all the necessary licences required to formalise, as key factors keeping firms in the informal sector.⁷

The opportunity to operate in the formal sector *should* offer small businesses improved access to markets, protection from harassment by officials, and improved opportunities to access suppliers and sources of finance – all of which are important

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to business growth. In general, the best way to grow the number of small businesses in the formal sector is to improve the business environment, reduce regulatory compliance costs, and support growth-oriented small businesses to expand and diversify their activities.

Regional integration initiatives underline the importance of trade reforms

Rwanda's entry into the East African Community presents a number of challenges and opportunities for the country, and highlights the need for the competitive placement of the country's businesses and products within the region.

As this study has shown, delays in exporting or importing goods have significant costs for businesses involved in these activities. Administrative barriers experienced at ports of entry and exit harm the ability of Rwandan firms to compete effectively for regional and international markets – and unnecessary importation costs are ultimately carried by Rwandan consumers. The efficiency with which businesses interact with Customs has substantial economic consequences for the economy more broadly. Suggestions gathered from surveyed firms for improved customs administration include:

- Improved access to information for importer/exporters
- Reduction of unnecessary delays in processing shipments
- Online information exchange with Kenyan/Tanzanian authorities to minimise the need to re-capture product information at each port or border crossing
- Rwandan customs clearance at the African port of arrival.

Interaction between government and business supports regulatory best practice

President Kagame has repeatedly stressed the need for collaboration between government and the private sector to attain Rwanda's development goals.

Experience in other countries shows that effective engagement between business and government in regular, structured forums, is a central component of improved regulatory practice. Efforts to improve the regulatory environment need to tap into local and international businesses' knowledge and experience of operating in the country. This requires effective dialogue between government and business to identify concerns and mutual priorities, and develop interventions that are capable of making a real impact.

A number of countries have demonstrated the benefits of high-level working groups that draw together government and business representatives on a regular basis, to address specific issues and work together to develop appropriate solutions. Such structures should be positioned to attract high-level participants from both the public and private sectors, with business interests represented by broad sectoral or multi-sectoral associations.

Taking the process forward

This study of businesses' experience of regulatory compliance costs and administrative burdens has identified a number of key issues, and provides a strong evidence base for constructive debate between government and business stakeholders.

The study is a diagnostic tool – highlighting issues that present themselves as priority areas for action, including the need to:

- Improve the efficiency and predictability of administrative processes associated with tax compliance. It will be important to look for ways to simplify procedures, reduce the need for in-person interactions between businesses and the authorities, make requirements easier to understand
- Review VAT regulations and the impact of advance payment of VAT (at the time of invoicing) on cash flow, particularly for smaller firms
- Review administrative processes associated with importing and exporting activities, to improve efficiency and reduce delays
- Review regulatory requirements related to work permits with a view to encouraging the acquisition and transfer of skills
- Develop the 'missing middle' by minimising regulatory disincentives to small business growth
- Ensure effective dissemination of regulatory information, recognising that businesses of different sizes and in different locations require different types of information dissemination
- Expand mechanisms for effective interaction and dialogue between business and government to help improve regulatory practice.

The study also provides a baseline – a snapshot of business people's experience of the regulatory burden at a specific point in time, namely mid-2008. Follow-up studies can be conducted in due course, both economy-wide and in specific sectors or regulatory areas, to measure changes against the baseline and assess the impact of regulatory reforms. The level of detail contained in the baseline report will allow for robust analysis of shifts in regulatory patterns and the impacts on businesses over time.

Endnotes

- 1 The Bill setting up the RDB was approved in July 2008.
- 2 The total costs associated with complying with tax regulations are approximately 1.5 times higher per employee for firms with less than 20 employees compared to firms with 20–35 employees.
- 3 Sources of and obstacles to economic growth in Rwanda: An analytical overview, Discussion Draft for Working Meeting of 30–31 Jan 08 (Revised 13.02.08).
- 4 Ibid.
- 5 Cited in UNCTAD *Investment Policy Review: Rwanda*, 2006, Advance Copy.

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- 6 Between the Department of Labour, the Department of Immigration and Emigration, and RIEPA.
- 7 *Designing a Small Business Tax System that Enhances Growth: Lessons from Africa*, Richard E. Stern, Paul A. Barbour, FIAS, World Bank Group, December, 2005.

Appendices



Appendix 1

The survey

The study was undertaken over three inter-related phases, commencing in December 2007:

- Conceptualisation, and development of survey instruments
- Fieldwork and data capture
- Analysis, reporting and dissemination of findings.

Project reference group

From the outset it was recognised that it would be vital to secure the involvement and support of business and government stakeholders at an early stage, for the project to lead to systemic reform of the business environment. A project reference group was established to provide guidance and input to the study. The reference group was chaired by Mr Emmanuel Hategeka, Secretary General of the Private Sector Federation. It included representatives of the PSF and GtZ.

The reference group met several times during the course of the study, and provided guidance and input in respect of the methodological approach; the scope of the study and the survey instrument; and the interpretation of the findings.

Conceptualisation and development of survey instruments

Initial research to inform the design of the survey began in December 2007. Between December 2007 and March 2008 the project team held a number of meetings with the project reference group and other key stakeholders. A desk review of existing research on the regulatory and operating environment in Rwanda was also undertaken, to provide contextual information and inform the process of questionnaire design and sampling.

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In early February the PSF hosted a stakeholder workshop with national government officials and key business representatives, to present the project objectives and methodology, and invite stakeholder feedback. The workshop also provided an opportunity to gather input from government and business about their priority concerns, in order to ensure that the research outputs would be useful in the context of the government's agenda for private sector growth and economic development.

Discussion following the presentation raised a number of priority issues for business, and provided useful inputs to design of the questionnaire and the sampling process. The survey questionnaire and sampling framework were finalised in consultation with the project reference group.

The sample

The survey covered a sample of 403 businesses in the formal sector. Given the small size of the formal sector in Rwanda, the sample was sufficient to provide a representative picture of regulatory and administrative challenges facing firms of different sizes. The survey covered all of Rwanda's four provinces and Kigali City, and included large urban developments and smaller towns.

The focus of the survey was on formal sector enterprises. The study deliberately excluded informal enterprises. This decision was made primarily in light of recent studies which have looked in depth at the informal economy.¹ It must be noted that the status of 'informal' businesses in Rwanda is somewhat unusual, in that the large majority of businesses are registered at least at district/municipal level – which creates some definitional complexities.

The Rwanda Revenue Authority generously agreed to share its databases of large and medium sized business taxpayers with SBP, for the specific purpose of informing the survey sampling framework. The data lists included large and medium businesses in each of the five provinces.

A purposive sample of 276 large and medium businesses was selected from the RRA lists – ensuring appropriate coverage across provinces and sectors. The sample of 127 smaller businesses was randomly selected, while also ensuring an appropriate regional spread.

The survey covered all sectors of the economy, including manufacturing, construction, trade (including retail) and services. Table A1.1 provides an overview of the sampling framework.

Table A1.1: Sampling framework

Total sample size		403	
<i>Consisting of:</i>			
Total by business size		Total by province	
Large and medium businesses	276 (68% of sample)	Kigali	204
		Northern Province	15
		Southern Province	20
		Eastern Province	21
		Western Province	16
Small businesses	127 (32% of sample)	Kigali	32
		Eastern Province	24
		Western Province	24
		Southern Province	23
		Northern Province	24
Total businesses sampled in Kigali		236 (59% of sample)	
Total businesses sampled in 4 provinces		167 (41% of sample)	

Large and medium businesses

According to data supplied by the Rwanda Revenue Authority, the population of large firms in Rwanda numbers 289, while medium sized businesses number around 2 500.

A sample of 276 large and medium firms was drawn for this study. The RRA differentiates between large and medium businesses in Kigali City – with 209 large businesses listed in Kigali City, and around 2000 medium sized businesses.² In the provinces, however, the differentiation between large and medium businesses is less pronounced. Many of the largest businesses in the provinces are in fact ‘medium sized’ when compared to the Kigali sample. The RRA therefore supplied a list of the 30 largest businesses in each province, and the sampling framework used a single category of ‘large and medium sized businesses’ for the purposes of sampling.

The distribution of the sample of large and medium firms between Kigali City and the provinces reflected the concentration of larger businesses in Kigali, as per the RRA lists. Thus, of the 276 large and medium businesses sampled, 204 were located in Kigali City, and between 15 and 21 in each of the four provinces.

Within Kigali City (204 businesses), the sample was concentrated in the districts of Nyarugenge, Gasabo and Kicukiro, all of which show significant concentrations of large firms according to the RRA database. Sectors represented within the Kigali large and medium business samples included:

- Agro-processing
- Banking and finance
- Industry (including manufacturing, construction, pharmaceuticals, petroleum/energy, and mining)
- Retail

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- Service providers (such as garages, cleaning services, clearing and forwarding agents, and professional services, transport-related services such as freight companies, airlines, tour and coach operators, hotels and restaurants, telecommunications and ICT providers)
- Media companies
- General commerce.

In order to draw a representative sample of large and medium firms in the Southern, Western, Northern and Eastern provinces, SBP worked with the RRA to identify the largest businesses in each province.

While some large businesses such as tea or coffee plantations were included despite being outside major centres, the sample for the most part concentrated on the districts and sectors in each province shown in table A1.2.

Table A1.2: Large and medium business sample – locations and sectors

Province	Districts	Sectors
Northern Province (15 businesses)	Gicumbi (Byumba); Musanze (Ruhengeri)	Agro-processing Construction General commerce Industry Services incl. tourism
Southern Province (20 businesses)	Huye (Butare); Muhanga (Gitarama); Gikongoro	Construction General commerce Industry incl. petroleum Services incl. tourism
Eastern Province (21 businesses)	Ngoma (Kibungo); Nyagatare (Mutare); RwamaGana	Agro-processing Banking and Finance Construction General commerce Industry Retail Services
Western Province (16 businesses)	Rusizi (Cyangugu); Rubavu (Gisenyi)	Agro-processing Banking and Finance General commerce Industry (incl. mining) Retail Services incl. tourism

Small businesses

The survey covered 127 small businesses. As far as SBP is aware, there is no reliable list of small businesses from which to draw a representative sample. Small businesses were thus selected using cluster sampling in specified locations. Table A1.3 indicates the precise locations within which cluster sampling was undertaken.

Table A1.3: Locations selected for cluster sampling of small firms

Province	Towns	Businesses per location
Kigali City	Nyarugenge	19
	Remera	13
Western Province	Rubavu	12
Agro-processing, brewery, cement factory, tourism	Rusizi	12
Northern Province	Gicumbi	12
Retail (food & manufactured products), mines, quarries, transport, tourism	Musanze	12
Southern Province	Huye	12
Agro-processing, commerce, mines, services, manufacturing, transport and communication	Gikongoro	11
Eastern Province	Rwamagana	12
Agriculture and agro-processing	Kayonza	12

Efforts were made to ensure representation of an appropriate cross-section of sectors in each location. Within each site, areas were selected in which to conduct a random selection of interviews. The sampling interval varied according to the apparent concentration of businesses in the area, and according to the general geographical spread of the settlement. In small centres enterprises were randomly selected across the whole community. In larger commercial centres, the sample was clustered according to concentrations of small business. Businesses were randomly selected in these sites. Where a large concentration and range of businesses exists, specific areas were purposively selected to ensure that a broad variety of businesses are included.

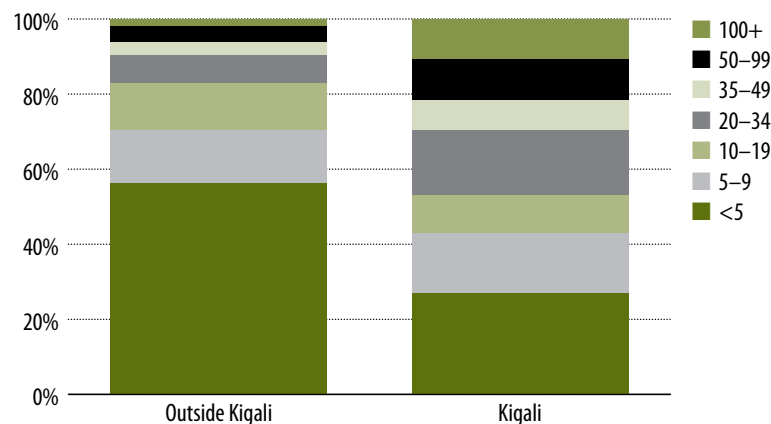
Businesses operating from collective sites or multi-occupancy sites (such as markets) were not included in the sample.

Distribution of sampled businesses by size

As can be seen in figure A1, the majority of micro firms included in the sample were located outside Kigali, while larger firms sampled tended to be concentrated within the capital city. This distribution pattern is broadly representative of the distribution of businesses by size in the overall economy, as reflected by the RRA data.

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Figure A1: Sampled businesses, by number of employees and location



Fieldwork, data capture and validation

The total sample of 403 businesses provides a sound statistical base for in-depth analysis.

Perhaps the most important challenge encountered in conducting the survey were the linguistic issues involved in moving between English, French and Kinyarwanda in administering the questionnaires and translating questions and responses. This required close liaison and consultation between SBP, and the Fieldwork Manager and his survey team.

Fieldwork

The fieldwork took place during April and May 2008. In-depth interviews were held with business owners or senior managers. Trained interviewers visited businesses personally, in order to secure a high response rate and to ensure that all questions and issues were clearly understood by the respondents. Multiple contacts were often required with large and medium sized business to enlist co-operation, prepare respondents for the information required and confirm appointments.

Because each aspect of costs is based on a complex pattern of direct and indirect impacts, respondents were asked for *estimates* of the order of costs, rather than for exact costs.

Data capture and cleaning

Initial data capturing and cleaning was undertaken by a team of data capturers in Rwanda, under the close supervision of the Fieldwork Manager, in late May. All responses were captured in a spreadsheet designed by SBP. The electronic data file was thereafter extensively checked by the SBP research team, against the original paper copies of the questionnaires, to verify the accuracy of the data entry and identify any anomalies.

There is an inherent challenge in any survey of correctly sorting and coding individual responses, and allocating the data to appropriate categories for analysis. For example, sometimes there appeared to be overlaps between regulatory categories and the associated cost estimates; or reported costs that did not stem from official requirements; and costs that appeared to be unique to a certain area or district. These inconsistencies were removed or corrected wherever possible.

Validation process

During June and July, SBP undertook an extensive data validation process. This included a series of in-depth qualitative interviews with senior representatives of ten selected large and medium businesses in Kigali, as well as the Rwanda Revenue Authority and Rwanda Investment and Export Promotion Agency.

These interviews served to validate and clarify a number of issues emerging from the survey. The interviews were semi-structured, and probed key issues and concerns emerging from the quantitative study in greater depth. They also explored in more detail the specific logistics and processes associated with particular compliance processes that the survey had indicated as being particularly cumbersome.

In addition, the information gathered from the interviews provided a number of short case studies which are included in this report, providing illustrative examples of the challenges facing business as identified by the survey.

Validation workshops

In October 2008 the Private Sector Federation hosted a validation workshop in Kigali. SBP presented the initial findings of the survey to a variety of stakeholders from government and business. Government representation included the Rwanda Revenue Authority, MaGerRwa, and the Rwanda Investment and Export Promotion Agency. The workshop provided an opportunity to set out the methodology, and to contextualise and discuss the most significant findings that emerged from the survey.

A further internal validation workshop was held with the PSF in late November, at which the draft report was discussed in detail.

Endnotes

- 1 For example, the *Rwanda Informal Sector Survey 2005-6*, conducted by the World Bank, INSR–NISR and Ministry of Finance and Economic Planning, covered 64,500 enterprises.
- 2 Note that this total includes public institutions and organisations such as schools, hospitals and political parties, which were not included in the business sample for the purposes of this survey.

Appendix 2

Regulation, red tape and economic growth

This appendix sets out a framework for understanding regulatory costs and benefits in some depth, and describes effective tools to reduce the compliance burden.

The regulatory environment is a key factor for growth and investment

Efforts to create a better business environment are ultimately driven by the goal of promoting long-term economic growth. Research and experience on a global level have resulted in a broad consensus about what has supported sustained economic growth in the past and what is likely to create favourable conditions for future growth.

No combination of institutions and policies can be guaranteed to create long-term economic growth, but there is broad agreement on the main ingredients:

- The operation of markets, specialisation of labour, pursuit of comparative advantage, and accumulation of capital (all of which drive increases in incomes per head)
- Technological, managerial, and institutional advances that increase efficiency
- Political, legal and market institutions that guarantee the rule of law, protect private property rights and ensure enforceability of contracts
- Strong and stable government, disciplined macroeconomic management, high national savings rates, and the pursuit of universal literacy and numeracy, which have been seen to precede and accompany rapid growth in the East Asian experience
- A supportive regulatory environment, and appropriate incentives that encourage entrepreneurs to take risks and expand their businesses.

If a country wants to grow, it must make itself attractive to private business, and foreign and domestic investors. This may range from improving infrastructure to developing more sophisticated industrial and trade policies, cutting red tape and raising regulatory quality.

Economic and social regulation

There are two broad categories of regulation: economic and social. Economic regulation is designed to alter the ways in which markets work. It does this by creating rules about what prices can be charged, influencing the number of firms in an industry, or trying to influence the ways in which firms function – for example, regulations governing company registrations or that set minimum standards.

Social regulation is generally intended to protect public interests such as health, safety, the environment, public order, and social cohesion. Although social regulation aims to change non-economic behaviour, it often has major economic effects.

The goals of regulation

Regulations are made in an effort to solve social and political problems or to achieve policy objectives that unregulated markets or unregulated social structures may be unable to address. For example, the market price of health care may be too high for a large proportion of the population, requiring regulation to ensure that more people are able to access health services. Similarly, highly competitive and unregulated retailers may be inclined to lower the quality of their goods in order to cut costs, potentially threatening public health, with the result that regulation is needed to protect public safety.

Free market enthusiasts have argued that regulation inevitably produces worse outcomes than unregulated competition and trade. This belief is based on scepticism about government's ability to intervene effectively in markets, and the idea that free markets can produce 'Pareto-optimal' outcomes. Neither is a strong argument. Scepticism about government capacity is often warranted, but the evidence simply does not support total disbelief in the value of government intervention.¹

It is now almost universally accepted that, when left to their own devices, unregulated markets do not necessarily create desirable outcomes. This view has been greatly strengthened by the global economic crisis experienced in 2008. Economic regulations are needed because they enable governments to help markets to function more effectively and responsibly, and to meet society's economic and development goals. Table A2.1 lists some of the main types of 'market failure' which economic regulation aims to address.²

There are also strong social reasons for regulation that go beyond economic considerations (or at least short-term economic considerations). These include regulation to increase the consumption of 'merit goods' such as education and health care, and to reduce the consumption of 'demerit goods' such as tobacco and alcohol.³

A crucial social justification for regulation is the need to make the distribution of goods, services, income, and wealth fairer. Redistribution has been an important reason for state intervention in both developing and developed economies. This may take the form of wealth redistribution, through intervention in private property rights, or income redistribution.⁴

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Regulation may also be required in the event of ‘regulatory failure,’ that is, when existing regulation is failing to create an acceptable market outcome or equitable resource distribution, and new regulation is required to improve the market outcome or to create a more equitable and sustainable distribution of income and wealth.⁵

Table A2.1: Regulation of market failure

Type of market failure	Likely problems	Regulatory mechanism to address problems
Monopoly/ lack of competition	High prices, poor service, lack of innovation	Competition laws, industry regulators
Asymmetrical information (producers/retailers have information which is not available to consumers)	Producers have incentive to sell poor-quality goods/sell goods at inflated prices to unaware consumers	Quality standards and inspections, labelling requirements, right to return unsatisfactory goods
Externalities: indirect costs of production, unintended side-effects resulting from production practices (often with wide-reaching effects)	Destruction of natural resources, pollution	Fines and fees imposed by government, taxes, enforceable property rights
Coordination problems	Change requires many actors to agree on one coordinated decision – e.g. whole sector must stop production and retool	Government regulation imposes a decision
Free-rider problems	Not enough people are willing to pay for a good because they think other people will cover the payment – e.g. not paying security costs because ‘everyone else will’	Government imposes a compulsory charge
Race to the bottom as competition encourages firms to cut costs to attract customers	May compromise employee health and safety/ quality of goods offered to consumers	Government regulation imposes minimum standards

Benefits and costs of regulation

Regulations create major benefits as well as costs. Regulations can have a wide range of positive impacts on markets and existing social structures. These benefits include, but are not limited to:

- Safer and higher-quality products and services
- Lower prices for goods and services produced in competitive markets
- Better access to health and education services for poorer people
- Safer working conditions and better wages for those in employment
- More innovation, which has positive effects on growth
- A more stable business environment, which has positive effects on investment – both domestic and foreign

- Improved ability to gather information to inform economic and development strategies and inform allocation of resources
- Less pollution, less pressure on natural resources, better environmental sustainability.

In principle, it would be preferable to try to determine *net* regulatory costs. Nevertheless, at least to begin with, it is appropriate to focus research effort and advocacy on regulatory costs alone for three main reasons.

First, the benefits of regulation tend to be reasonably well understood and transparent – everybody can more or less see what they are and who they benefit. Regulatory costs are far less transparent, and there is often considerable confusion about who pays them in practice.

Second, regulatory benefits are very diverse and not necessarily quantifiable. The costs of regulation, on the other hand, and specifically the compliance costs of regulation, lend themselves relatively easily to an estimation of monetary value.

Third, reducing regulatory costs can in itself bring very real benefits both immediately and in the longer term.

Because regulatory costs are often less obvious than benefits, there has been a strong tendency in many countries for regulatory costs to increase steadily. The increasing complexity of modern economic activities, rapid technological advances and changing social relations have impelled governments everywhere to regulate more and more extensively. Voters in turn often bring pressure to bear on governments to regulate in ways that seem to have the potential to protect jobs, safeguard health and safety, protect pensions and savings, increase fairness or redistribute benefits. No matter how laudable the various intended objectives may be, it is crucial that the costs associated with achieving them are understood and can be justified. A failure to understand these costs can create serious unintended consequences, with potential negative impacts on particular social groups or economic sectors.

Groups with vested interests in particular regulatory issues may include producers, retailers, employers, trade unions, consumer associations, external interests such as international bodies, and even government itself. An understanding of the costs of regulation and the distribution of the burden across different interests is crucial in weighing up the motivations of different interest groups and the strength of their respective positions. Each group is likely to seek different benefits from a regulatory proposal, but may be unaware of, or choose to overlook, the costs that will be incurred by firms, and ultimately end users, as a result of compliance requirements and efficiency impacts. Particularly in cases where the benefits of regulation are concentrated on a specific group, it is important that the costs to the economy and/or society more broadly are recognised and justified.

We therefore argue that it is crucial to develop a well-grounded understanding of regulatory costs, both qualitative and quantitative, even where the equivalent quantitative information about the benefits of regulation may not be available.

Why it is important to cut red tape

The cumulative impact of the regulatory environment is an important factor in determining a country's overall economic and development prospects. The survey results presented in this report clearly demonstrate that regulations impose significant costs on firms, and on the Rwandan economy as whole. The resources spent by businesses on regulatory compliance represent real time and money that could be employed in other, more productive ways. The evidence, in line with studies in other countries, shows that various features of the regulatory environment discourage business growth and job creation in the formal economy.

High regulatory costs also keep emerging enterprises out of the formal sector.⁶ Where compliance costs are high and the benefits of regulation are small or doubtful, informal enterprises have little incentive to formalise. The benefits of formalisation, such as secure property rights, access to legal protection and access to finance, are perceived to be outweighed by the time and costs associated with regulatory compliance and the uncertainty that promised benefits will materialise. Easing the path to formalisation for small businesses is thus not only a matter of reducing regulatory costs, but also improving regulatory quality as applicable to the smallest firms in the economy.

The socio-political costs of reforming the regulatory environment need not be high, as long as the focus is on reducing pure red tape costs. The rewards, in the form of more streamlined and efficient systems, resources returned to the economy, and the creation of a more enabling environment for business, could be very large indeed.

Raising regulatory quality

One of the key objectives of this survey was to identify the most troublesome regulations and administrative procedures facing businesses in Rwanda, in order to inform priorities for reform. However, it is also useful to look more broadly at the regulatory environment as a whole, and to identify different approaches to influencing and managing the legal and regulatory framework in which businesses operate, so as to minimise costs and maximise benefits. These efforts must however be underpinned by a change of attitude toward regulation. Without an appropriate attitudinal change, the risk is that practical techniques for regulatory cost management will be applied in mechanistic and inefficient ways, which may end up increasing bureaucratic complexity rather than reducing it.

The concept of 'regulatory best practice' (RBP) has gained increasing currency in countries at various levels of development.⁷ The approach, which aims to improve the way in which regulations are formulated and implemented, is directed toward making the regulatory environment as favourable as possible for trade, investment and growth, thus enabling the pursuit of socio-economic policy objectives such as improving equity, reducing poverty, and increasing employment. RBP requires government to create an environment that is good for all business, from large corporations to small

and medium enterprises, by ensuring that inappropriate legislation, regulations, and administrative requirements do not inhibit growth or prevent markets from operating effectively. It is characterised by five core principles:

- Proportionality: regulators should only intervene when necessary. Remedies should be appropriate to the problem and costs should be identified and minimised
- Accountability: regulators must be able to justify decisions, and are subject to public scrutiny
- Consistency: government rules and standards must be harmonised and implemented fairly
- Transparency: regulators should be open and regulations should be simple and user-friendly
- Targeting: regulations should be focused on the problem and minimise side-effects.

While RBP includes traditional approaches to regulation, it also recognises that flexibility is sometimes required. This is particularly true in situations where compliance will be expensive, or difficult to monitor and enforce.

RBP requires creative and careful consideration of various options in order to achieve a particular policy objective, together with an assessment of the possible unintended consequences of each option. The process requires research and identification of good practice elsewhere, together with sufficiently wide consultation with experts and stakeholders to understand potential impacts on different sectors, possible knock-on effects, incentives and challenges.

This process of comparative review and stakeholder engagement enables identification of the range of mechanisms that might be employed to meet a particular policy objective - of which traditional regulation is only one. Possible alternatives might include:

- Improving implementation and enforcement of current legislation/regulation
- Improved coordination among government departments
- Targeted information and education as a means of encouraging desired behaviours
- Self-regulation, including codes of good practice, voluntary standards, and industry codes developed by business with government involvement
- Incentives for desirable behaviour, and 'naming and shaming' for non-compliance
- 'Comply or explain' provisions, exemptions, and voluntary opt-outs.

Thinking through unintended consequences and knock-on effects may bring to light the need to apply different standards or compliance procedures to different groups, such as large and small business, or urban and rural interests. Different levels of enforcement, monitoring, and inspection may also be appropriate.

Regulatory management tools

Simple and robust tools are available for public servants and interest groups to assess the costs and benefits of particular regulations, and to find ways of reducing regulatory costs without reducing the benefits of regulation. Important tools in this regard include regulatory cost surveys, regulatory review, procedural audits, and encouraging competition.

Regulatory cost surveys provide quantitative evidence about the impact of red tape on foreign investment, new business start-ups, and barriers to formalisation and/or expansion. The fact that this information quantifies the costs of compliance as perceived by businesses themselves enables organised business to use the information to lobby government for regulatory reform in specific areas. The present study constitutes Rwanda's first comprehensive review of the costs of regulatory compliance. Going forward, we recommend that more detailed sectoral and regional regulatory cost surveys could provide a useful source of information for government and business to assist in the prioritisation of reforms.

Regulatory review can help governments to analyse and improve the regulatory process. Retrospective regulatory review involves going through existing statutes and regulations to identify regulations that should be redesigned because experience has shown that their costs – economic and social – are not justified by their benefits. It is also used to identify regulations that are no longer needed and can be safely abolished.

Prospective regulatory review – generally known as **RIA** (Regulatory Impact Assessment or Analysis) – involves testing different options for achieving policy objectives, and assessing, for each option, whether the likely benefits of the proposals justify the associated economic and social costs. Regulation is often only one of several options that can be identified – for example, industry self-regulation may be one alternative; another is to do nothing except to enforce existing regulations more effectively.

Prospective regulatory review in its simplest form operates on the basis of a checklist of questions which public servants are required to ask themselves while they are developing a new regulation, together with checks to ensure appropriate consultation with stakeholders. The key questions contained in the OECD regulatory quality checklist (1995), are as follows:

- Is the (regulatory) problem correctly identified?
- Is government action justified?
- Is regulation the best form of government action in these circumstances?
- Is there a legal basis for regulation?
- What is the appropriate level of government for this action?
- Do the benefits of regulation justify the costs?
- Is the distribution of effects across society transparent?
- Is the regulation clear, consistent, comprehensible and accessible to users?
- Have all interested parties had the opportunity to present their views?
- How will compliance be achieved?

RIA is thus a tool that is used to analyse the objectives of a regulatory proposal, the risks to be addressed by the regulation and the different options for delivering the objectives. In doing so it makes transparent the expected costs and benefits of options for different stakeholders – the implications for compliance as well as the cost of enforcement for government.

As a basis for targeted administrative reform, it is useful to undertake **administrative barriers reviews** (as carried out, for example, by the World Bank's Foreign Investment Advisory Service) or more closely focused **procedural audits** to observe and track direct business interactions with government departments and agencies step-by-step, so as to uncover blockages at the points where they occur. In effect this requires a methodology similar to a 'time and motion' study. Procedural audits of this kind are essentially the responsibility of government. For effective and committed reform, such audits must be 'owned' by the departments and agencies concerned.

Competition policy is another important component in the toolkit of regulators and can be a useful alternative way of reducing the compliance and administrative costs associated with regulation, which more often than not are passed on to consumers. Competition-based approaches can provide alternatives to more traditional and expensive approaches to regulatory problems. Incentive-based structures, such as the creation of new markets, or enhancing competition in existing markets, can be a highly efficient means of achieving policy objectives, for example. Companies that are required to compete with one another for a share of the market have incentives to operate efficiently. The need to ensure profitability is likely to result in efficiency savings and reduced costs. Policy-makers and citizens can often rely on the energies and incentives created by competition to deliver goods and services without the need for an elaborate system of regulation and all its associated costs.

However, while the introduction of competition can and should lead to better services for customers, it may also result in a race to the bottom, with the risk of declining safety standards or lowered product quality. Competition is thus only a desirable alternative to traditional regulation if competition is itself well-regulated. Developing a competition culture takes time, and requires input from different sources. General competition authorities and sector regulators will need to expand their advocacy and education roles. Government departments will need to bolster their expertise in the field of competition, enabling them to provide support for the development of a competitive environment for their specific industries. Efforts are needed to raise awareness and activism among consumers, who play a key role as watchdogs of competition.

Endnotes

- 1 The theoretical conditions under which free markets produce ‘Pareto-optimal’ outcomes are unlikely to arise in the real world – the theory specifies that all goods are produced at the lowest possible cost, and that everyone has ‘perfect information’ about the prices paid by everyone else. What’s more, it is highly unlikely that a ‘Pareto-optimal’ situation, in which one person can only be made better off at the expense of another, would be socio-politically desirable. This is because a distribution of this sort may be very unfair, and is likely to be unsustainable.
- 2 Why regulatory governance matters, CRC Policy Brief no 2, 2004.
- 3 D Parker, Economic regulation: a preliminary literature review and summary of research questions arising, CRC working paper no 6, University of Aston, October 2001.
- 4 Ibid.
- 5 Lee, Developing and applying regulatory impact assessment methodologies in low and middle income countries.
- 6 We have noted elsewhere that the ‘informal’ sector in Rwanda has unusual and distinctive features, but there are nevertheless important qualitative differences between ‘registration’ at the local level and full participation in the formal economy.
- 7 SBP, *Gaining Momentum: The state of regulatory best practice in Africa*, November 2003.



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