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## Licensing 159 activities—not 909

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One October evening in 2004, Kakha Bendukidze, the minister of economy, and his deputy, Vakhtang Lejava, were discussing Georgia's byzantine system of construction licenses and permits. The construction sector was heating up in Tbilisi, but bureaucratic hurdles were weighing down on entrepreneurs. Lejava suggested establishing a one-stop shop and speeding up the process of construction permits by adopting a "silence-is-consent" rule.

Minister Bendukidze, a maverick reformer, argued that only a clean break from the past would do. This conversation led to the Law on Licensing and Permits and Regulation 140 on issuing construction permits, both issued in 2005. The result: the number of activities requiring a business license fell from 909 to 159.

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### Prologue

The Rose Revolution of November 2003 brought in a government determined to reform and revive a moribund economy. Since 1999, the economy had barely grown and budget revenues lagged at about 79% of projections. The result was an increased external debt and some creative accounting techniques such as "forwarding" budget funds from one budget item to another and making fictitious budget offsets. In 2002, the International Monetary Fund suspended its programs in Georgia. This cut off the country from international capital markets, with external debt already above 50% of GDP. The following year budget revenues increased somewhat due to investment in the Baku-Tbilisi-Ceyhan oil pipeline; but expenditures jumped even faster. At the end of 2003, the total internal debt in unpaid salaries and pensions amounted to \$120 million and half the population was living under the poverty line. It was time for bold changes.

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### Over-licensed and under-monitored

Georgia had a complicated licensing regime typical of centrally planned economies. The 2002 Law on Grounds for Issuance of Licenses and Permits for Entrepreneurial Activities made some cosmetic changes to bring the regime in line with European principles, adopting the language of freedoms—that is, the free movement of people, goods, services, and capital. But the law did not simplify any of the licensing hurdles facing entrepreneurs. More than 900 business activities still required a license. Nor did the law impose any discipline on government agencies responsible for approving licenses and permit to do so in a timely and transparent fashion. Corruption was rampant.

These problems were most prevalent in the construction sector. A construction permit for a commercial warehouse in Tbilisi required 18 different procedures, including 9 approvals from as many agencies. Before applying for a construction permit, the builder needed permission from agencies as diverse as the Center of Archeology at the Academy of Science and the Inspector of Sanitary Observation.

The effect of such stringent requirements was twofold. First, they deterred many construction companies from complying with all the legal requirements. According to Natia Jokhadze, an official at the Ministry of Economy's Department of Urbanization and Construction, "The most frequent problem in construction in Tbilisi [was] the absence of project and planning documents and permits." Illegal construction activity was the rule, according to statistics from the Main Architectural and Construction Inspection Agency. In 2004, only 207 of the 484 ongoing construction projects in Tbilisi had permits.

Second, the cumbersome process meant long delays. Bribes became the way to speed things up. Jokhadze remarks, "After corruption in the police and customs, corruption in Georgia was most widespread in the construction sector."

The most striking example was the Main Administration for the State Comprehensive Evaluation of Construction Designs. Although a government agency, the Administration functioned like a private fiefdom with a monopoly on the approval of project designs. It required a "facilitation fee" to speed up the process, which could otherwise drag on for months. And the state assumed no responsibility for the safety of construction designs that the Administration approved.

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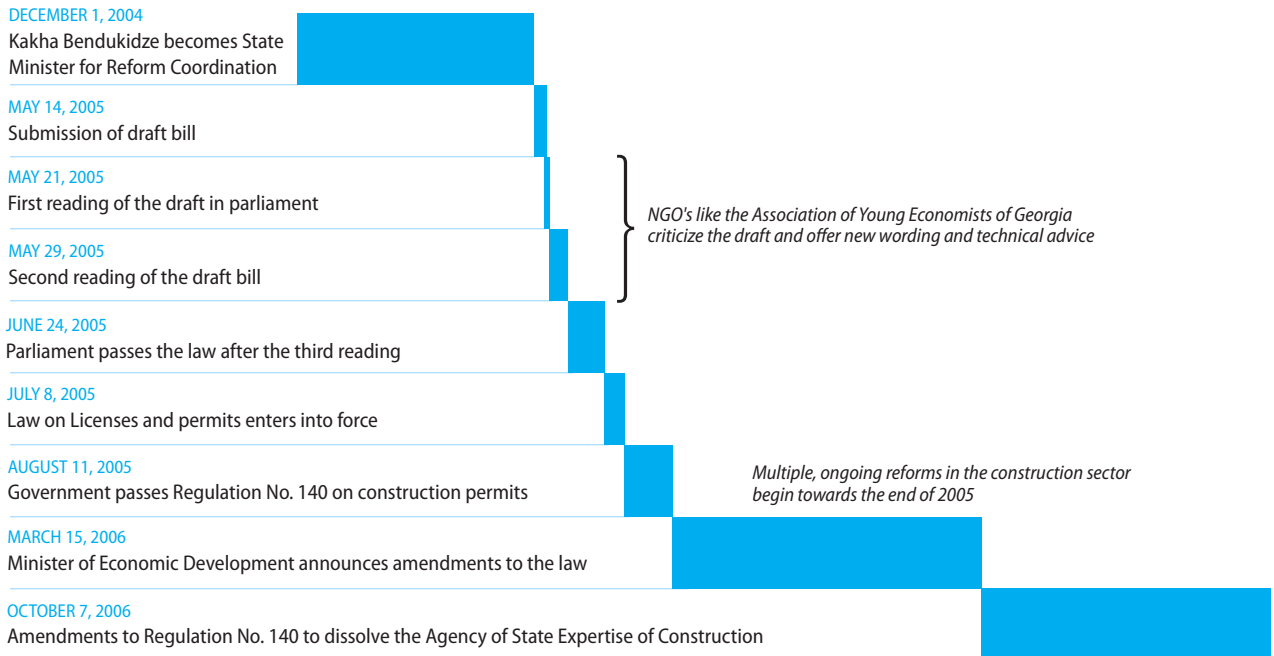
### The super-reformer

In the summer of 2004, President Saakashvili invited Kakha Bendukidze to become Georgia's new minister of economy. Labeled as a "different sort of oligarch" by *The Economist* and as a patriot by the president, Bendukidze had the knowledge and drive to turn around the ailing reform efforts. At the time, Bendukidze was president and CEO of Russia's largest engineering company, United Heavy Machinery. In this capacity, he oversaw more than 200,000 workers and a budget larger than the state government budget of Georgia.

Bendukidze and his team started with an ambitious privatization program, but within a few months their agenda outgrew the confines of expanding private sector activity and generating budget revenues. In December 2004 Bendukidze became the State Minister for Reform Coordination. "I will be in charge of not only economic reforms but I will also recommend and oversee structural reforms in other sectors, for example in the Energy Ministry and the Agriculture Ministry. Of course, this does not mean that I will be responsible for electricity supply; I will recommend structural reforms which I think are necessary to carry out," said Minister Bendukidze in a televised interview in December 2004.

One of the first orders of business was a new law on licenses and permits. By all accounts the reform was entirely Bendukidze's initiative. He commissioned the draft law from his team of experts and within 6 months it was ready for submission to parliament.

FIGURE 1

**Timeline of licensing reform in Georgia**

Source: Doing Business database.

**Passing with flying colors**

The Ministry of Reform consulted on the proposed reforms with the Association of Young Economists of Georgia, the Federation of Georgian Businesses, and a number of national experts. Most Georgian economists and businessmen hailed the draft law as an important step in Georgia's transition to a market economy. To quote George Isakadze, a prominent businessman, "Everybody agreed that country needed reforms in this sphere. The only difference was in the strategy—how to do it. This was a great start."

There were some doubters. The Association of Young Economists pointed to a number of provisions that were vague and which "allowed [for] different interpretations." For example, one expert, Ana Kadagidze, criticized an article allowing an issuing body to extend the administrative proceedings beyond statutory time limits as long as it notifies the applicant within 15 days of filing. She worried that this would allow government bureaucrats to extend the timeframe for licenses indefinitely, 15 days at a time.

As the Association hosted roundtables to discuss the draft law and distributed the resolution to its members for comments and consultation. In addition, they arranged three meetings between businessmen and the bill's drafters. The Fed-

eration of Georgian Businesses advertised the consultation meetings through television and other media outlets. “Many businessmen attended these meetings and expressed their concerns, but some of these concerns were not incorporated in the final version of the bill.” Their main concern: that the lack of a license—a barrier to entry—would increase competition.

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## A licensing revolution

It took three readings of the bill before Parliament passed the Law on Licensing and Permits on June 24, 2005. The law entered into force two weeks later. Its key benefits:

- Reducing the number of licenses required for doing business.
- Shifting many licenses to pure informational obligations, whereby a business can start operations and simply inform the authorities.
- Introducing a one-stop shop for licensing, “silence-is-consent” rules and statutory time limits.

The process of eliminating licenses rested on a simple question: “Why do we need this license?” All ministries and agencies had to show that their license was needed to minimize health, safety or other risks. As a result, the law reduced the number of business activities requiring a license from 909 to 159. “And it’s not over yet,” says deputy-minister Lejava. The government plans to reduce the number of required licenses to 130 by the end of 2007.

The one-stop shop allows entrepreneurs to submit all their documents to one department, which is obliged within a month to undertake all required steps to issue a license or inform an applicant of the reasons for refusal.

If questions arise or additional measures are necessary, the terms of issuance might be extended up to three months or—if the government decides—up to six months. But if the entrepreneur fails to receive any answer within a month, this automatically means that the application requirements have been satisfied (“silence-is-consent”), in which case all responsibility is assumed by the state official who failed to do the job efficiently.

The new licensing law and the general administrative code (amended in June 2005) impose the following statutory time limits:

- 30 days after filing an application for a decision on granting a license.
- 20 days after filing an application for issuing a permit.

### Focusing on construction

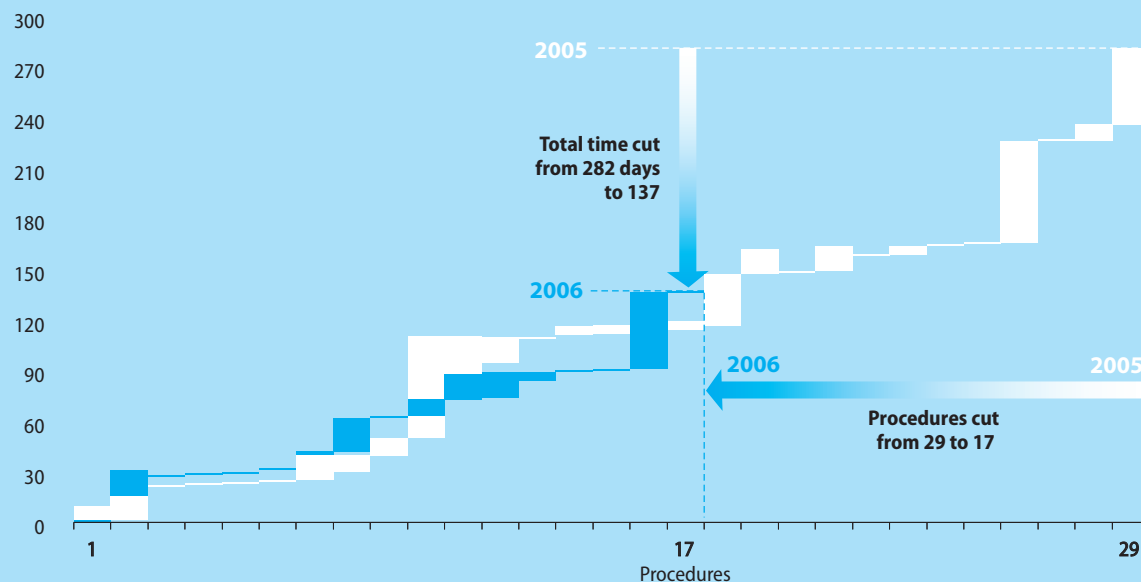
The reformers solidified their success by adopting Regulation 140 (On the Terms and Conditions of Issuing Construction Permits) on August 11, 2005, only a month after the licensing law entered into force. This time the reform team consulted with the U.S. Agency for International Development on ways to improve the draft regulation.

Minister Bendukidze had previous experience in large construction projects and knew the specifics of what needed to be done—and how to do it. The reformers also knew who not to talk to. They fought against any institutionalized dialogue with large construction companies. Lejava says, “It would not have been productive to discuss these ideas with them and they would not be interested anyway. Our goal was to try to help the smaller firms so that we could reduce the entry barriers for them.” Instead, the reform team organized several consultations to review the technical details of the draft with the Association of Civil Engineers, the Association of Developers, and the Union of Architects.

Unlike the licensing law, the proposed construction licensing regulations triggered fierce opposition. The Main Administration for the State Comprehensive Evaluation of Construction Designs opposed the idea of introducing private experts, which would eliminate some forms of state approval of construction documents—its main source of fees and bribes. After several months of vociferous

FIGURE 2

#### Time to build a warehouse in Georgia, 2005 and 2006



Source: Doing Business database.

confrontations the Administration was dissolved. Private experts now evaluate construction designs—according to the old standards, until new standards are developed and reviewed.

In addition to changing the administration of construction permits, Regulation 140 reduced the number and type of structures requiring a construction permit. For example, buildings of less than 100 cubic meters no longer require a permit. Most important for small businesses, Resolution 140 simplifies the procedures and lowers the cost of issuing permits:

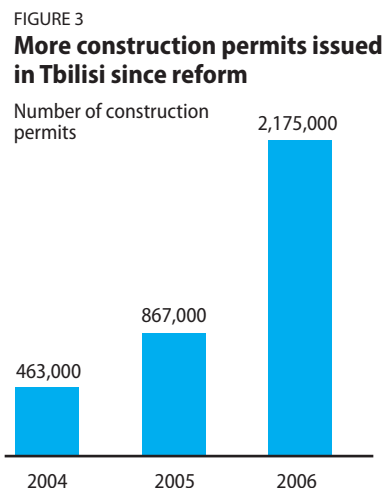
- It eliminates most of the approvals needed to apply for a construction permit. As a result, the number of procedures needed to build a warehouse dropped from 29 to 17 (figure 2).
- As a byproduct, the time to build a warehouse dropped from 285 days to 137.

The Ministry of Urbanization and Construction became the Department of Urbanization and Construction under the Ministry of Economy. Following the reorganization, the average salary of public officials in construction licensing was raised 20-fold—from a mere 15–20 lari in 2004 to 300–400 lari in 2006. Aggressive recruitment of younger experts increased the energy and vigor of the licensing administration. Meanwhile, more experienced officials were appointed heads of departments and divisions.

## The impact

Lejava is upbeat about the reforms, “Let’s have a poll and see whether any of these companies would prefer living under the old regulations or the new?” The answer is most certainly the new.

Gia Kurtskalia from Magi Style, a construction company, remarks, “If I were a starting company, then I might have felt a bigger impact. The new law made life easier for firms operating without construction licenses. But for companies operating with all the legal documents, we felt no major changes. For the most part it seems that it should be easier.” Data from the USAID’s Georgia Business Climate Reform project suggest an increase of 151% in the number of construction permits in Tbilisi issued from 2005 to the first nine months of 2006 (figure 3).



The new regulations contributed to the further expansion of construction. To quote Prime Minister Zurab Nogaideli, “In 2005, the construction industry is the second most dynamically developing sector after the financial sector.” Indeed, the share of construction in GDP grew from 3.7% in 2000, to 6.4% in 2003, to over 9% in 2006.

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### **Changing the game—but not the players**

According to Isakadze, insufficient implementation momentum remains a challenge for Georgian reformers. The government did not prepare all relevant regulatory changes in time. And the absence of a communication campaign means that people simply do not know what the system offers them. Ignorance of the new laws, coupled with confusion, highlights the problems of “learning by doing.”

The biggest problem is bureaucratic implementation. The one-stop shop for issuing licenses and permits is still a challenge, mostly because different administrative bodies lack effective electronic communication. Gia Kurtskalia observes, “It is visible on public officials’ faces that it is still difficult. They have become more accountable, and we are not North America or Europe to make such a jump. There are day-to-day problems—computers do not work.”

The silence-is-consent rule also had a mixed impact on issuing permits. After adopting Resolution 140, the government passed 10–12 amendments in quick succession. But the administration did not have enough time to train its staff. Without training and expertise, bureaucrats cannot keep up with the increase in demand. The result: if a negative decision is not reported to the applicant in time, the application is approved by default. This may still be a better outcome than having the building go up illegally.

The reform was not widely publicized. Until a recent publicity campaign, the business community, especially outside Tbilisi, was not aware that 85% of licenses and permits had been abolished. According to Isakadze, “More public awareness would have avoided the confusion the reform caused in the regions.” Teimuraz Diasamidze, director of a company considered sizable and visible in the market, was not even aware of these measures, responding “which reforms?” Opinion is unanimous that a more targeted and effective public education campaign could have been launched when the law was adopted.

The reforms do not change the life of bigger companies significantly, as they have the resources to hire independent experts. But they do affect small and medium-size companies, responsible for finding their own experts for various pre-construction procedures. “Following the American example was good, and it will



bring the Georgian standards up to the world's best practices," notes Tsagerali. But he is still wary of the drastic reforms that happened overnight. For instance, companies were stunned to go to the Geological Service and receive the following response: "If you know how to do a geological survey, go and do it yourself!" On the positive side, a bribe was not requested alongside this advice.

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## Epilogue

According to Georgia's current minister of economy, Giorgi Arveladze, "Promotion and development of the construction sector remains a top priority." The government has identified three areas where it needs to enhance performance. First, it plans to launch awareness campaigns for small and medium-size enterprises by printing and disseminating information in plain language. Second, it pledges to ensure the proper administration of registration and permit issuance. Lejava says, "There is no magic bullet to solve these problems right away. Implementation of reforms in transitional economies lags behind the actual reforms. But we are catching up and will keep up." Third, it vows to concentrate more on enforcing regulations and punishing violators.

The Ministry of Reform Coordination plans to submit a new construction code to the spring session of Parliament. The draft code covers basic principles defined by the Law on Licenses and Permits and contains provisions for:

- Mandatory professional certification of specialists responsible for construction works, those working on construction sites and those servicing construction appliances.
- Professional liability insurance for specialists responsible for construction works.

Optimistic about the next chapter of reforms, Chogovadze says, "The liberation of the free entrepreneur from any restriction of red tape is the future of Georgia." Ever so bullish on the results of reforms, in 2004 Minister Bendukidze promised that the economic growth in Georgia will reach 12% annually by 2007. Three years on, many reforms have taken place and the economy in 2006 grew by 10.5%. Another successful year may make Bendukidze a prophet.