

Government Inspections

Lessons from Reforms

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Most inspection regimes in developing countries impose unnecessary costs and risks on businesses, harming competitiveness while failing to prevent tragic and unnecessary losses due to fires, earthquakes, and other disasters. There has thus been a strong interest in reform models that will reduce the burden of government inspections while improving their effectiveness. This Note offers lessons from reform experience drawn mostly from European, North American, and transition economies, where competitive pressures and accession to regional trade organizations have sharpened the impetus for reform.

Government inspections of businesses are important mechanisms for enforcing regulations intended to safeguard human health, safety, and the environment and to ensure the proper functioning of the economy (such as tax and banking regulations). But in recent years business communities in many countries have complained to governments about tax inspectors who harass businesses and threaten to freeze their accounts, building inspectors who demand compliance with meaningless regulations and cause delays in business start-up, sanitary inspectors who interpret requirements inconsistently and favor cronies and bribers over their competitors, and environmental inspectors who extort bribes rather than enforce needed controls. Businesses say they are considered guilty until proven innocent and at risk of severe penalties even for trivial infractions (box 1).

Many governments too see a need for reform. Tragic and unnecessary losses resulting from workplace fires, industrial accidents, and the collapse of buildings during earthquakes or other disasters have led them to conclude that their inspection regimes are not living up to their mandates.

What are the keys to successful reform?

Experience in reform of government inspection regimes suggests eight key lessons.

Be comprehensive rather than piecemeal

Box 1 The burden of inspections

Where inspections seem arbitrary or unfair, they can appear particularly burdensome. In the 1990s businesses in the Russian Federation sometimes faced conflicting demands from fire inspectors, with federal inspectors requiring that fire extinguishers be placed 1.45 meters from the floor and municipal inspectors demanding that they be hung at 1.35 meters. Businesses learned to keep two hooks on the wall, switching their extinguisher from one to the other depending on which inspector showed up. In 2000 an entrepreneur in Lithuania complained that she had been heavily fined by tax inspectors for moving her cash register from one room to another without obtaining prior permission. And in Azerbaijan sanitary inspectors have been known to accept a bribe from an established company to find a pretext for shutting down a new competitor.

Most reforms of inspection regimes achieving sustained success have been broad programs covering most inspectorates dealing with businesses—and many have been embedded in even larger programs of comprehensive regulatory reform. These comprehensive reforms often include governmentwide programs to improve the drafting of regulations, better assess their impact, and enhance monitoring and accountability. Such comprehensiveness is an important feature distinguishing successful reform efforts (Canada, Latvia, Mexico, the Netherlands) from less successful ones (the Philippines, the Russian Federation).

While inspectorates have different mandates, they can be corrupted in the same ways. Tax and building inspections, for example, appear very different, but both can be used to extract bribes rather than ensuring fair tax enforcement or sound building materials.

Piecemeal reforms can be useful, short-term palliatives, but they tend to be vulnerable to backtracking and reversals, such as when there is a change of government. Worse, where governments suffer from entrenched, systemic corruption, high-level officials cut off from one source of revenue will quickly turn to another—for example, switching from worker safety inspectors to fire inspectors.

For example, inspection reforms in Russia limiting an inspectorate's "planned inspections" of a business to two a year did nothing to halt "unplanned inspections," demands for bribes, or other abuses. The reforms in Russia would be strengthened if they included requirements for performance indicators for inspectorates based on outcomes (e.g., reduced incidence of workplace fires), risk-based selection of firms to be inspected, and improved accountability for individual inspectors.

In the Philippines, the Government failed to put in place broader reforms to ensure accountability for achievement of objective performance indicators (e.g., enhanced revenue and lower costs). Their attempted customs inspection reforms were aimed at improving collections by introducing third-party certification and risk-based selection of inspection targets but they failed to achieve even the primary goal of increasing net revenue. A lack of political will to ensure accountability at the highest levels of the Customs Administration led to backtracking, as early improvements (e.g., a lower proportion of shipments subject to full customs inspection) evaporated over time.

Contrast these results with those of inspection reforms associated with broader programs of regulatory reform. In the Netherlands a new approach to regulatory compliance was aimed at improving outcomes while simultaneously reducing costs for both government and business. The Government of the Netherlands developed a checklist of several key determinants of compliance grouped into three categories as follows¹:

- **Self-enforcement:** such as the constituents' (i.e., businesses') knowledge of the objectives of the rules and their level of acceptance of such objectives.
- **Mechanisms of control:** such as the probability of a business being subjected to an inspection, the probability of detection of an offense during an inspection, and the possibility of using risk assessment to increase the efficiency of inspection programs to identify high-priority problems.
- **Sanctions:** such as the probability and severity of sanctions, as a last resort to ensure compliance when self-enforcement and control dimensions are considered inadequate.

The Government of the Netherlands uses the Table to tailor the most effective compliance strategy for all kinds of business regulation. Those that are subject to a high degree of "self-enforcement" (e.g., workplace fires) usually require fewer mechanisms of control or sanctions. Conversely, where self-enforcement is not a realistic expectation (e.g., tax compliance), a targeted inspection strategy and the possibility of sanctions may be required to ensure an adequate level of compliance.

¹ Source: Government of the Netherlands, Table of Eleven (T-11) Key Determinants of Compliance, see Jacobs and Associates, 2005c

The Government of the Netherlands included a program of self-inspection in place of many government inspections, which enabled (for example) the ministry responsible for maritime safety to greatly reduce the administrative burden on shipowners. The ministry simplified detailed reporting and inspection requirements and made the shipowner, not the inspector, responsible for safety in most cases. These reforms reduced the number of ships needing inspection and the number of follow-up investigations required—without affecting such outcomes as the incidence of shipping accidents. They reduced the administrative costs for shipowners by about 80 million euros a year, with similar improvements for most other government inspectorates.

Mexico's inspection reforms were also supported by broader legal and institutional reforms—to clarify objectives, train inspectors, develop a compliance policy, introduce risk-based selection of inspection targets, and the like. The inspection reforms have largely achieved their goals, and the success has been sustained for several years. In customs, where the reforms introduced risk-based inspection and outsourced most inspections, the time to clear a shipment at the Mexico City airport has fallen from up to three days to an average of only 20 minutes even as the volume of trade has expanded enormously.

The course of reform can vary, however, with a relatively modest reform of inspections sometimes serving as the starting point for broader regulatory reform. In Latvia an initial cabinet instruction to improve transparency and accountability in inspections in 1999 led to a much broader law on administrative procedures in 2001, which then strengthened and deepened the reforms of the inspectorates. These reforms shortened the average duration of key inspections from 6–12 hours to 2–5 hours by 2003, reduced the frequency of inspections, and improved their quality as perceived by businesses—all with no deterioration in outcomes. While the inspections reforms happened to be a starting point, the principles were seen to be more broadly applicable to business regulation across the board, and supportive of the Government's efforts to improve governance and accede to the European Union.

Get sustained, high-level political support

Major reforms naturally are likely to face resistance from entrenched interests, particularly from inspectors who do not want to lose their jobs (or opportunities to collect bribes) and from higher officials in inspectorates who do not want to lose their power. That makes it critical to get high-level political support from the outset.

In all the successful cases of reform cited, the impetus for the reforms came from the very top levels of government—the president, prime minister, or deputy prime minister. The reforms were coordinated from the center of government, usually with active support by strong pro-reform members of the cabinet, though the details were delegated to lower-level staff. By contrast, reforms led from lower levels of government (such as the ministry of economy) usually fail because of the lack of authority over the many different ministries and agencies with regulatory and inspection functions. In the Philippines the disappointing outcome in the customs inspection reforms has been attributed in large part to the lack of sustained, high-level political support.

In all the successful examples the reform process also engaged both business representatives and inspectors from various levels (through workshops and roundtable discussions, for example) to draw on their practical experience and to build support for the reforms. Interestingly, another key factor in the most successful reforms was a concern about competitiveness, a concern often enhanced by the dynamics of strong regional trade organizations (the North American Free Trade Agreement for Canada and Mexico, the European Union for Latvia and the Netherlands).

Government leaders were able to use the importance of maintaining national competitiveness as an argument to overcome bureaucratic resistance.

Focus on objectives, not means

Most inspectorates cling to an outmoded and inefficient reliance on punishment as a deterrent for noncompliance: Tell the business what to do and fine it if it fails to comply. More generally, too many governments are too “loose” on the objectives of their regulatory and inspection regime and too “tight” on the regulations. That results in regulations that are overly detailed, rigid, and prescriptive (such as requiring that buildings’ walls be at least 20 centimeters thick or that packaged food contain a specific amount of a specific preservative)—encouraging a myopic focus on the means rather than the far more critical objectives (ensuring that buildings can withstand earthquakes of a certain magnitude or reducing outbreaks of food poisoning to below a realistic threshold).

Successful reformers have learned to be “tight” and transparent on the objectives and “loose” on the regulations, understanding that new materials, processes, or technologies may be more efficient than old ones.

Consider the example of Canada. In the early 1980s many government agencies justified their regulations and related inspections by reference to a law that was itself often vague or flawed. As part of the regulatory reform program, the government required all ministries and agencies to clarify and publicize the objectives of their regulations. That led, for example, to a decision to consolidate several agencies involved in food safety inspections into a single program, eliminating redundant inspections and clearing up confusion about priorities and strategies for ensuring compliance. This in turn helped to reduce costs significantly while avoiding any deterioration in outcomes.

Rely on risk-based analysis

Risk assessment techniques can increase the efficiency of inspection programs by helping to identify high-priority problems (e.g., industries vulnerable to toxic waste spills), determine the probability that a particular business may be out of compliance (e.g., industries that may be tempted to under-report cash revenues for tax purposes) and ascertain the probability that an offense will be detected during an inspection (e.g., industries prone to hiring illegal aliens). Such variables can be used to target inspections where they are most likely to find serious infractions and to improve overall compliance.

Risk-based selection of inspection targets is designed to improve efficiency and effectiveness by focusing scarce inspection resources on businesses most likely to be out of compliance. Among developing countries, Mexico is one that has successfully introduced risk-based inspection as part of a broader program of regulatory reform. Its customs service supplements a small number of random inspections of shipments with risk-based inspections triggered by such factors as the type of goods declared (those that can be easily smuggled or have been smuggled in the past), new importers without previous records, customs brokers with dubious records, and strategic sectors. [[Shall I move the stats from the Mexico example on pg 2 to here?](#)]

Rely on alternative inspection mechanisms

Increasing reliance on alternatives to government inspections can yield substantial savings for the government and lighten the burden on businesses. Alternatives can include mandatory self-inspection (as with maritime safety in the Netherlands), outsourcing (such as the use of licensed customs brokers in Mexico), and third-party certification (as with forestry certification in Canada). In all these cases some government inspections still take place as a backup to and a check on the alternative inspections.

Make inspectors accountable

Holding inspectorates accountable, down to the level of individual inspectors, helps improve efficiency and deter abuse. Inspectorates should be held accountable for improvements in outcomes, such as reductions in workplace accidents and fires.

In Mexico, which aimed to reduce corruption in customs posts, the government systematically reviewed the performance of all inspectors working in the main customs offices. Based on the performance reviews and in-depth interviews, 20 percent of the inspectors were retained, about 40 percent were retired with pension benefits, 35 percent agreed to leave the service, and 5 percent were expelled and indicted on corruption charges. While hard data are not available, anecdotal evidence strongly suggests that corruption in Mexican customs is much lower today than it was before the reforms.

To deter abuse in Latvia, each inspector is required to have a clear program of inspections and to provide written reports for each inspection, describing what was inspected and what the findings were. In addition, inspectorates are required to publicize the rights and responsibilities of businesses being inspected, including their right to appeal. These changes have empowered businesses to fight corruption by improving their access to information about regulatory requirements and ensuring that they have effective recourse in case of problems. The business community reports that petty corruption is much less a problem than it was in the 1990s, and the country has improved significantly in Transparency International's Corruption Perception Index.²

Train inspectors to be business counselors

The government of Latvia also improved the effectiveness of its inspection regime by training its inspectors in client orientation. Inspectors are encouraged to become “consultants” to businesses—advising them, for example, on how best to guard against workplace fires—on the assumption that the businesses want to improve their own performance in avoiding problems in the workplace.

Monitor progress

Monitoring outcomes, such as maritime accidents, emissions of pollutants, and the incidence of workplace fires, can help show whether a government's objectives are being met. For an inspectorate, monitoring can help assess how cost-effective its compliance strategy has been and provide a basis for measuring the performance of individual inspectors. Business surveys can identify the burden of inspections on businesses and how this burden changes with reforms.

Latvia has conducted biannual business surveys since 2001 to assess such outcomes as the frequency and duration of inspections, the business community's perception of the quality of inspections, and incidents of both sanctions and bribes. Inspectorates are required to keep records on the number and location of all inspections as well as the results, and most are developing outcome-based performance measures.

Conclusion

Reforms of inspection regimes are relatively inexpensive in terms of budgetary resources and the benefits accrue relatively quickly. The costs of reform can be further reduced, and compliance increased, by simplifying the regulatory requirements on businesses. Many developing countries, especially low-income ones, impose unrealistic requirements given their level of development and their enforcement capacity. Most of the resistance to reform comes from inspectors who are “the experts” but also stand to lose significant revenues from bribes, and sometimes also from entrenched business interests who have established relations with “their” inspectors and prefer to

² http://www.transparency.org/policy_and_research/surveys_indices/cpi/2005

avoid competition from new business entrants. This situation encourages many businesses to operate informally, allowing them to escape all kinds of standards—those that should be high priority as well as those that could be considered low priority.

The World Bank's annual *Doing Business* reports have shown, for example, that businesses in many poor developing and transition economies still face very burdensome procedures for licensing and inspections. Obtaining the necessary permits and inspections for constructing a simple warehouse takes more than a year in Brazil, Bosnia and Herzegovina, Cameroon, Côte d'Ivoire, the Islamic Republic of Iran, Nigeria, Russia, and Zimbabwe—but only two to three months in many industrial countries and about four to five months in Jordan, Mauritius, Panama, and the Baltic countries (World Bank 2005, pp. 95–97). Why spend a year when two to three months will do?

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