

ECONOMIC EVALUATION OF ADMINISTRATIVE BURDEN FOR CONSTRUCTION IN JELGAVA MUNICIPALITY

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Abstract

The aim of this research is to make an economic assessment of the administrative burden, which is created by the construction regulation, on enterprises of Jelgava municipality in Latvia and to find solutions of how to reduce the administrative burden on enterprises by having no negative impact on the construction process. The research was carried out in the period 2009-2011. To evaluate the administrative burden, the Standard Cost Model with some modifications and adaptations was used. It was concluded that 9 legislative acts related to construction are creating a notable bureaucratic burden (EUR 2.94 million annually) on enterprises in Jelgava municipality. The authors have developed 37 recommendations to reduce the administrative burden and by implementing these recommendations, the administrative burden on enterprises could be reduced by 45% or EUR 1.33 million annually.

Keywords: *administrative burden, construction, Jelgava municipality, Latvia.*

JEL classification: D73 - Bureaucracy; Administrative Processes in Public Organizations; Corruption.

1. INTRODUCTION

The challenge for governments is, on the one hand, to balance their need to use administrative procedures as a source of information and as a tool for implementing public policies, and on the other hand, to minimise the interferences implied by these requirements in terms of the resources demanded to comply with them (OECD,2009:6).

In many countries sub-national political entities (states, provinces and municipalities) perform an important function in fostering a sound business climate. A local government is often the first point of interaction for businesses, where the highest administrative burden is concentrated. Traditionally, reform efforts have been applied at the national level. Given recent decentralization trends and the greater responsibility of municipalities to apply regulations, however, local reform is becoming ever more important (Sislen,2007).

Large attention is paid to simplifying administrative procedures in both the European Union and OECD countries. The process of administrative simplification in OECD countries is carried out under a slogan “Cutting Red Tape”. Yet the EU implements the Better Regulation Policy aimed at simplifying and improving existing regulation, to better design new regulation and to reinforce the respect and the effectiveness of the rules, all this in line with the EU proportionality principle. Part of the Better Regulation Policy is the Action Programme for Reducing Administrative Burden in which the European Commission proposes actions in order to reduce the cost stemming from EC and national regulations by 25% until 2012. These costs are presently estimated to amount to 3.5% of GDP in the EU. Achieving this objective could lead to an increase in the level of EU GDP of approximately 1.4% or € 150 billion in the medium term. So far, reduction measures presented or foreseen represent savings in excess of € 30 billion (EC,2007; EC,2009).

According to the European Commission’s assessment, the overall administrative burden on businessmen in Latvia is approximately 6.8% of GDP. It is almost two times more than the average level of 3.5% of GDP in EU-25 countries and more than the level of 1.5% of GDP in Sweden and Finland. According to the “Guidelines for Development of the Public Administration Policy for 2008-2013”, a goal was set in Latvia – to reduce the administrative burden on average by 25% until the year 2013 (Ministry of Economics,2009). The direct financial gains from reducing the administrative burden, which can be achieved without doing an automatic budget consolidation, could be a significant measure of saving funds and increasing productivity at the present situation in Latvia (Ernst&Young,2010:4).

The construction industry is a source of one of the highest administrative burdens in Latvia, according to assessments made by foreign institutions and a survey of Latvian businessmen on the quality of business environment. According to the World Bank's study „Doing Business 2010”, Latvia is ranked in the lowest 78th position regarding getting construction permits if compared to the neighbouring countries – Lithuania and Estonia (Ministry of Economics,2009:22).

The **research aim** is to assess the administrative burden in the construction process in Jelgava municipality by means of the Standard Cost Model. To achieve the aim, the following **research tasks** were set forth:

1. to assess the administrative burden in the construction industry in Jelgava municipality, adapting the Standard Cost Model to the needs of the present research;
2. to make recommendations for reducing the administrative burden.

2. METHODOLOGY

The Standard Cost Model methodology (SCM Network, 2005) was used to measure the administrative burden (AB) facing Latvian enterprises when complying with the construction regulations. The Standard Cost Model was launched in March 2007 by the EU Commission as part of its Better Regulation Policy. The methodology used is based on the EU “standard cost model”, drawing on national variants currently used in 20 Member States. The purpose of the Standard Cost Model is to provide a common cost assessment tool which would support the Action Programme objective which: “aimed at measuring administrative costs, identifying and reducing administrative burdens, without undermining the underlying objective of the legislations” (EC,2007; EC,2009; Cavallo,2007).

Administrative costs are measured on the basis of the average cost of the required action (price) multiplied by the total number of actions performed per year (quantity). The part of administrative costs corresponding to what businesses do solely because of a legal obligation is considered as an “administrative burden”. The part corresponding to what businesses would usually do even in the absence of a legal obligation is called “business-as-usual costs” (EC,2010:7).

Taking into account that detailed guidelines for applying the SCM methodology can be found at the SCM Network website - <http://www.administrative-burdens.com>, this part of the paper mainly focuses on description of data resources as well as on assumptions that were used in order to implement and adapt the SCM in Latvia.

The process of construction in Latvia is regulated by national normative documents – laws, regulations of the Cabinet of Ministers, and related municipal regulations. Totally, 3 national and 6 municipal legislative acts regulating the construction process in Latvia were analysed. In this research, the administrative burden assessment was done according to the *ex-post* scheme, evaluating those legislative acts and applying the costs which were topical at the time when the research was carried out (i.e. years 2009-2011). The *ex-ante* scheme was applied to determine the administrative burden (AB) in construction for a medium term, assuming that the national economy will gradually overcome the crisis and the construction activity will increase, reaching the level of the previous years.

The SCM methodology is criticised for not including some costs in it, for instance, in case a production process is prolonged or delivery of goods is delayed due to doing some administrative procedures (Cavallo,2007). In a Standard Cost Model used in Australia, such costs are called delay costs which include costs related to idle times of land, capital, and labour as well as foregone income in the result of losing business opportunities (State Government of Victoria,2010). Therefore, in the research conducted in Latvia, the idle time costs incurred by idle time of financial capital due to doing administrative procedures were computed for the construction process. All the costs related to preparing construction documents, including developing a construction design and municipal payments directly related to receiving certain services from a municipality were included in the computation.

In order to get valid research results, various stakeholders - businessmen, professional organizations, experts and public institutions - were involved in the process of the administrative burden assessment. The authors conducted more than 80 in-depth business interviews with businessmen and citizens involved into the construction process and dealing with Jelgava city municipality during the process of getting different permits for construction. Within the research, more than 20 meetings with the experts from Jelgava city municipality and different public institutions (for instance, Ministry of Justice, Latvian Builders Association, State Land Service, Faculty of Rural Engineering of Latvia University of Agriculture, etc.) were conducted.

3. COMPUTATION OF THE ADMINISTRATIVE BURDEN FOR CONSTRUCTION IN JELGAVA MUNICIPALITY

Jelgava is the fourth largest city of Latvia with 64900 residents. As a result of the economic crisis, the construction activity in the city decreased from 852 construction initiators in 2007 to 318 in 2010.

The total administrative burden in construction in 2010 amounted to EUR 1.29 million, but with increase in the construction activity in a medium term, the annual administrative burden is estimated at EUR 2.94 million. The AB comprises the standard administrative procedure in construction to which, in accordance with the legislation, all construction projects as well as renovations, reconstructions, restorations, and demolitions of existing buildings are subject and also so called simplified administrative procedures in construction and various permits related to construction operations.

The standard administrative procedure in construction accounts for the largest part of AB (88% in 2010 and 93% in a medium term). The standard administrative procedure consists of the following stages (see table 1): 1) receipt of the permission for starting construction from the municipality; 2) elaboration of the construction design; 3) receipt of the construction design approval from the municipality; 4) receipt of the construction permit from the municipality; 5) construction works; 6) receipt of the approval of corrections for the construction design from the municipality; 7) building acceptance in the municipality.

Table 1: Computation results for the administrative burden in Jelgava municipality regarding the standard administrative procedure in construction, EUR

Stages of construction	Procedures		Idle time		Total	
	2010	Medium term	2010	Medium term	2010	Medium term
1. Starting construction	15 030	27 327	22 500	97 453	37 530	124 780
2. Construction design	56 713	127 023	32143	97453	88 856	224 476
<i>Expenses of construction design</i>	<i>327 152</i>	<i>890 211</i>	-	-	<i>327 152</i>	<i>890 211</i>
3. Approval of design	12 743	34 027	77544	210323	90 287	244 350
4. Construction permit	19 333	60 278	110080	300507	129 413	360 785
5. Construction works	35924	104965	-	-	35 924	104 965
6. Corrections for design	9 955	27 089	122653	248517	132 608	275 607
7. Building acceptance	100 131	193 954	188697	321611	288 828	515 564
Total	576 982	1 464 874	553 616	1 275 864	1 130 598	2 740 738

Source: developed by the authors

To start a construction project, an approval of Jelgava municipality has to be obtained, which states that implementing the construction project is possible and corresponds to the territorial plan of the local municipality as well as the respective construction regulations. To elaborate a construction design, it is required: topographical information approved by Jelgava municipality and technical standards from the institutions engaged in a particular construction project, for

instance, suppliers of electricity, gas, and water and other public utility companies. The construction design has to be submitted for approval in the municipality, and in order to start construction works, a construction permit has to be obtained from the municipality. The administrative burden emerges also during construction, as a construction company has to keep a large amount of records and collect and register various documents related to construction works.

A survey of businessmen engaged in construction showed that deviations from the construction design approved by the municipality usually arise during construction. Therefore, the largest part of construction designs has to be corrected and repeatedly submitted for approval in the municipality. In 90% cases, the need for repeatedly submitting a construction design becomes apparent after construction works are completed and the construction company wants to put a building into service. It means that any idle time creates an additional administrative burden, as the intended use of the building cannot be started and no return is gained from investment because some administrative procedures have to be completed. To put a building into service, approvals of all the institutions interested in construction regarding compliance of the building with the legislation have to be obtained, updated topographical information has to be prepared and submitted for approval to the municipality, as well as a building inventory file has to be ordered at the State Land Service.

According to Latvia's legislation, all public institutions, including municipalities, have to process applications within a month. The survey of Latvian businessmen showed that businessmen were able to complete their administrative procedures related to construction within 30 calendar days in most cases, although the average periods of doing administrative procedures range from 16 to 170 days. During the recent two years, putting a building into service took the most time for businessmen or on average 170 days (Laboratory of Analytical and Strategic Studies Ltd.,2009:113).

The administrative burden regarding the standard administrative procedure in construction includes also idle time costs. To do construction business, large funds are needed, which are attracted as own capital or loans. If these funds are "frozen" and give no return because it requires some time to do administrative procedures, the return that is not gained has to be added to administrative burden costs. In 2010, idle time costs accounted for 49%, but in a medium term – 47% of total administrative costs (see Table 1).

If analysing the cost structure by stage of construction process, the largest administrative costs are related to developing a construction design and putting a

building into service. With the construction process approaching its end, idle time costs significantly increase, as a more and more larger amount of funds is attracted, the idling of which incurs larger costs. Recommendations for reducing idle time costs in the final part of doing administrative procedures regarding construction are of great importance. According to Table 1, the largest reduction in the administrative burden can be achieved by decreasing idle times in the three main stages: submitting a construction design for approval in a municipality, obtaining a construction permit in a municipality, as well as putting a building into service.

After analysing the administrative burden created by several normative acts, it has to be noted that the largest part of burden (approximately 65%) is created by the regulation of the Cabinet of Ministers „General Construction Regulations”. The second largest cause of burden is the regulation of the Cabinet of Ministers regarding putting buildings into service.

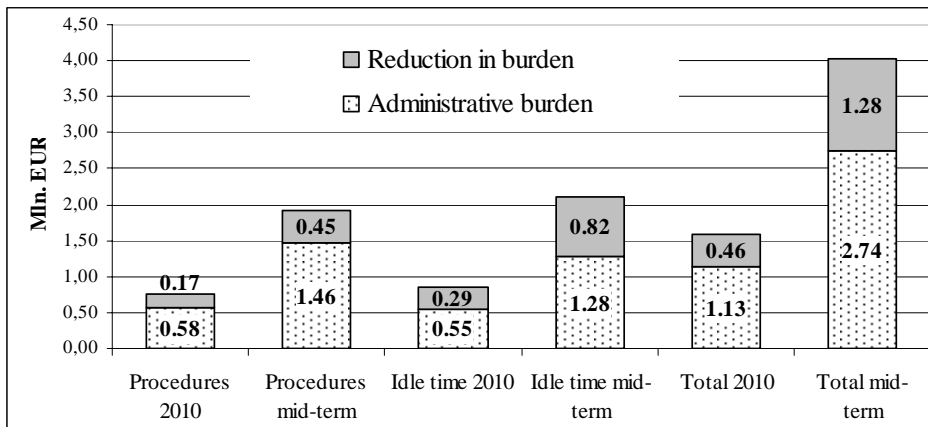
4. RECOMMENDATIONS FOR REDUCING THE ADMINISTRATIVE BURDEN

In the result of the present research, 37 recommendations for reducing the administrative burden in construction in Jelgava municipality were elaborated. As a result of implementing the recommendations, the burden for businessmen could decrease by EUR 0.5 million in 2010 and EUR 1.33 million annually in a medium term, which ensures a decrease of 39% and 45% respectively. Therefore, the goal set by the EU and Latvia regarding reducing the administrative burden by 25% would be achieved. The recommendations were grouped according to two characteristics – the kind of administrative procedure and the level where they are implemented.

The largest part of reductions in the administrative burden, which are achieved in the result of implementing the recommendations, will be gained by improvements in administrative procedures regarding the standard administrative procedure (93% in 2010 and 96% in a medium term). Since a significant share of the AB in the standard administrative procedure consists of idle time costs, the next figure shows possible reductions in the administrative burden in the result of implementing the recommendations for administrative procedures and idle times separately. The burden of doing administrative procedures can be reduced by 30-31%, but the recommendations for shortening idle times can cause a much more significant impact on reducing the total burden, as their reduction reaches 52% in 2010 and 65% in a medium term. By introducing the recommendations, the total

administrative burden for the standard administrative procedure could be reduced by 41% in 2010 and even 47% in a medium term.

Figure-1: Reductions in the administrative burden for the standard administrative procedure in Jelgava municipality, mln. EUR



Source: developed by the authors

To ascertain the extent of impact of reductions in the administrative burden, information was summarised on the distribution of financial gains from implementing the recommendations if introducing the amendments to the national or municipal normative documents. Although the largest part of the administrative burden is created by the national normative documents, the majority of the recommendations can be implemented at the municipal level, which does not require lots of time and funds. To reduce the administrative burden estimated for 2010, EUR 333734 or 67% of all the financial gains from implementing the recommendations relate to making amendments at the municipal level, i.e. to various related regulations and forms, but 33% of all the financial gains relate to the national level, i.e. amendments to laws and regulations of the Cabinet of Ministers. Yet in a medium term, even 70% of all the financial gains can be acquired at the municipal level.

5. CONCLUSION

The Standard Cost Model provides a standard formula which could be applied against any proposed policy change or legislation to assess the administrative cost or burden. The SCM methodology was successfully applied in estimating the burden created by the administrative procedures in construction for businessmen and residents in Jelgava municipality.

The Scandinavian countries' experience shows that the main AB reduction directions at the municipal level are: identification of priority documents to improve work organisation and simplification of administrative procedures by shortening idle times and establishing "one stop" agency (Ernst&Young, 2010:57). The recommendations made in the present research to reduce the administrative burden are oriented towards two directions - simplification of administrative procedures and shortening of idle times. At the initial stage of an administrative procedure, the burden for municipal customers could be reduced by introducing the so called principle of "one stop" agency. A significant reduction in the AB could be achieved by uniting the procedures of examining construction designs and obtaining construction permits. The administrative burden could be also reduced by decreasing the cost of developing construction designs.

Construction is one of the priority areas in Latvia's annual „Action Plan to Improve the Business Environment” for several years, and it is envisaged to reduce the period required for administrative procedures in construction from 180 to 65 days (Ministry of Economics,2009:23). Yet the amendments to the legislation are delayed, therefore, the possibilities provided by the present legislation are stressed in the recommendations on shortening idle times. Thus, the municipality is able to shorten the period of doing administrative procedures from 1 month that is stipulated in the legislation to, for instance, 1-2 weeks by determining priority documents and improving work organisation.

The recommendations require amendments to both national and municipal normative documents. Yet the research result shows that the largest part of the recommendations can be implemented at the municipal level. Such a situation emerged because a municipality as an administrative institution for construction can enforce the requirements of national legislation without being in conflict with laws. It means that a part of the recommendations can be implemented in Jelgava municipality in a short term, as making amendments at the municipal level takes a shorter time and requires less resources if compared to making amendments to national normative documents. Yet the recommendations for introducing amendments to national normative acts will positively impact not only the administrative burden in Jelgava municipality, but in the whole country as well.

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