

The Case for Business Registration Reform in Latin America

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Foreword

The informal sector constitutes a significant segment of most Latin American economies. The millions of micro and small entrepreneurs in the region often perceive that the costs of entering the formal economy and operating in it outweigh the benefits. The “barriers” to entry include opaque and tedious start-up requirements, as well as expensive ongoing obligations—all of which influence entrepreneurs in their decision as to whether to become and remain formal. These types of regulatory costs are particularly important to small and microenterprises, which generally lack administrative resources to deal with cumbersome and time-consuming requirements.

This paper proposes a conceptual framework for understanding and analyzing how business regulations affect small and microenterprises. In doing so, it also makes a case for why particular attention should be paid to the process of *initial registration* of businesses and why this is a promising area for improvement and reform. To show what *has* been done and what *can* be done in this area, the paper explores the experiences of various countries around the world that have made efforts to streamline this often lengthy and complicated process. Drawing from these experiences, the paper outlines a number of concrete guidelines for how to go about such an undertaking. Finally, the paper brings the topic down to the operational level by describing a recently approved IDB project in Costa Rica. The effort will create a self-sustainable one-stop-shop for business registration by involving the private sector and employing widely available technology in a new way.

Business regulation is a very broad topic and there are literally hundreds of different aspects that could be addressed by policymakers and project managers. Business registration is only one of these areas, and streamlining this process may not radically alter the overall regulatory context for private enterprise in a country. However, it does constitute a reasonable and rational first step in any serious reform effort.

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Making the Case: Business Registration as a Priority Area for Reform

The Virtues of Formality

Informality is one of the defining characteristics of economic activity in Latin America. The informal sector, which is made up primarily of micro and small enterprises, is no longer seen as a shadowy and unproductive sector of the economy, but rather as an integral part of the economic productivity of the region. Nevertheless, there are convincing arguments that an increased rate of formalization among these enterprises would bring significant benefits for microentrepreneurs, their employees and society in general (see Box 1).

A high degree of voluntary formalization is a desirable goal from several viewpoints. First, businesses receive protection under the law, which enables them to promote themselves without fear of intervention from the state, enter into stable and long-term relationships with suppliers and customers, and gain access to government support programs. They also gain peace of mind and a degree of certainty in the knowledge that they will not face penalties for avoiding taxes or failing to meet other government requirements. Second, the government receives higher tax revenues and is better able to make policy decisions, thanks to more comprehensive information about the private sector. Third, the employees of the registered businesses are more likely to enjoy social security benefits, a safe work environment, and more stable employment conditions. Finally, consumers and society in general benefit through the increased adherence of legally registered businesses to minimum product, health and environmental standards, through an improved distribution of income (as more lower and moderate income people are able to begin and expand their own enterprises), and through economic growth and efficiency gains.

Given the multiple benefits of increased formalization of informal enterprises, governments should try their best to offer a regulatory environment that encourages the *voluntary* formalization of businesses. In particular, an important component of such an environment is a simple, fast, and inexpensive process for the initial registration of the business with the relevant government entities. The initial registration is a very visible “obstacle” and often constitutes the first encounter between the entrepreneur and the government. As such, it sets the tone for their future relationship. A rational business registration process will diminish any objection or hesitation on the part of entrepreneurs and encourage them to formalize their businesses.

Box 1. Benefits of Formality

Benefits for Microenterprises

- ✓ Avoidance of government penalties
- ✓ Ability to expand business without fear of government intervention
- ✓ Ability to conclude legally enforceable agreements with suppliers and customers
- ✓ Access to trade fairs and export opportunities
- ✓ Access to new or lower cost sources of financing
- ✓ Ability to limit personal liability
- ✓ Access to government support programs

Benefits for Governments

- ✓ Expanded tax base
- ✓ Increased knowledge of economic activity

Benefits for Consumers, Employees and Society

- ✓ Improved income distribution
- ✓ Improved health and safety standards
- ✓ Economic growth due to increased investment levels and economic efficiency gains
- ✓ Enhanced coverage of the social security system

The Regulatory Context

Business regulations are based on a broad range of legal instruments and decisions, including licenses, permits, codes, laws, decrees, and even informal measures such as *guidelines* and *instructions*. Some regulations are in the form of initial one-time obligations, while others are in the form of ongoing obligations. There are five basic areas of regulation that directly affect every business: commercial registration, taxation, labor standards and social security contributions, health and safety requirements, and specific operational permits and licenses. If the business is to undertake some sort of industrial or polluting activity, it will also have to comply with specific environmental regulations. All these regulations require initial registration and, apart from commercial registration, also ongoing compliance.

Commercial Registration

The first step in the process of making a business legal is commercial registration, which is a one-time obligation. This creates an entity that can legally interact with public and private entities, and it furnishes the government with information on new company formations that can be used to design economic policies. In many countries, commercial registration requires a monetary fee and substantial amounts of time spent preparing the appropriate forms, particularly if one registers a partnership or corporation.

Taxation

Business enterprises are typically required to pay a wide variety of taxes at the national, state, and local levels. The most common forms of taxation are income or corporate taxes and sales or value-added taxes, but governments also impose capital gains taxes as well as levies and duties on certain industries. Taxation is sometimes mismanaged by governments when taxes become extremely high or the process of paying them becomes unreasonably complicated or time-consuming. Admittedly, precisely when this happens is a matter of opinion; yet it is clear that taxes rank as one of the most important issues to entrepreneurs (Tokman and Klein 1996; Morrison 1994).

Labor Standards and Social Security Contributions

Labor-related requirements are intended to protect the rights of employees in terms of pay, working conditions, social security, and unemployment benefits. Steps to meet these requirements begin during the initial registration process, and may involve initial monetary contributions to certain funds such as social security. The ongoing obligations represent the most significant labor-related cost to the business. This labor protection, while socially desirable and a cornerstone of employee rights, imposes significant costs on individual businesses, both at start-up and over the life of the firm. Excessively rigid or complicated regulations, or prohibitively expensive mandatory contributions, will have the same effect as excessive or complicated taxation policies: they will contribute to the perception that the costs of operating in the formal economy outweigh the benefits.

Consumer Health and Safety

Governments also engage in regulation to protect consumers, with the aim of preventing unsafe or unhealthy products from reaching the shelves. Like labor-related obligations, health and safety standards represent ongoing obligations, although there is a sometimes lengthy registration process and an initial fee as well. This is clearly an important area for government involvement. However, regulations that are complicated or overly strict or are applied in a discriminatory manner can impose unjustified costs on companies. In some cases, the benefits derived from these regulations in terms of protecting consumers may be insufficient to justify their costs.

Operational Permits and Licenses

The municipality normally requires a business to obtain various occupational permits and licenses—usually related to location, construction, occupational qualifications, or environmental concerns—to operate in certain sectors or occupations. Operational permits and licenses are primarily an initial obligation (including an initial registration process and accompanying

fees), although in many cases they must be renewed periodically. The most common problems in this area include excessively complicated and time-consuming processes and the common use of ex-ante inspections (rather than random inspections after registration).

In sum, regulations are essential to ensure that businesses compete on a level playing field and that their activities do not directly or indirectly harm employees, customers or society in general. At the same time, due to their complexity and high level of impact, business regulations may inflict significant costs of various kinds on businesses. When regulations are excessive, misguided or abused, it affects social welfare through lower productivity and leads to higher prices and substandard products for consumers. In many cases, these social costs can be very significant (ILO 1997; Tokman and Klein 1996).

The Cost of Regulation

Regulatory issues have been cited as one of the principal constraints to growth as perceived by micro and small entrepreneurs from around the world. More than the mere existence of regulations, however, entrepreneurs express frustration at the complicated nature, the high cost, and the overly bureaucratic implementation of the regulations (Lagos 1995). Each of the five types of regulation mentioned above (commercial registration, taxation, labor standards, health and safety standards, and operational permits) gives rise to several different costs for businesses. These costs which are summarized in Table 1, can be divided into four main categories:

1. *Initial monetary costs*, in the form of registration fees and other charges paid to the government and others involved in the registration process (such as notaries).
2. *Initial indirect costs*, in the form of administrative expenses and unrealized revenue arising

from the time spent on the registration process instead of running the business.

3. *Ongoing monetary costs*, in the form of payments for taxes, renewable permits, worker insurance and social security.
4. *Ongoing indirect costs*, in the form of administrative expenses related to ongoing compliance as well as in unrealized revenue arising from the time spent on regulatory compliance instead of running the business.

Even in countries where a pro-business mentality permeates the government, regulations are sufficiently burdensome to impose significant costs to the economy. In the United States, for example, the overall cost of regulation is estimated at US\$250-500 billion, which represents approximately 2.75 to 5.50 percent of U.S. GDP. Further evidence of the cost of regulation is found in a survey of 360 businesses that the U.S. Small Business Administration undertook in 1995 (Hopkins 1995; OMB 1999).

The survey shows that, on a per-employee basis, firms in the survey spent an average of roughly US\$17,000 (excluding capital costs) on regulatory compliance; the very smallest firms (1-4 employees) spent as much as US\$32,000 per employee. Compliance costs on a per-employee basis generally fell as firm size increased. In addition, nearly two-thirds of the surveyed firms believed they face more than minor regulatory burdens; a quarter of them described their burdens as "substantial."

Among the surveyed firms, two areas dominated as the source of greatest concern: federal tax compliance paperwork and payroll record keeping. Here again, the pattern of disproportional burden on small firms was reported. Simplifying reporting and record keeping requirements was a virtually universal reform request.

Table 1. Initial and Ongoing Costs of Formality

	INITIAL REGISTRATION	ONGOING COMPLIANCE
MONETARY COSTS	<p>Type of Costs: Initial monetary costs in the form of payments to government agencies, notaries, and others and for related requirements.</p> <p>Relative Importance: Significant, but small compared to ongoing contributions and compliance.</p>	<p>Type of Cost: Ongoing monetary costs in the form of tax, labor and other contributions.</p> <p>Relative Importance: Often the most significant costs to the entrepreneur.</p>
INDIRECT COSTS	<p>Type of Costs: Initial indirect costs in the form of administrative and opportunity costs arising from spending time and effort on the registration process instead of production.</p> <p>Relative Importance: Important, particularly for small and microenterprises with limited administrative resources.</p>	<p>Type of Costs: Ongoing indirect costs in the form of administrative and opportunity costs from spending time and effort on compliance instead of production.</p> <p>Relative Importance: Can be extremely important if the government bureaucracy is not transparent and client-oriented.</p>

Source: Elaborated by authors.

Although the costs imposed on businesses and governments by regulations vary by country, a pattern of very high costs also emerges in Latin America. Studies of individual countries have attempted to put exact dollar figures on these costs by simulating the registration of a new small business. The precise numbers should be accepted with some caution—nevertheless, they illustrate the significant costs imposed on these businesses.

For example, a study carried out in Peru found that the *cost of legality* (the difference between the costs of operating fully within the law and an informal enterprise) is between US\$590 and US\$1,231 per month for a small business (Tokman and Klein 1996). A similar study in Costa Rica found that a typical microenterprise (with five employees or less and annual sales of US\$25,000) pays approximately US\$3,600 per year in ongoing obligations, including taxes (Fundes 1999). Finally, a third study in Argentina found that just the registration of a small business typically requires 129 working days and a minimum of US\$1,000 in fees to go through the required 34 steps (CEB 2000).

Clearly, while formality does have some benefits, it also imposes serious costs on businesses (as well as governments) in developed and developing countries. Ideally, these costs would be outweighed by equal or greater benefits to society. However, this is not always the case; the existence of large informal sectors in many Latin American countries suggests that the costs of such regulations in these countries outweigh the benefits they are meant to provide (Lagos 1995).

Why Business Regulations Matter to Informal Enterprises

Many small and microentrepreneurs operate in complete or partial informality. It would therefore seem reasonable to question whether business regulations really matter to them. After all, if they operate outside the legal framework, does it really matter if that framework changes? This paper takes the position that business regulations *do* matter to small and microentrepreneurs, even to those who operate in complete or partial informality. This position, in turn, is based upon two simple assumptions about the costs and

benefits of formality/informality as well as the behavior of entrepreneurs:

Assumption 1: Formality and informality both involve costs and benefits to the entrepreneur

Indeed, many of the benefits of formality are the opportunity costs of informality (for example, the ability to advertise openly). Conversely, the absence of many of the costs of formality (for example, taxes and other contributions) constitute the benefits of informality. From the perspective of the entrepreneur, the challenge is to determine whether the costs outweigh the benefits or vice versa.

Assumption 2: Small and microentrepreneurs behave rationally

Given the perceived costs and benefits associated with each decision regarding the formality of the business, small and microentrepreneurs will behave in a rational way to maximize their overall well-being. Since a fundamental aspect of personal well-being is material welfare, the entrepreneur will attempt to maximize material benefits without compromising other values. Naturally, the entrepreneur's cost-benefit calculation may be constrained by a lack of information, particularly in the cases of small and microentrepreneurs, but that fact does not invalidate the calculation. Rather, the calculation will be made with any available information—verifying existing information or acquiring new information is simply an additional cost of making a more informed decision.

In summary, entrepreneurs weigh the cost and benefits of formalization and formality, and pursue the course that will maximize their material and personal well-being. Consequently, government decisions that affect the costs and benefits of formalization and formality will influence the decisions of entrepreneurs—formal as well as informal. If costs are raised but benefits are decreased or remain the same, some business may opt to go underground. If costs are diminished and benefits increase or remain the same, a larger number of business owners will opt to formalize and stay formal. Simply put, it has to pay to formalize.

Not only do business regulations matter to small and microenterprises—formal as well as informal—but they arguably matter more to these enterprises than to larger ones (Morrison 1994). Although small and microenterprises are quite heterogeneous, they have a number of characteristics in common that leave them particularly exposed to changes in the regulatory environment once they have formalized.

Box 2. Can Business Regulations Explain Informality?

Most microenterprises and some small enterprises operate in partial or complete informality, not complying with some or all regulations in the areas of taxes, labor, health and safety, social security and operational permits. Does this noncompliance mean that regulations do not matter or matter less to them?

One answer to this question was provided by Peruvian economist Hernando de Soto in his 1984 book, *The Other Path*, where he depicts the informal sector as the logical result of excessive and inappropriate regulation. Informal enterprises simply respond to “the impossibility of complying with the existing regulatory apparatus.”

In making the argument, de Soto documented a simulation that he and his researchers carried out in Peru, in which they attempted to legally register a fictitious small business (a rudimentary clothing factory). During this process they experienced firsthand the many of steps and high cost of registration and regulatory compliance faced by Peruvian entrepreneurs in their daily activities.

De Soto's view is based upon a fundamental assumption: that microentrepreneurs in the informal sector, as rational business people, conduct some sort of cost-benefit analysis to determine whether or not formality is in their interests.

Opponents of this view (Tokman and Klein 1996; Ricardo Lagos 1995) argue that the informal sector should rather be thought of as an outcome of the decentralization and reorganization of production and work processes at the global level. According to this view, not complying with legal regulations is a *consequence* of carrying out economic activity in the informal sector, not its *cause*.

For starters, small and microenterprises are usually owner-operated businesses with limited administrative resources, management capabilities and familiarity with government institutions. They therefore tend to be more vulnerable to new or additional regulations that increase the complexity of and time required for compliance.

Small and microenterprises also typically have uncertain cash flows and limited access to financing. Consequently, fixed monetary obligations that do not vary in accordance with cash flows or revenue (such as labor costs, which are often fixed due to laws controlling the firing of employees) may create more serious difficulties for smaller businesses than for larger businesses.

Box 3. Peru's Major Regulatory Reform of the Early 1990s

To deal with excessive paperwork and cumbersome bureaucratic procedures, the Peruvian government asked the Instituto de Libertad y Democracia (a Peruvian think-tank headed by Hernando de Soto) to draft a law and an administrative strategy to streamline bureaucratic procedures and facilitate institutional reform. For two years, public hearings and debates were held on the matter, featuring legal specialists, congressmen and the general public. These events not only added substance to the proposal ultimately crafted, but they also created significant support for it.

As a result, in June 1989, the new law was unanimously approved in Congress with no major modifications (Law No. 25035 for Administrative Simplification). The government now had the mandate and means needed to decrease or eliminate unnecessary red tape, streamline public administration, and substantially reduce transaction costs.

The new law rested on four pillars: 1) substituting most ex ante requirements that create legal bottlenecks with ex post controls; 2) keeping the costs of operating legally below those of operating illegally; 3) decentralizing decision-making procedure; 4) promoting user participation to control the application of all decisions.

Source: Instituto de Libertad y Democracia.

Small and microenterprises are also affected differently, though not always more severely, than larger businesses because of some other typical characteristics. Since they tend to use relatively more labor and less capital in their operations, and typically employ family members to carry out many of the business' activities, changes in labor policies have a different impact on them as compared to larger businesses. Furthermore, the fact that small and microenterprises are often home-based or operate from informal market venues mean that they are subject to different zoning laws than larger businesses. Finally, since small and microenterprises generally buy and sell in domestic markets, they tend to be more affected by policies that have an impact on local economic conditions, as opposed to changes in export and import policies.

For these reasons, small and microenterprises are generally more sensitive and vulnerable than larger businesses to changes in certain aspects of the regulatory framework. In particular, given their limited administrative resources and uncertain cash flows, changes in fixed fees or administrative complexity tend to have a more significant impact on these businesses than on larger ones.

The Case for Business Registration as a Priority Area for Reform

Business regulation is a complex topic that covers many different processes and requirements. As a result, the range of possible reforms is virtually unlimited. However, one of the more promising areas for reform, in the context of promoting small and microenterprises, is the business registration process. This process, often marked by redundant and overly complicated procedures, is the immediate and crucial hurdle that the entrepreneur faces to become formal and operate legally. A complicated and lengthy registration process creates a lasting negative impression that prevents new businesses from being formed and discourages already operating (informal) businesses from taking the step to formality. Although conditions vary from country to country, there are several other reasons why business registration reform should be given a high priority:

Business registration is specific and addressable from a public policy point of view. Business registration is carried out by government entities and is therefore perfectly addressable through public policy. The same cannot be said about all other issues facing microentrepreneurs. For example, the fact that many small and microenterprises have limited access to financial and non-financial services is not necessarily a result of barriers that the government can directly and effectively address.

Reform of the business registration process has a positive and immediate impact on small and microenterprises at a crucial stage in their development. In most cases, business registration takes place early in the life of an enterprise when it is a small or microenterprise. Consequently, a faster, cheaper and simpler process will primarily benefit smaller businesses, which provide the majority of employment opportunities in virtually all countries.

Reform of the business registration process implies no social trade-off. Because reform of the business registration process does not involve particularly sensitive issues or the redistribution of wealth or income, this type of reform runs little risk of large-scale opposition or protest. In fact, everyone has something to gain from a re-

form that makes registration and compliance easier and more efficient. The potential source of conflict would be limited primarily to the government agencies most directly affected by the reforms, which may perceive that their regulatory mandates are being threatened.

Many other potential areas of reform do not measure up to these criteria. The underlying issues may be difficult to directly address with public policy; they may not have any obvious differential impact on small and microenterprises; or they may entail significant social trade-offs or the redistribution of wealth. In addition, reform of initial business registration is a good place to start since achievements in this area could be extended in a longer-term effort to make ongoing compliance easier.

Although business registration is a promising area for reform, it is important to recognize that its overall impact may be limited. While it does lower the cost of *becoming* formal, it does little to raise the benefits or lower the costs of *being* formal. And as was pointed out earlier, the consideration of such costs and benefits does influence entrepreneurs' decision of whether or not to formalize. Therefore, the effect of business registration reform may be diminished if the ongoing costs of formality remain high.

From Theory to Action: Reforming Business Registration

An Agenda for Latin America

Typically, a Latin American microentrepreneur who wants to register his or her business must run a gauntlet of repetitive, convoluted, and tedious requirements at various government agencies. The myriad of formal requirements and the long processing times of the authorities virtually guarantee a drawn out, onerous, and costly registration process (see Table 2).

At the low end, the Panamanian entrepreneur must navigate through 7 procedures; at the high end, the Bolivian entrepreneur must steer through a full 20 procedures. In Panama, this process takes the entrepreneur 14 working days, in Bolivia it takes the entrepreneur 82. However, in terms of number of days, Bolivia is not the worst in Latin America. In Ecuador, the process takes an amazing 141 working days. On average, the business registration process imposes 13.5 procedures and requires 92.7 working days for the region's entrepreneurs. In terms of calendar time, the process usually takes several months since government agencies seldom provide immediate responses to registration requests. For example, estimates have put the total calendar time of registration at 3-5 months in Panama, 6-8 months in Venezuela, and 8-10 months in Ecuador.

But this is not the whole story, because these numbers are for the most basic and fundamental registration requirements (commercial registry, taxes, social security, health and safety, general municipal permit). If a business needs specific industry or environmental permits, conducts foreign trade, or trades in goods subject to excise taxes (such as liquor), then the number of procedures and amount of time to register increase significantly. Finally, if the business operates far away from the capitol, then the required travel will further increase the time need to achieve full registration.

For the dubious pleasure of navigating the business registration process, entrepreneurs in Latin America have to pay fees from the equivalent of 0.06 percent of GDP in Uruguay to 2.63 percent in Bolivia. On average, entrepreneurs in the region pay fees the equivalent of 0.47 percent of GDP. While this cost is significant in some countries, it is probably not enough to constitute a real deterrent to registration. However, if the cost of notarization and registering trademarks were to be included, the cost would increase considerably (typically by US\$200 and up).

Finally, in many countries entrepreneurs are confronted with bureaucracies where extortion in the form of informal *rush fees* is business as usual.

A regional comparison does not make matters look any better for Latin America – it ranks dead last behind USA, Europe, Asia and even Africa. Just to put things into perspective, it takes about twice as long and costs twice as much to register a business in Latin America as it does in Europe. This may give the impression that the complexity of the registration process is a function of the income level of the country, but that is only true to a limited extent. In fact, the nature of the business registration process is more correlated with a country's general political system. The more open and participatory the system—the simpler and faster the business registration process. Unfortunately, a more demanding business registration process does not seem to be associated with higher quality products, less pollution or improved public safety. Instead, stricter regulation creates more corruption and a larger informal sector.

At the end of the day, the primary beneficiaries of an extensive and demanding business registration process are not the entrepreneurs or the general public, but the politicians and bureaucrats (Djankov et al. 2000).

Today, virtually every government in Latin America recognizes business registration as an important component of the overall regulatory environment for private enterprises (ILO 1997). The global economy is gradually pushing governments to find ways to enhance the competitiveness of the private sector, particularly for small businesses, which are crucial in generating employment. Also, in many countries, a general shift in how private citizens, businesses and the

government view one another is underway. Governments are now expected to promote the private sector and serve its citizens, not the other way around. Finally, the increasing availability of personal computers and data networks is allowing governments to consider a wider range of options to expand the possibilities for convenient and efficient streamlining the business registration process. Ideally, the governments are looking for solutions that allow the registration process to be quick, simple, inexpensive and

Table 2. Business Start-up Registration in Latin America^a

COUNTRY	NUMBER OF STEPS	TIME (BUSINESS DAYS)	FEES (% OF GDP)
Argentina	12	71	0.23
Bolivia	20	82	2.63
Brazil	15	67	0.67
Chile	12	78	0.12
Colombia	17	55	0.12
Ecuador	12	141	0.16
Mexico ^b	15	112	0.57
Panama	7	14	0.31
Peru ^b	14	171	0.21
Uruguay	9	105	0.06
Venezuela	15	124	0.11
Latin America avg.	13.5	92.7	0.47
Africa region avg. ^c	12.0	83.0	0.88
Europe region avg. ^d	9.3	59.5	0.18
Asia region ^e	10.0	71.1	0.27
USA	4	7	0.01

Source: Djankov, Simeon and Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Schleifer, "The Regulation of Entry", National Bureau of Economic Research. 2000.

Notes:

- a. The table includes only procedures where the entrepreneur(s) are required to interact with outside entities (such as government agencies, lawyers, auditors, and notaries). Procedures that the entrepreneur(s) can avoid or delay until the business is registered (such as reserving exclusive rights over the company name) are not included. Further, the estimated costs do not include bribes, opportunity costs, and foregone profits, which obviously can be significant in many countries. Finally, the numbers assume that the entrepreneur knows all steps beforehand and does not need any time to gather information regarding the process. It further assumes that the minimum time for each visit to an agency is one day, given that entrepreneurs often come from out of town and many agencies are only open a couple of hours per day.
- b. As Box 4 indicates, other observers report a very different duration of the registration processes in Peru. Similar discrepancies can be noted for Mexico, where some claims that the registration process requires significantly less steps and time than indicated in this table.
- c. 9 countries
- d. 24 countries
- e. 11 countries

accessible in multiple locations close to where the businesses operate.

International Experiences in Streamlining Business Registration

In spite of the increased interest and possibilities in the area of business registration, turning theory into action has proven to be a relatively complex undertaking. The issues involved cut across local, national and agency jurisdictions, include complex legal and technical considerations, and at times challenge special interests. Nevertheless, there are countries around the world that have confronted the issue and come

up with innovative and efficient solutions. The greatest successes have been achieved in Europe and North America, but significant progress in streamlining business registration processes has

also been achieved by countries in other regions. Notably, Australia (1989), Ontario, Canada (1994), Mexico (1995), Peru (1990-92) and Spain (1996) all reformed their business registration systems during the 1990s with some success. Their experiences highlight some basic issues that must be addressed in any reform effort, and present some generally applicable principles for how to achieve success in this effort (SRI International, 1999; European Commission, 1997).

Choosing the Approach to Business Registration Reform

When reforming the business registration process, governments will be confronted with at least six fundamental issues, or choices, that must be sorted out at the planning stage, before the actual work is started. In many cases there is no “right answer”; rather, the choices must be based on the particular characteristics and conditions of each situation/country.

Should the reform seek fundamental change or just administrative improvements in the current system?

Some reform efforts seek to comprehensively change the underlying regulatory framework for the business start-up system; others take a more modest approach by essentially trying to make the existing system work better. Spain, for example, did not really change the fundamental workings of its registration system but rather aimed to streamline its administration by delegating the primary contact functions (such as receipt of applications) to the municipalities. The decision-making authority remains with the central government agencies. As a result, while registration has become much simpler, the total processing time remains several weeks in length. Ontario, Mexico and Australia, on the other hand, made efforts to address some of the underlying bottlenecks.

Box 4. Reaping the Rewards of Business Registration Reform in Peru

In 1990, the government of Peru made a major commitment to address the obstacles that small businesses were facing in operating in the formal economy. Later the same year, the government sponsored a new law aimed at radically reducing the time required to obtain a license to operate a business legally. As part of this reform, the Unified Business Registry was established.

The introduction of the Unified Business Registry reduced red tape and costs dramatically: the nearly 300 days it previously took to obtain a business license were cut to one day—and one desk; the cost was slashed by seven , from US\$1,200 to US\$174. Consequently, between 1991 and 1997 alone, 671,300 businesses were legalized, creating 557,770 new jobs.

The creation of the Unified Business Registry also saved a total of US\$700 million dollars in administrative expenses and losses. In addition, the collection of just three of the most important taxes increased by an annual average of US\$248 million. The Unified Business Registry has since been absorbed into the federal tax administration.

Source: Instituto de Libertad y Democracia.

Should the reform effort seek broad or targeted results?

While a broader deregulation effort may allow for a comprehensive change in business regulations that includes the registration system, it is often easier to gather support for a narrower, high visibility project that focuses on the business start-up process. The streamlining effort in Spain, which was not part of any larger deregulation program, illustrates this latter approach. In contrast, Mexico's effort to streamline business registration was part of a major national program designed to significantly deregulate the country's economy. Ontario and Australia also followed a *broad* reform approach.

What should the role of technology be to facilitate the registration process?

Some reform efforts incorporate sophisticated technology to interface with businesses and process their applications; others take a more low-tech approach in which the simplification results from administrative or procedural changes rather than the incorporation of technology. Ontario has chosen a high-tech approach whereby virtually all aspects of business registration can be completed on-line within 20-30 minutes. Spain's effort, originally low-tech, is increasingly incorporating technology to streamline the process further. Naturally, this approach requires significant networking and database capacity to share the information among the relevant government agencies. Mexico and Australia also made serious efforts to use technology as a means to streamline the registration process in their countries.

What levels of government should and need to be involved in the reform effort?

Simplification projects can be carried out at different levels of government, either separately or jointly. In either case, a fair amount of coordination between central and local/regional governments is important to maintain consistency in the registration process. Generally, the ability of the federal government to demand collaboration is given by the constitutional devolution of power to state and local communities. Consequently, in some countries, states and local communities cannot be obliged to participate in reform efforts promoted by the federal government.

Australia, Mexico and Spain all took a similar approach to the issue of inter-jurisdictional collaboration. In general, federal agencies were required to participate in the project, but individual states or communities were not. However, states and local communities were invited and offered federal assistance to facilitate the reforms. In Australia, the federal government provided partial funding as an incentive for reform but allowed the states to develop their own programs. Queensland took the lead and developed the Smartlicense, a system that later served as a best practice example for other states. Efforts for collaboration were also met with success in Mexico and Spain. In Spain, for example, the success of the reforms has resulted in an ever-increasing number of municipalities wishing to sign on with the program. However, the voluntary and somewhat piecemeal approach to reform has also produced some geographic differences in business registration procedures.

Table 3. Different Countries' Approaches to Streamlining Business Registration

CATEGORY	MEXICO	AUSTRALIA	ONTARIO, CANADA.	SPAIN
Fundamental vs. administrative reform	Fundamental	Fundamental	Mix	Administrative
Broad vs. narrow reform	Broad	Broad	Broad	Narrow
Role of technology	Mix	High-tech	High-tech	Low-tech
Levels of government involved	National	Local & nat'l	Local	Local & nat'l
Inter vs. intra-agency reform	Intra-agency	Inter-agency	Inter-agency	Inter-agency
Voluntary vs. mandatory participation	Mandatory	Mandatory	Mandatory	Voluntary

Source: SRI International, 1999

Should the reform focus on intra-agency procedures or inter-agency relationships?

A simplification process may emphasize the internal workings of government agencies or the interaction among them. Mexico focused its efforts on making the individual agencies more responsive and efficient, while Spain, Ontario and Australia emphasized the integration and harmonization of agency requirements. For example, in Ontario the streamlined business registration process encompasses several inter-jurisdictional divides, not only in terms of level of government, but also thematic areas such as health, taxes, labor and operational permits.

Principles for Streamlining Business Registration

The experiences Australia, Peru, Spain, Mexico, Canada (Ontario) are instructive in identifying certain basic principles that should characterize any reform effort of the business registration process. If applied, these principles will enhance the likelihood of achieving a faster, less complicated and more responsive system of registering businesses, regardless of the choice made in relation to the six issues, or approaches, discussed earlier.

Undertake a comprehensive review of business start-up formalities

Governments often lack comprehensive and detailed knowledge of their own business registration system—knowledge that is absolutely necessary for the design of an effective reform program. As part of the simplification effort in Mexico, a special deregulation unit was set up under the Ministry of Industry and Commerce to review all existing business formalities, including start-up requirements. Although the review and revision of the regulatory process can be time-consuming, the comprehensiveness of the approach led to much more fundamental reform than if the government had sought fast results.

Use widely available technology to facilitate the interaction between businesses and the government

The internet networking revolution is opening up extraordinary opportunities for creating unified points of contact that are not limited by office hours, geographical location, or manpower. However, it is important that the technology used in the registration process correspond to the skills and abilities of agency staff and prospective clients. A highly sophisticated system such as Ontario's may not (yet) be feasible in countries where the use of technology has not come as far. For places with less technological sophistication and fewer financial resources, the state of Ceará in Brazil provides a good example of what can be done. In 1985, the state adopted a low-tech assembly-line system in which several of the agencies involved in the registration process stationed personnel at the offices of the Junta Comercial (municipality). These officials are authorized to process registration requests. As a result, the time to register at several agencies has been cut from weeks to a few hours.

Establish a single business identification number to expedite and track the processing of official requests

While a unified government interface is important to businesses, a single identification number will enhance the government's ability to provide fast and reliable service to businesses. Oregon and Ireland are examples of two governments that have begun to unify various identification numbers. In Oregon, the single business identification number is used when reporting, paying, or making inquiries about employment-related obligations, such as withholding, unemployment, and transit taxes and workers' compensation assessments. Similarly, Ireland has brought tax registration details for income, social security, value-added taxes together under a single registration number.

Set target deadlines for as many procedures as possible

A useful principle is *affirma ficta*, whereby official requests accepted by the authorities are automatically approved if the responsible agency does not respond within the time period specified in the law. Mexico has successfully introduced such a system, which now allows businesses to start operations within 7 working days in the case of low-risk activities and 21 working days for businesses whose activities require health, safety or environmental controls.¹ This compares to 46 days and 200 days, respectively, before the reform (SRI International, 1999).

Peru provides another example of how to curtail the bureaucracy's ability to prolong the application process. Once an administrative process has been initiated, it may not be halted on grounds of insufficiency or inadequacy of the provided documentation but only for reasons of inaccuracy. Furthermore, if the applicant has not heard from the agency within 60 days, he or she has the right to assume that the application has been approved. Peru has also taken the additional step of instilling accountability among public agencies by forbidding them to demand machine-typed forms, more than one copy of any document, or uncommon forms of identification from clients.

Maintain close coordination between national and local authorities.

The case of Spain illustrates how close coordination between municipal, regional, and national governments has created a framework that can be easily expanded upon, in terms both of geographic coverage and functional scope. New municipalities that want to sign on to the voluntary program need only sign standard, ready-made agreements with the national and regional authorities that commit them to manage incoming paperwork in a standardized way. An on-line system will soon connect all layers of government over the internet, allowing officials from

¹ According to records, 73 percent of activities are considered low-risk.

each level to track the status of applications and files.

Provide adequate training and resources to licensing authorities

One of the success factors in Australia was the award of federal funds to help states cover the costs of reform. Additionally, the federal government provided training to licensing authorities on the use of new technologies for business registration.

Make all information regarding registration requirements and procedures widely available and accessible to the public.

In Australia, entrepreneurs have easy access to regulatory information through the Internet and other media. The popular Business License Information Service (BLIS) provides a comprehensive database of registration and permit needs through the Internet, while other programs make the same information available via diskette or telephone. In addition to these dissemination strategies, it is also important to provide assistance in completing the requirements. Technical assistance tends to have the greatest positive effect on small businesses and microenterprises, which generally do not have the resources to spend on legal assistance. The success of business registration efforts in Ceará, Brazil, is partly built on the technical assistance given to applicants, many of whom are illiterate or semi-literate.

Maintain a feedback loop whereby clients can express their (dis)satisfaction with the process.

The strength in Ontario's reform process comes from consistent review and innovation. The state has successfully incorporated the principles of customer input, review, and program innovation as core features of its streamlining efforts. For example, many of the new regulations have *sunset* clauses built in to ensure that these regulations will be reviewed within a certain time limit. This process helps to ensure that the red tape burden will be minimized in the future, as well.

Involve the private sector

In addition to the issues outlined above, the role of the private sector is becoming an increasingly important issue to consider. Business registration has traditionally been controlled and managed by the state. However, as ideological changes and technical advances create new opportunities for public-private partnerships, the role of the private sector in the registration process is becoming an increasingly important aspect to consider. In the United States, for example, individuals can hire the services of private registered agents, and with just a phone and fax, can form a corporation in just 24 hours. Similar efficiency can be experienced in the United Kingdom, where private services provide *shell companies* that can be instantaneously activated. These shell companies are legally incorporated and registered companies that remain inactive until an owner has been identified and a business purpose established.

Some Final Considerations

In addition to the principles already mentioned, political commitment, budgetary power and con-

stituent support are crucial aspects of any reform program. For example, the success of the streamlining efforts in Ontario and Mexico were principally due to the political commitment of the premier and the president, respectively. Whenever impasses were reached, these individuals would step in to create momentum and make the bureaucracy resolve any problems.

Budgetary power can make or break a reform effort. The implementation of the Mexican reforms, although successful in the end, was considerably delayed due to the limited leverage that the implementing agency had over other government departments. Experience has revealed that agencies with power over other agencies' budgets, such as the Office of Management and Budget in the United States, tend to receive more cooperation.

Finally, constituent support is important for the legitimacy and long-term survival of the program. Spain built constituent support among municipalities by using a voluntary approach and gradually proving the benefits of reform. Ontario and Australia consulted extensively with the private sector before and during the reforms.

A Case Study in Business Registration Reform

It is useful to learn about approaches and principles in international best practices, but how can theory be applied in practice? And what will it cost? These are the basic questions a project officer or government official would face if tasked with the design of a proposal to streamline a country's business registration process.

Because of the complexity of business registration reform, there is no single way to structure a reform effort. This is particularly true when country differences are taken into account. So, instead of trying to define a universal approach, it may be more useful to present a concrete example (Costa Rica) and let it serve as a basis for others to use and adapt as necessary. Suffice it to say that it is just *one* example of what can be done in this area.

Sizing Up the Potential Benefits of Reform

The government of Costa Rica and the Inter-American Development Bank recently agreed to co-finance a reform of the country's business registration process. The reform will cut the total calendar time to register a business by an estimated 75 percent and reduce the cost by an estimated 25 percent. In total, about 93,000 entrepreneurs will benefit over a ten-year period, each one of them saving the equivalent of approximately US\$130 (in time and fees) as the result of faster and cheaper processing under the reformed system. The project will not only benefit the entrepreneurs, but also the government, which will be better able to monitor and analyze patterns of registration, including the partial evasion of certain requirements. While the total cost of the project will amount to US\$960,000, which includes approximately US\$180,000 for its administration (a coordinator and a part-time assistant), a tentative cost-benefit analysis indicates that the project will have a net present value of approximately US\$4.4 million, mainly as a result of the large number of entrepreneurs that will benefit.

The project will be implemented in close collaboration with a technical secretariat established by the Costa Rican government as part of a nationwide effort to eliminate and modify excessive and inappropriate regulations. This arrangement will provide a direct path and the means to formally propose legal and regulatory changes to the executive and legislative branches of government. Alternatively, in other countries, the project could be co-financed and carried out by one or several private entities, with the collaboration of the government in submitting legal and regulatory proposals. In either case, it is obviously crucial to have a clear and strong commitment by the government.

The Maze of Business Registration in Costa Rica

In Costa Rica, it currently takes several months and several hundreds of dollars to register a business, depending on such factors as the company form (sole proprietorship, partnership or corporation), sector, or level of public health hazard associated with the business. To fully register a business, entrepreneurs in Costa Rica typically must approach at least six government authorities:

1. Commercial Registry
2. Tax Authority
3. National Insurance Institute
4. Social Security Institute
5. Ministry of Health
6. Municipality

The sequence of these visits is largely mandated: the Commercial Registry must be approached first and the municipality last, and registration at the National Insurance Institute must occur before registration with the Social Security Institute. Depending on the nature of the business, there may be additional requirements associated with each of these steps (for example, a restaurant must obtain clearance from the fire depart-

ment before registering with the Ministry of Health). However, before even approaching any of the six government institutions, the entrepreneur must first have the company's articles of incorporation notarized by an attorney, deposit a nominal amount of capital with a bank, and pay the stamp duties associated with the registration at the various institutions. At some point after registering with the Commercial Registry, the entrepreneur must also request the announcement of the company's creation in a particular official government journal.

The Nuts and Bolts of the Proposal

The proposal to create a one-stop-shop for business registration in Costa Rica has three dimensions: technical, legal and organizational².

The *technical* dimension of the project aims to establish the infrastructure of the streamlined registration system. In this case, it turns out to be quite simple. Basically, it consists of the installation and programming of a database through which all registration information will be channeled. The database will be based in a nonproprietary application such as Microsoft Access, and it will run on a server hosted by a private company. The information in the database will be accessible to the six government entities involved in the business registration process. The interface of the database will look like a web page, and the data will be available for downloading after users have provided the appropriate password. The entities connecting to the database will not have to acquire any additional hardware or software since the database application will be running on the server. The connection could be made using a simple dial-up modem. In addition to the database, the technical component includes the design of a unified registration form that will integrate all the information that the government agencies involved in the registration process request of the entrepreneurs.

² The proposal is based on a concept developed by CEAL, the Center for the Economic Analysis of Law, which assisted in the preparation of the project.

The *legal* dimension of the project focuses primarily on the legal and regulatory reforms needed to make the technical component work. The most important reforms for the functioning

of the one-stop-shop system are regulatory in nature and meant to ensure that the government agencies can legally recognize the electronic information transmitted through the database system, and that applicants do not have to appear in person at these agencies. In addition, the project will seek to update local laws to assure a generalized legal recognition of electronic information and to modify requirements relating to the notarization of a company's articles of incorporation and their publication in the official government journal.

The *organizational* dimension of the project addresses the issues of how the system will be managed and how the one-stop-shop service will be provided to the public. This may be the most innovative aspect of the proposal, because it envisions the creation of a nonprofit association whose members will *jointly* manage the database and *individually* offer the service to the public. The founding members of the association will likely be the chambers of commerce and industry, who have local offices in various cities and a direct mandate to serve entrepreneurs. However, membership will be open to any organization that wishes to offer the registration service through its network.³

To host and service the database, the association will contract a private firm and will thus need to meet only occasionally to make the overall decisions regarding maintenance and upgrading of the system. As a result, the association will not require any facilities or staff of its own. The costs of maintenance and upgrading of the database will be covered by a standard fee charged on each standard registration. A break-even analysis of the one-stop-shop system indicates that it will be entirely sustainable with a standard charge of US\$12 per registration in year

³ The final decision on how the network will be managed will be taken during the implementation of the project and based on an additional review of the different options in this regard.

one, decreasing to US\$7 per registration in year 10.

Beyond that fee, the individual offices/affiliates of the association's members will be free to add any charge they like to cover the costs of providing the service to the entrepreneurs. They will also be free to customize and differentiate services as far as the underlying technology permits. Moreover, if the individual government entities so wished, they could offer the one-stop-shop services to their clients directly.

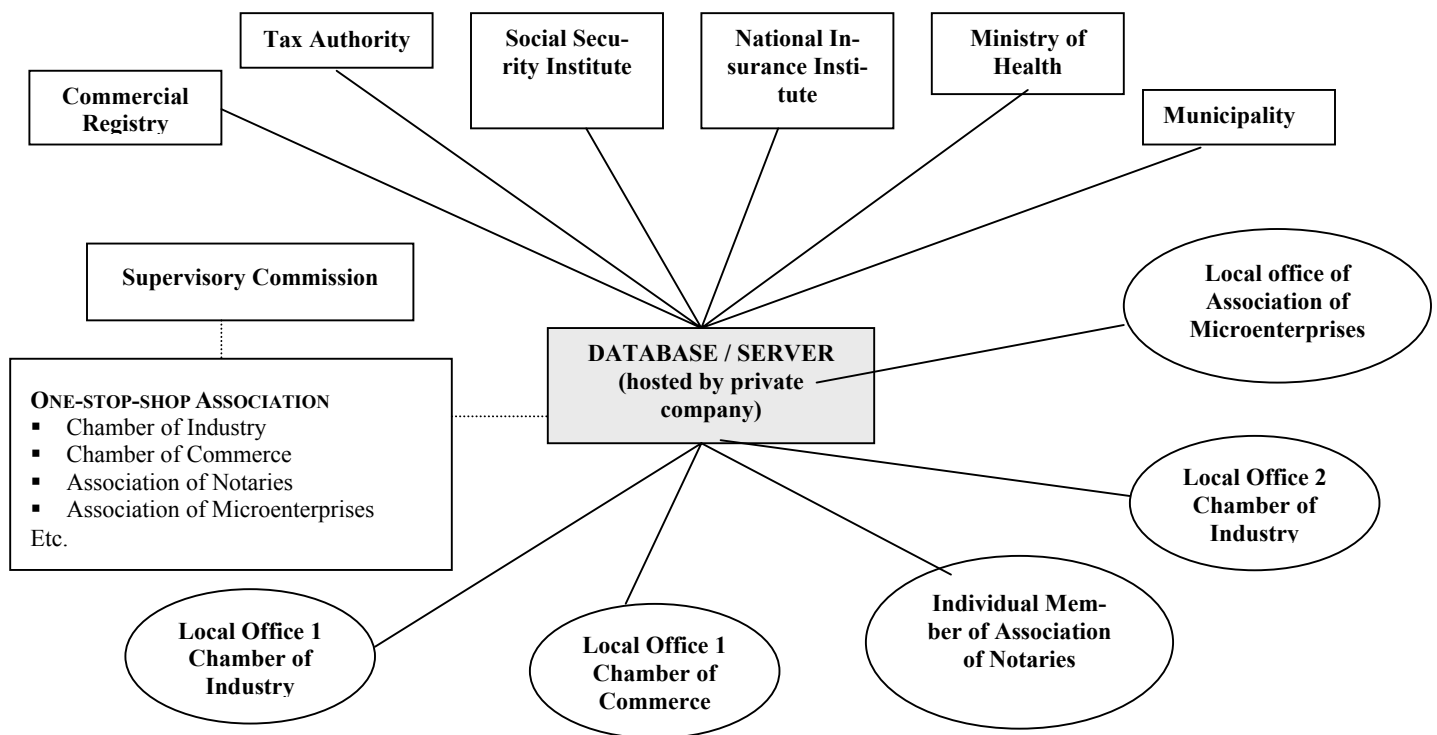
The proposed arrangement for managing the one-stop-shop system is shaped by several important considerations. First, through the local offices of the association's members, the system is able to provide wide geographic coverage at very reasonable cost. Second, the use of a non-profit administrator prevents potential misuse of a monopolistic situation (since there is only one one-stop-shop network). Third, the freedom of individual offices/affiliates to design and charge for their services encourage competition and innovation in the provision of one-stop-shop services to the ultimate clients. Fourth, the fee financing means that the system is self-

sustainable and not dependent upon the vagaries of yearly government budget negotiations. Fifth, the fact that the association's members offer the services through its local offices/affiliates means that there is a natural and seamless channel to raise complaints and suggestions for improvement of the system.

The government will retain a supervisory role in the administration of the system through the creation of an interministerial commission. This body will make sure that the association strictly follows its statutes and operating procedures; it will not make day-to-day decisions regarding the one-stop-shop system.

Figure 1 shows the basic structure of the proposed system. The six entities at the top of the diagram are the government agencies that make up the registration process. The five entities at the bottom of the figure are examples of those that might potentially provide the registration service. It is important to point out, however, that the government agencies will also have the option of providing this service themselves. The database, at the center of the diagram, will serve as the central point of contact between all of the actors.

Figure 1. Proposed One-Stop-Shop Registration System



Does this Project Address the Principles for Streamlining Business Registration?

It may be appropriate at this point to compare the project and the proposed reforms with the “principles for streamlining business registration” discussed earlier. This comparison shows that most—but not all—of the principles are addressed by the design of this project.

Principles Addressed

- √ Before approving the project, the IDB and the Government conducted a review of the current system. During this process, unnecessary, outdated and inappropriate requirements have been identified, and their foundation in law/regulation was established.
- √ The new system will eliminate redundant forms, regulations, steps and processes. It will merge the various informational requirements onto one form. The steps necessary for an entrepreneur to register a business will be consolidated, eliminating a variety of steps that previously delayed the process without adding value.
- √ A unified window of contact will be established. Entrepreneurs will use the one-stop-shop at various locations throughout the country, rather than going through various layers of bureaucracy at the local, state and national levels.
- √ Technology will be used as a central component of the new process, linking the six different agencies together using a common database/server and a simple interface.
- √ Coordination between national and local authorities will be greatly facilitated, since they will be involved in a common process. This coordination will cut processing times dramatically by enabling a parallel consideration of each registration request among the six government entities.
- √ A feedback loop will be created in the new system, whereby applicants can express their

concerns and suggestions via the local one-stop-shop.

- √ In addition, the proposed system has the potential to lower fees, particularly if notarization requirements are modified or eliminated, as well as encourage innovation and customization of registration services.
- √ Some initial technical training and orientation will be provided to the organizations that wish to offer the one-stop-shop registration service. However, since the primary candidates for providing this service (such as the chambers of commerce and industry) already work closely with entrepreneurs, a major training component will not be necessary.
- √ A single business identification number will be established within the one-stop-shop system, but it will not automatically extend to the government entities. These entities may choose to adopt the single number or add it to their own tracking numbers, but they will not be required to do so. This undertaking is a candidate for a follow-on project that will provide a further level of simplification and user-friendliness.

Principles Partially Addressed

In spite of its potential to significantly improve the registration process, the proposal is not a cure-all for the problems plaguing the registration process in this Central American country. In fact, there are some important aspects that the proposal will not address or only address partially.

- √ The one-stop-shop system will make all registration information available to the public through a web site, but only during the implementation of the project will significant resources be spent on informing the entrepreneurial community of the existence of the one-stop-shop system. However, it is entirely possible that the organizations offering the one-stop-shop registration service will advertise on their own to attract customers.

√ While the one-stop-shop system will provide for the parallel processing by the six participating government entities, it will not entail a major streamlining of the internal operating procedures of these entities. Some money will be available for this purpose; however, it has been purposely de-emphasized, since a major component in this area would have dramatically increased the dimension and complexity of the project. As a result, however, it will be difficult to achieve overall registration times of less than two to four weeks, which is the typical processing time of some of the entities. Given this, a major re-engineering of the government entities would be a natural candidate for a follow-on project.

Principles Not Addressed

√ The project will not provide resources to help entrepreneurs in filling out forms and completing the process in general.

This is something that the organizations providing the one-stop-shop service can choose to offer to its clients, either for free or for an additional charge.

This project in Costa Rica highlights both the potential and the challenges of a business registration reform by demonstrating how one country is attempting to address the deficiencies of its current system. For Latin American entrepreneurs to enjoy the benefits of a more efficient process, their governments must not only learn from the experiences of other countries, but must also take decisive steps to turn these lessons into action. Sometimes reform will work well with tried and tested techniques; in other instances, new and innovative approaches are needed.

With this project, the government of Costa Rica has decided to try something new and innovative.

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