Cutting Red Tape in Lima
How Municipal Simplification Improves Investment Climate

David Sislen, Taimur Samad, Sarah Anthony, Luke Haggarty, Igor Artemiev

Regulatory simplification has become a part of many countries’ efforts to improve the investment climate and the overall economy. Reducing “red tape” can lift constraints on private sector development and foster economic growth. In Latin America, where decentralization has advanced considerably in recent years, there is emerging consensus as to the need to focus reforms at the municipal level, where barriers tend to be especially high. The experience of Lima, Peru shows how streamlining municipal business registration and licensing procedures can lead to positive economic outcomes.

What is red tape reduction, and why?
Regulatory simplification reduces or eliminates unnecessary administrative requirements, affording businesses greater efficiency and productivity. The benefits of such reform include increased formalization of the local economy, improved regulatory supervision, increased compliance with laws and norms, and decreased opportunities for corruption.

Simplifying business regulations has recently come to the forefront of development discourse, highlighting the important roles of the private sector and a sound investment climate in countries’ economic growth and development. Governments across the globe are taking action: in 2004, 99 countries introduced 185 reform programs to ease doing business.

Efficient business regulation is beneficial for both the public and private sectors. Gains within the public sphere include orderly development (e.g. city planning) and firms’ compliance with health and safety norms and tax obligations (a main source of funding for public services). As for the private sector, simplified rules stimulate the transfer of small businesses to the formal sector, resulting in more opportunities for accessing capital, contract enforcement, and overall growth.

On the other hand, when regulation is inefficient and cumbersome, costs become prohibitive for firms (especially small and medium size enterprises – SMEs – which cannot afford to hire a third party to handle the paperwork), causing businesses to evade regulation rather than comply with it. The result is a growing informal sector. Figure 1 shows that countries with more efficient regulatory systems have the lowest shares of informal sector-generated GDP.

There is some evidence of a link between a country’s GDP per capita and efficiency in regulation, but the direction in which causality runs is unclear. Doing Business in 2006 reports that rich countries impose the least regulation and have recently made greater strides in streamlining than the rest of the world, increasing the business start-up gap between rich and poor nations. The cost to start a business in poor countries is 113% of income per capita, compared to 7% in high income countries, and the average minimum capital requirement in poor countries is 299% of income per capita – 10 times the level of OECD countries.

The importance of sub-national simplification
In many countries sub-national political entities (states, provinces, regional governments and municipalities) have an important function in fostering a sound business climate. Local government is often the first point of
interaction for businesses and, at least in the LAC region, where the highest administrative burden is concentrated.

Traditionally, reform efforts have been applied at the national level. Given recent decentralization trends (worldwide, and especially in Latin America) and the greater responsibility of municipalities to apply regulations, however, local reform is becoming ever more important. Local governments generally face capacity constraints in this area and need assistance and training to effectively carry out their increased responsibility.

Key components for successful municipal red tape reduction

Based upon recent work by the World Bank Group on municipal simplification, a number of characteristics for a successful reform program have been identified:

- **Political will** – demonstrated by municipalities signing a public agreement to reform and providing space and technical counterparts for the reform team.
- **Stakeholder engagement** – to avoid paralysis and breakdown of reform efforts, usually due to changes in administration. Public-private roundtables of beneficiaries can oversee the progress of reform, ensure a comprehensive approach in project design, and eventually expand the reform agenda with the municipality. A stakeholder-managed public information campaign raises awareness of reform efforts. Institutional support and coordination enable inter-governmental support and partnerships among government, private sector, NGOs and multilateral organizations.
- **Integrated strategies** – outlining the role of all actors at each stage in the process.
- **Building local expertise** – to ensure sustainability and work on future reforms.

The case of Lima, Peru in 2005

Business regulations in Peru in 2005 were among the most time-consuming in the region. Starting a business, for example, required 102 days (the LAC regional average was 63 days) and cost about 38% of the average income per capita. The regulatory process associated with a standard construction permit (“building a warehouse”), averaged 321 days and 366% of income per capita. It does not come as a surprise, then, that 60% of Peru’s economic activity in 2005 was informal. Relative to its neighboring countries, the Peruvian regulatory framework was particularly onerous (Table 1).

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of Steps</th>
<th>Number of Days</th>
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<tbody>
<tr>
<td>Peru</td>
<td>10</td>
<td>102</td>
</tr>
<tr>
<td>Ecuador</td>
<td>14</td>
<td>69</td>
</tr>
<tr>
<td>Bolivia</td>
<td>15</td>
<td>50</td>
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<tr>
<td>Colombia</td>
<td>12</td>
<td>43</td>
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<td>Chile</td>
<td>9</td>
<td>27</td>
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Table 1 - Starting a Business² (data applies to largest city)

Most of the regulatory bottlenecks contributing to economic informality are concentrated at the local level. In the case of Lima, Peru’s capital city, although municipal level procedures made up only 3 of the 10 required steps to start a firm (pre-reform), they represented 60% of the total time required to do so. This is in line with the finding that 65% of legal complaints about red tape were directed at municipal level procedures.

Generating consensus on the need for municipal level reform

A body of work by the World Bank Group identified the need to cut red tape in Lima. The red tape reduction initiative was designed as part of an ongoing program of technical assistance between the Bank and the Metropolitan Municipality of Lima (MML). This city development strategy effort, focused on metropolitan-level strategic planning and targeted interventions for poverty reduction and fostering economic growth, was complemented by a 2004 Investment Climate Assessment which pinpointed red tape reduction as a critical component for Lima’s growth, and an Administrative Barriers Assessment, conducted to examine urban development procedures in 6 districts of the city. The latter found that processes for obtaining operating licenses and construction permits were the main obstacles for investors. These processes were quite slow and there were considerable backlogs in many districts. Several agencies often required identical information from the entrepreneur and even performed reviews of the same documents.

Based on these findings, the MML committed to improving the situation and asked for the Bank Group’s assistance. The IFC LAC Technical Assistance Facility started a project with the municipality on operating license reform, and also worked jointly with the...
IFC’s Foreign Investment Advisory Service (FIAS) to improve the construction permit process and to adopt a methodology for municipal red tape reduction.

**Implementing reform**

The MML applied the following methodology for reform implementation, comprising a four-step strategy:

1) A detailed diagnostic to precisely identify problem areas in municipal level procedures;

2) Development of a specific reform proposal with detailed solutions;

3) Implementation of this proposal, including the approval of laws/ordinances by the local legislature; assessment and training of staff in new processes; publication of a new operating manual; and implementation of a workflow system that includes a monitoring and evaluation framework;

4) Introduction of sustainability mechanisms, such as continuous training programs within the municipality; a communications campaign to raise the target population’s awareness of the reforms; and the creation of a private-public advisory council to oversee the implementation and continuity of reforms across changes in administration.

The operating license reform has been implemented and revisions to the construction permit process are currently in the implementation stage. Each step of the reforms involves municipal counterparts to ensure that the proposal reflects the reality of the municipality and its administrative capabilities.

**Operating license reform:** Prior to the reform package only 34% of applicants seeking to open a business in central Lima completed the process, indicating the need for a more streamlined system. The objectives of the reforms were to institute a single window for applicants (eliminating numerous trips to various agencies); ensure better, more personalized client service; implement a workflow void of redundancies; install a fully electronic approval process; build the capacity of municipal officials to manage the new system; and ensure continuous improvements by incorporating reform beneficiaries into the advisory council.

Additionally, the municipality adopted the standard international industry classifications (SIIC) for the categorization of sectors and established four “risk categories” to differentiate licensing requirements and cost according to a firm’s complexity and size. Early results of the program, reported below, are very encouraging.

**Construction permit reform:** Work on reforming the construction permit process started in Spring 2005. By December the metropolitan authority approved an ordinance to simplify zoning, and in 2006 work began on the application review process.

The latter consists of dividing applications into categories according to the complexity and urban impact of the proposed works, affording beneficiaries a quicker, simpler route to obtaining a permit (thereby improving the current application approval rate of only 30%). The design of the reform has also considered the historic value of many of the city center’s structures and incorporated the input of various stakeholders. The objective of the new process is to bring new investment and employment opportunities without changing the appearance of the historic district.

**Outcomes:** Changes to the operating license process include vast reductions in the number of requirements (e.g. certified copies of documents), inspections, visits to the municipality, and days to obtain a permit (Figure 2). Data collection on firms registering their activities is ongoing, and the initial numbers are promising: more than twice as many licenses were issued in 2006 than during the entire 2002-2005 period (Figure 3).

Not only did the reform of inspections combine several steps into a single multi-purpose inspection; it also made the process more efficient and user-friendly. The outcomes of these reforms are encouraging and demonstrate the potential for further improvements in the future.
the process more objective, with clear criteria and simple yes-or-no answers. The reduction in visits is particularly important for SME owners as their costs in both time and transport to the municipality decrease. Simplification of these procedures can also reduce levels of corruption, as less contact between the entrepreneur and public servants diminishes opportunities for illicit activity.

Regarding construction permit reform, once implemented, the process should comprise no more than 31 steps (versus 206 today) and 11 documents (versus 40 today). With no ex-ante inspections and fewer visits and payments to the municipality, the existing average of 321 days should drop to between 2 and 30, depending on the scope and urban impact of the project.

Scalability and sustainability

The IFC Facility is now engaged in a program to expand application of these reforms to other municipalities across Peru, through two main vehicles: the National Municipal Simplification Plan and the Municipal Scorecard.

The National Municipal Simplification Plan (TramiFácil) is supported by a consortium of 24 leading institutions from Peru’s central and local government, the private sector, international institutions, and NGOs. TramiFácil seeks to spread municipal simplification by:

- Applying a workplan with specific targets and responsibilities for each institution involved in the reforms, fostering cooperation and coordination among municipalities;
- Working with local advisory councils to ensure sustainability of reforms and quality control of work across the country;
- Promoting awareness of the issue of Municipal Simplifica-

The Municipal Scorecard is a project designed by the Facility to enable comparison of key indicators for bureaucratic efficiency across municipalities in the region. In 2007 the Scorecard will measure the efficiency of operating license and construction permit processes and is being applied in Honduras, Nicaragua, Bolivia, Peru and Brazil. The Scorecard will allow for both national and international comparisons of municipal performance in the regulation of the private sector and is expected to expand its coverage of countries and regulatory issues over the next few years.

Conclusion

Municipal level red tape reduction is an effective measure for improving investment climate and is becoming increasingly important, given today’s decentralization trends. Initial results from the Lima experience show that government reform paired with beneficiary engagement can indeed induce economic formalization. Ultimately, it is expected that better economic data at the municipal level and more formalized firms will attract private investment, spur economic growth, and create jobs.

Notes

1 - Out of 155 countries. The ease of doing business averages country rankings across the 10 topics covered in Doing Business. Source: Doing Business
2 - Source: Doing Business in 2006
3 - Source: Metropolitan Municipality of Lima

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