Summary
December 2008

CUTTING THE COST OF RED TAPE

for business growth in Rwanda

This is a summary of the findings and recommendations contained in the main report, *Cutting the cost of red tape for business growth in Rwanda*. The study was commissioned by the Rwandan Private Sector Federation (PSF), funded by the Deutsche Gesellschaft für Technische Zusammenarbeit (GtZ), and executed on behalf of the German Federal Ministry for Economic Cooperation and Development. The survey was conceptualised and carried out by SBP drawing on the comprehensive regulatory review methodology (CRR©) developed in its pioneering regulatory cost studies in South Africa.[1]

How much does regulatory compliance cost the private sector in Rwanda annually? What does it actually cost businesses to submit tax returns? To register? To comply with import and export regulations, and with labour laws? Which are the most time-consuming regulations? The most difficult to comply with? Do regulatory costs stop businesses from growing, or employing more people?

This ground-breaking study pinpoints key regulatory areas and administrative procedures that are burdensome to business, and quantifies the costs of complying with these regulations for firms of different sizes in the various sectors, and for the economy as whole.[2]

Regulatory costs can have serious negative consequences, from 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. The survey results demonstrate that regulations create significant costs for businesses in Rwanda, and that features of the regulatory environment discourage business growth and job creation in the formal economy.

Conducted in 2008, the survey was solidly based on a country-wide sample of 400 formal-sector businesses, ranging from large corporations to small enterprises. Currently just over 27 000 businesses operate in the formal sector[3], as defined for the purposes of this study.

Economy-wide compliance cost surveys are still rare in the developing world, and this pioneering work makes an important contribution not only to policy debates in Rwanda but also to the data sets for Africa and indeed globally.

Economic growth and the regulatory environment

The Rwandan government is strongly committed to building an enabling environment to drive economic growth and job creation, diversify the private sector, reduce dependence on external aid and transform Rwanda into a middle income country. A business-friendly regulatory and administrative environment is crucial to this effort, and the survey findings provide a strong evidence base for targeted reform to support these objectives.

No combination of institutions and policies can guarantee long-term economic growth, but if a country wants sustained growth it must 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 appropriate industrial and trade policies, cutting red tape and raising regulatory quality. The guiding question must always be 'Will this policy, project or measure make it easier for a business to start and to flourish?'

The cost of complying with regulations

Complying with regulations and administrative procedures necessarily entails costs for business. These 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. Put simply, using tax as an example, compliance costs exclude the actual tax that is paid, but include all the costs associated with submitting the tax returns and making the payment.

Compliance costs are of two types: **once-off costs**, such as the costs associated with initial business registration, and **recurring costs**, which arise on a regular basis (often annually). Some costs affect all firms, such as those associated with annual registration, tax compliance and labour regulations, while other costs are **sector** or **activity specific**, such as compliance costs associated pharmaceuticals, or with exporting. Compliance costs will change from year to year, as regulatory requirements and administrative procedures evolve.

Compliance costs can never be reduced to zero, but targeted initiatives to reduce red tape and streamline administrative processes can free up resources – time and money – that businesses can use more productively to grow their operations.

Compliance costs in Rwanda: The headline figures

In 2007, Rwandan businesses incurred regulatory compliance costs of at least RwF 55 billion.[4] To put this in context, the aggregate costs equate to approximately 3 percent of GDP – which 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).

Composition of regulatory costs to business

	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%

Looked at from a different angle, the average annual cost per firm amounts to more than RwF 2 million. Beyond the headline figures, the survey establishes not only overall aggregate compliance costs but relative compliance costs in various regulatory areas and for businesses in various size bands. These are discussed in detail in the main report. As such, the findings are a valuable tool to prioritize problem areas where the

Red tape and regulatory good practice

'Red tape' is the short-hand term for unnecessary or excessively complicated regulations and inefficient administrative processes that people find frustrating and that multiply compliance costs.

Of course, regulations are necessary for many good reasons – and not all regulations are 'red tape'. But standing in long queues to get official papers stamped or signed, and filling in complicated official forms with your business on hold, it is hard not to think that regulations are a waste of time – in other words, simply 'red tape'. So the key issue is how to reduce the amount of red tape faced by businesses without reducing the benefits that regulations can bring.

Current approaches to regulatory good practice don't rely on simple slogans or hard and fast rules, such as 'deregulation' or even 'less regulation'. Instead, they emphasise the importance of assessing the benefits and costs of regulation in practice. 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 compliance costs as low as possible.

A number of tools are available to help build a better regulatory environment. These include compliance cost studies, regulatory reviews, detailed procedural audits, and regulatory impact analysis (RIA) in the case of new proposals.

regulations and the procedures involved in implementing them should be looked at more closely, as a basis for reform.

International comparisons

How do regulatory costs in Rwanda compare with those in other countries? This looks like a straightforward question, but there is really no simple answer. Economy-wide compliance cost studies are still relatively rare – and even where data exist, comparisons should not be taken too literally because of differences in method and scope.

Despite comparability problems, three key messages emerge from various studies conducted in recent years – and these are also borne out in the Rwandan survey. First, regulatory compliance costs invariably affect SMEs disproportionately. Second, businesses in a range of countries say that regulatory costs are increasing – a perception strongly shared by businesses in Rwanda. Last, as a percentage of GDP, regulatory costs tend to be higher in developing and transition countries than in advanced countries.

Troublesome and time-consuming regulations

Businesses were asked to identify the three regulations that they found most time-consuming, troublesome and costly. The combined responses are shown below.

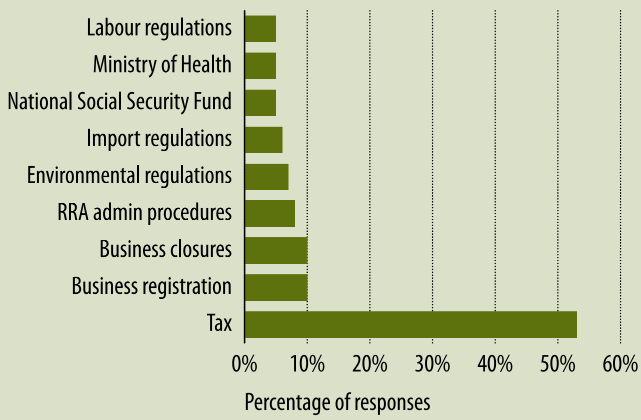
Tax emerged as the most problematic regulatory area by far, cited in 53 percent of the responses. Problems incorporated under the broad 'tax' heading include compliance with VAT, CIT and PAYE regulations, as well as preparation for tax audits. Interactions with the Rwanda Revenue Authority (RRA) were explicitly cited by another ten percent of respondents, further increasing the mentions of tax-related regulations. A large part of the perceived troubles centre on the costs of complying with tax paperwork and the need to visit RRA offices in person.

Business registration and **compulsory business closures** – that is, closure during business hours because of public meetings and other requirements – were the second most likely areas to be identified as troublesome and time-consuming, but at ten percent each were significantly less prevalent among responses.

Businesses that engage in **importing and exporting** report very significant problems associated with these activities. The largest component of import and export compliance costs arises from delays attributed to Customs and the Rwanda Bureau of Standards.

Rwanda's **skills deficit** emerged as another key concern for larger businesses. 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 the business community to find out what skills local industries require, and ensuring that the regulatory environment facilitates the entry of skilled foreigners, with appropriate mechanisms to encourage skills transfer. While the process of acquiring work permits is straightforward,

Most time-consuming and troublesome regulations



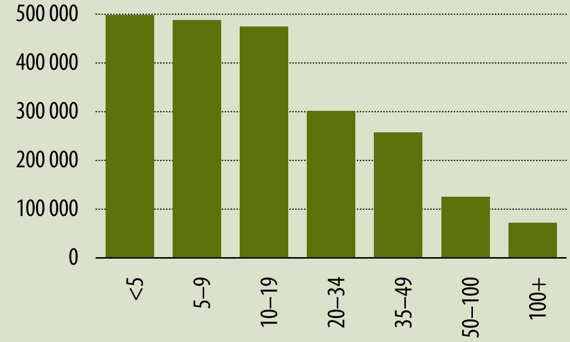
Going beyond perceptions to actual costs

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 government officials in the data analysis stage, but the primary voice throughout the survey is that of businesses of all sizes, operating in Rwanda.

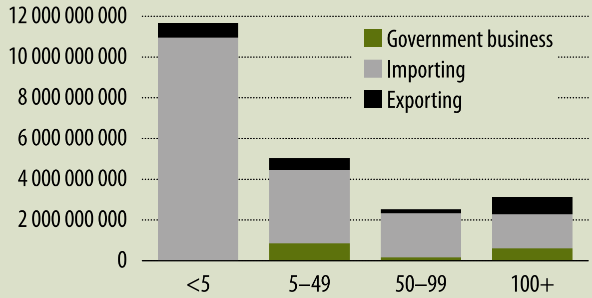
Compliance cost studies go well beyond surveys that report only on perceptions. The methodology provides a well-informed, evidence-based estimate of how much it costs in cash and resources (including staff time) for firms to comply with regulations. Businesses are asked to estimate the real costs of 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.

In addition, by analysing the types of regulations identified by businesses as particularly troublesome and costly at some level of detail, the Rwandan study was also able to identify administrative bottlenecks and other sources of frustration.

Tax compliance costs per employee



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



businesses complain about the high costs of work permits, the need for annual renewals, and the three year limit on renewals, which can entail a serious loss of experience, skills and intellectual capital at the end of the contractual period.

Compliance costs have a disproportionate impact on SMEs

Regulatory studies in various countries have shown that compliance costs are generally regressive, affecting smaller firms much more than larger firms. 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. While big firms bear the largest costs absolutely, small firms bear the heaviest burden in relation to their size.

The survey results confirm that this is also the case in Rwanda. Tax compliance costs per employee, for example, are almost seven times higher for micro businesses than for larger firms.

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 and specialised staff functions. The burden of time and effort associated with meeting regulatory compliance requirements is more keenly felt in small firms, where the owner-manager is often also the book-keeper, form-filler, perhaps even the person who stands in the queue and can't attend to the business while doing so.

Businesses' priorities for regulatory reform

Compliance costs associated with tax, importing and exporting together account for approximately 75 percent of Rwanda's aggregate regulatory costs – and a staggering 90 percent of costs for firms that are actually engaged in importing and exporting. Major reductions in overall compliance costs can be achieved by concentrating on these three areas as priorities for reform.

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

Improvements in the **regulation and administration of taxes** comprised by far the most common set of responses, mentioned by 44 percent of respondents. Easing tax compliance was ranked most highly among micro-firms, mentioned by over 50 percent of respondents; but it was in fact listed by 40 percent or more of respondents in all size categories, with the exception of the largest firms (100+ employees) – though even here it was the top priority for 25 percent of the businesses.

Improvements to **import and export regulations** were prioritised by 20 percent of businesses with

50–100 employees (against a sample average of four percent). 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. Administrative barriers at ports of entry and exit harm the ability of Rwandan firms to compete effectively for regional and international markets, and raise costs for consumers inside Rwanda. The efficiency with which businesses interact with customs has substantial economic consequences for the economy as a whole.

One fifth of all firms mentioned **general regulatory issues** such as reduction of red tape, improvements in sector-specific regulations, improved information on regulatory requirements, improved administrative procedures, faster processing times and reduction in the cost of official documents.

The burden of regulatory compliance acts as a disincentive to growth for individual firms. When firms were asked to identify **key constraints to business growth** – whether regulatory or non-regulatory – regulatory requirements (tax, general regulations, administrative procedures and public meetings) taken together accounted for just over 40 percent of all responses, which were spontaneous and unprompted. Fourteen percent of the largest firms (100+ employees) specifically cited regulatory constraints as a factor discouraging them from increasing employment.

Tax and customs procedures are priority issues

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. A particularly problematic area 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. This creates cash flow problems, especially for smaller businesses.

A very significant component of tax compliance costs results from **administrative inefficiencies**, with time-consuming, in-person monthly payments at RRA offices. Businesses complain about a lack of predictability and consistency, and say that requirements and processes in RRA offices can change from one visit to the next, sometimes depending on the particular official with whom one interacts. For businesses outside Kigali, transport and time costs involved in getting to RRA offices are a real burden.

Calculating the costs of compliance

The methodology is explained in detail in the main report. In brief, 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 for compliance costs in seven regulatory areas: business registration (initial, and annual), tax regulation, labour regulation, export, import, and doing business with government (tendering). 'Other' regulatory costs identified by respondents, but which were difficult to quantify for various reasons, were not included in the aggregate figure. Sector or activity specific costs were adjusted as appropriate. For example, for exporting, importing and doing business with government, aggregate values were weighted by the probabilities of firms participating in these activities in each size group.

Inefficiencies such as these can be addressed by improving procedures, without necessarily involving any changes in policy or the relevant regulations. According to survey respondents, this could include relatively simple steps such as reducing the need for in-person visits, seeing that the required forms are always available, ensuring that staff members are trained to be helpful and courteous, and communicating any changes to the regulations clearly and effectively.

The RRA has already taken some steps to improve outreach. It has increased the number of decentralised offices in the provinces, and plans to implement online tax filing, which will certainly be of great benefit to many firms. However, few of Rwanda's very numerous small businesses have access to the Internet – hence the importance of other measures such as opening up payment options at local banks.

For businesses engaged in **importing and exporting**, staff time spent on obtaining documentation, as well as fees paid to external consultants and agents, account for a significant proportion of the costs. These are even higher for exporting than for importing – which could have serious implications for the potential export growth path of the Rwandan economy. Many businesses criticise customs authorities for substantial delays in clearing and forwarding imported items. A related concern is the perceived lack of consistency and predictability in the application and enforcement of regulatory requirements. Recent studies confirm that procedural obstacles account for up to half the time that goods are in transit, while unpredictable delays at each stage add to the costs borne by businesses.

The argument for reducing compliance costs in general applies right across the economy. 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; while smaller businesses provide crucial entry points into the formal economy and could potentially absorb a large percentage of the working-age population into the labour force.

Going forward

This study provides a strong evidence base for constructive debate between government and business stakeholders.

It highlights key issues, including the need to:

- Improve the efficiency and predictability of administrative processes associated with tax compliance. It will be important to simplify procedures, reduce the need for in-person interactions, and make requirements easier to understand
- Review VAT regulations and the impact of advance payment of VAT (when invoicing) on cash flow
- Review administrative processes associated with importing and exporting activities, to improve efficiency and reduce delays
- Review regulatory requirements related to work permits to encourage the acquisition and transfer of skills
- Minimise regulatory disincentives to small business growth
- Communicate regulatory information effectively, recognising that businesses of different sizes and in different locations have different needs
- Expand mechanisms for effective interaction and dialogue between business and government to help improve regulatory practice.

For closely targeted reforms, procedural audits should observe and track direct business interactions with government step-by-step, to uncover blockages at the points where they occur. These audits are essentially the responsibility of the departments and agencies concerned. The aim must be to simplify procedures wherever possible.

The study also provides a baseline. 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.

Endnotes

1 SBP, *Counting the cost of red tape for business in South Africa*, June 2005; and *Counting the cost of red tape for tourism in South Africa*, November 2006.
2 SBP, *Cutting the cost of red tape for business growth in Rwanda*, December 2008.
3 This figure excludes some 46 000 individually-owned businesses operating from collective sites or multi-occupancy sites such as markets, which were not included in the survey.
4 The aggregate figure reflects compliance costs in seven regulatory areas: business registration (initial, and annual), tax regulation, labour regulation, export, import, and doing business with government (tendering). The estimated aggregate total cost does not include all regulatory costs, and is based on a restricted number of formal businesses. Actual aggregate costs for Rwandan businesses are undoubtedly somewhat higher in practice.

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