

The background of the cover features a person wearing a white lab coat and blue gloves, working on a large, bright orange, crystalline or gelatinous substance. The substance has several sharp, pointed, and somewhat translucent lobes extending upwards and outwards. The setting appears to be a laboratory or industrial environment with various equipment and structures visible in the background.

**4LIBERTY.eu**  
REVIEW

NO. 10  
April 2019

# (Not So) **SMART REGULATION**

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L I B E R T É !

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# (Not So) Smart Regulation

It may seem somewhat counterintuitive that regulation, introduced to provide standards and norms, often makes the lives of entrepreneurs more difficult than when not in place at all. Nevertheless, this is frequently the challenge we, as a society, must face. And so, we are confronted with regulation that is not as smart as it should nor could be.

The concept of smart regulation was defined by the European Commission in Stakeholder Consultation on Smart Regulation, released back in April 2010. According to the document, "[s]mart regulation is not about more or less legislation, it is about delivering results in the least burdensome way". And it is precisely the burdensomeness, or rather its magnitude and scope, that are often criticized by various market players.

It is rather curious that already the very word 'regulation' evokes chiefly negative connotations. Commonly associated with such terms as 'overregulation' or 'red tape', it does not bring out the warmest of feelings among entrepreneurs. Whenever a new piece of regulation is being introduced on the EU level, numerous businesses in respective member states are on pins and needles in anticipation of what it will mean for them. Here, gold-plating (a pretty name for an annoying practice) is only one of the dreaded consequences.

In reality, the fatuity of regulation is primarily a result either of regulators pursuing their own political interests, or their being overzealous in implementing the regulation introduced on a European level. What we, therefore, are in need of is a kind of *lex regula*, a set of norms that would serve as a guiding light and at the same time a restrainer, warding off any attempts of introducing regulation that, instead of making the lives of entrepreneurs easier, would render them more complicated.

This is why we appeal to all European regulators to return to and embrace the historical 17th-century origins of the concept of regulation, meaning "reducing to order", thus serving its inherent purpose of assisting, instead of creating unnecessary barriers and burdens. So that, in the end, all regulation would cater to the needs of entrepreneurs, and not merely the regulators, meanwhile adding more paperwork and needless duties to the working agendas of the former ones. We trust that the tenth issue of 4libert.eu Review may therefore act as both a reason for re-opening the discussion on what sets apart smart from fatuous regulation, and as an indicator of where the problems lie in the CEE region.

Let the principle of *multum in parvo*<sup>1</sup> be the one that ultimately all regulators would follow, making all regulation sound, needs-based, and truly smart.

Olga Łabendowicz  
Editor-in-Chief of 4liberty.eu Review  
Coordinator of 4liberty.eu network

<sup>1</sup> Latin for "much in little".

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# Less and Better Regulation Means Better Life



\*  
DETMAR  
DOERING

**I**magine you wanted to do business on your merchant vessel in the west of Germany. It is the year 1259 and you pass Cologne with your barge. The city has just been granted the so-called staple right. Actually, you wanted to sell your goods further upriver. The new rule, however, forces you to first offer the goods here at Cologne at a generally unfavorable price for three days before you are allowed to continue your journey. In 1346, this will happen to you in Tallinn; in 1440, even in the distant shores of Poltva River near Lviv.

“  
WOULD YOU LIKE TO GO SHOPPING AND TREAT YOURSELF TO SOME REALLY NICE CLOTHES? CONSIDER YOURSELF LUCKY THAT YOU DO NOT LIVE IN THE 12<sup>TH</sup> CENTURY. NOBLEMEN MAY ONLY BUY CHIC CLOTHES IN DIFFERENT COLORS

”  
IF HUMANKIND HAS TAKEN A TREMENDOUS UPSWING SINCE THE LATE EIGHTEENTH CENTURY, IT IS BECAUSE THIS TIGHT CORSET, INTO WHICH INDIVIDUALS HAVE BEEN FORCED, RAPIDLY BEGAN TO DISINTEGRATE

Or let us consider a different scenario. Would you like to go shopping and treat yourself to some really nice clothes? Consider yourself lucky that you do not live in the 12<sup>th</sup> century. Noblemen may only buy chic clothes in different colors – and even they may have to wear only their family colors. For the lower classes, simple clothing is prescribed and the professional guild membership must be visible on their clothes. Apparel, according to the church – which began to “uniform” its clergy in the 6<sup>th</sup> century – must be the image of the hierarchical divine world order.

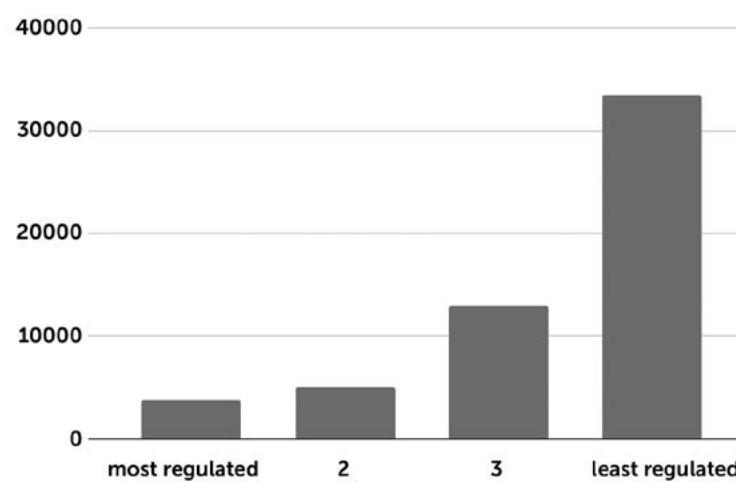
You urgently need money and have to borrow it somewhere with interest, because

otherwise who would lend it to you? After the 12<sup>th</sup> century, this is prohibited almost everywhere in Europe. The Bible forbids it, basta! Yes, the Jews are exempt from the ban and you can borrow from them. If there happens to be greater unwillingness to repay the debts, then the Jews are simply persecuted and killed, and one can put forward highly religious arguments for his actions. An extraordinarily dirty deal...

Most readers will probably no longer wish to live in the Middle Ages, following these few examples. Too strange and different, the worldview of that age seems to be compared to that of today. And we also know the consequences of the tight regulation of all possible aspects of life in these times. That there could be wealth for the mass of people seemed to be too impossible to imagine.

Still, in the 17<sup>th</sup> century, philosopher Thomas Hobbes would explain that the life of the then ordinary person of his age was "poor, nasty, brutish, and short". Three factors

Figure 1: Regulation and GDP per Capita in USD (ppp)



Source: Economic Freedom of the World 2018, World Bank

“

## STAPLE RIGHTS, DRESS CODES, AND INTEREST BANS HAVE BEEN A THING OF THE PAST SINCE THE 19<sup>TH</sup> CENTURY

turned regulation into a tight prison, leaving little room for the individual to unfold his talents and knowledge, and in so doing took away society's wealth-enhancing dynamics.

1) People were not seen as creative and independent individuals, but rather as part of social or moral categories to which they ideally belonged within the order of

things. This would lead to an ever-closer compulsory determination of status and activity.

2) As a consequence, a moralization of the public and private space came into operation. Lifestyles based on a different set of values (as long as they did not threaten others) were seen as non-desirable and became subject of legal regulation.

3) Social improvement, economic momentum, and progress were not key objectives of policy development. Politics was – at least ideally – the realization of a given natural and unalterable idea of order.

But if humankind has taken a tremendous upswing since the late eighteenth century, it is because this tight corset, into which individuals have been forced, rapidly began to disintegrate. Ecclesiastical authority, aristocratic privilege and the guild system – they all fell prey to the Enlightenment. Staple rights, dress codes, and interest bans have been a thing of the past since the 19<sup>th</sup> century.

The fact that people whose lives are not excessively regulated by the state, and who are able to determine their legitimate goals for themselves, are more creative and productive and live in more productive and creative societies, can still be fairly well proven empirically. Figure 1 shows the most recent data on regulation from the Economic Freedom of the World index, which measures the restriction of economic activity in 162 countries. The data (World Bank) are placed on a scale from 0 (totally regulated) to 10 (completely unregulated). The quartiles of the countries with the lowest, second lowest, second highest, and highest levels of regulation are correlated with those countries' gross domestic product per capita.

”

## THE COUNTRIES WITH THE LIGHTEST REGULATION HAVE ALMOST TEN TIMES HIGHER GROSS DOMESTIC PRODUCT THAN THE OVER- REGULATED COUNTRIES

The result is clear: the countries with the lightest regulation have almost ten times higher gross domestic product than the overregulated countries.

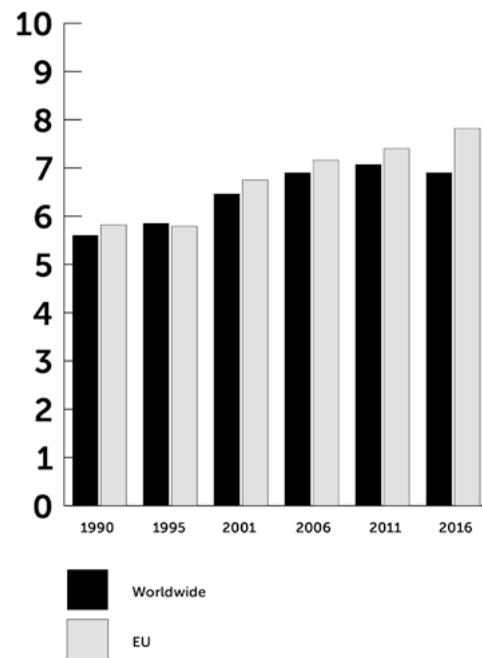
This also explains why the European Union (EU) is still an important economic player in the world. It is often thought to be a haven of hyper-regulation and therefore it should be in worse shape than it actually is.

There are, of course, innumerable anecdotal examples of nonsensical regulation by the EU and they are often exploited by Eurosceptics. But such regulations are found elsewhere as well. What counts is not the absolute amount of regulation alone, but also the comparative one – that is, whether this amount stands out as unusually negative when compared to that of other countries.

Looking at the valuation of regulation in the EU since 1990 compared to the world

average, the EU does even look a little better than others (although certainly not perfect). The EU has also been involved in all major international "fashions" of regulatory policy – during the 1990s, it has been more deregulated like most other countries, and since the financial and the Euro crisis in the late 2000s, regulation appears to be on the upswing again.

Figure 2: Regulation Compared: EU vs. the World



Source: World Bank (2018) Economic Freedom of the World

One should not, however, fall into the error of paying attention only to the quantity of regulation. There is always a qualitative element as well. As the industrial rise of Europe began in the 19<sup>th</sup> century, some regulatory projects of unprecedented proportions came into existence. For the first time, even institutions were created to globalize them. New rules were introduced in the creation

## “ LOOKING AT THE VALUATION OF REGULATION IN THE EU SINCE 1990 COMPARED TO THE WORLD AVERAGE, THE EU DOES EVEN LOOK A LITTLE BETTER THAN OTHERS (ALTHOUGH CERTAINLY NOT PERFECT)

of measures, weights, damage regulations at sea, telegraph traffic, and much more. Such rules were supposed to make spontaneous and free economic processes more friction-free and reduce transaction costs. Some of them may have made free economic development possible on a grander scale for the first time in history. The phenomenon distinguishes this kind of regulation from the stifling regulation of pre-modern ages.

Unfortunately, the knowledge about this qualitative, freedom-enabling dimension seems to be recently on the decline. A dense network of anti-discriminatory rules, political correctness, and protective measures of all sorts (e.g. over-bureaucratic consumer protection) is leading again to the classifica-

tion of individuals into categories and victim groups. The right-wing populist answer to this and other challenges of globalization responds with similar categories, albeit with different omens – backward looking and national-tribalistic.

In many ways we may be more akin to the medieval idea of regulating life goals than we would like to assume. Regulatory restraint and the preservation of a liberal perspective in setting rules have become a difficult task.

We keep standing strong and firm against threats and violations to personal freedoms. •



\*

DETMAR  
DOERING

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# Is Doing Business Report a Good Tool for Describing Business Regulation in All Countries? (A Serbian Perspective)



**M**arket regulation has long been one of the significant topics in social sciences since at least the 19<sup>th</sup> century, with two main opposing views coming from different schools of thought. First, that regulation is necessary to reach desired social goals and increase economic efficiency; and second, that regulation is unnecessary since it leads to economic waste and erodes individual choice and freedom. However, since there were no reliable instruments of measuring the overall quality of the regulatory environment in different countries and over time, there was a clear need for a tool which would measure just that. This gap was successfully bridged with the introduction of the *Doing Business* (DB) report by the World Bank in 2003, which covered a large number of countries and areas important for small and medium enterprises. This sparked a new wave of interest in empirical research regarding the effects of business regulation.

Throughout the years, the DB has become one of the key international benchmarks. Its publication is awaited by the media and policy makers across the world to help evaluate reforms various governments have implemented. Its rankings and data are widely used for investment and business decisions by private company's management and for making other international benchmarks (such as *Index of Economic Freedom* by Heritage Foundation). Due to its prominence, many governments across the world have been willing to make long strides in order to improve its rankings in the DB, in order to attract foreign investors, improve its image in the business community and increase its economic growth. Empirical research supported these efforts, since it implied that a better score in the DB really leads to higher economic growth.

“  
MANY GOVERNMENTS ACROSS THE WORLD HAVE BEEN WILLING TO MAKE LONG STRIDES IN ORDER TO IMPROVE ITS RANKINGS IN THE DB, IN ORDER TO ATTRACT FOREIGN INVESTORS, IMPROVE ITS IMAGE IN THE BUSINESS COMMUNITY AND INCREASE ITS ECONOMIC GROWTH

This was also the situation for countries in transition. Since their background was even more difficult for conducting business than those of over-regulated advanced market economies, due to their authoritarian background, lower quality of administration, weak rule of law, rampant corruption, and other legacies of the centrally planned economy and state socialism, many transition econo-

mies made more efforts in advancing their DB rankings over the years. This has led to somewhat paradoxical situations: is it really so, that regulatory environment is more business friendly in Georgia (ranked 6<sup>th</sup> in the DB) than in the United States (8<sup>th</sup>), or the United Kingdom (9<sup>th</sup>)? Or that business in Macedonia (10<sup>th</sup>) is less burdened than in Sweden (12<sup>th</sup>) or Australia (18<sup>th</sup>)? Or that Belarus (37<sup>th</sup>) is a better business destination than Switzerland (38<sup>th</sup>)? Truth be told, the *Doing Business* report has lost a significant part of its explanatory power, at least for countries in transition, due to political economy of reforms and disregard of the level of rule of law.

#### METHODOLOGICAL INTRODUCTION

The methodology of the *Doing Business* report slowly evolved over the time. It now includes the following areas:

- starting a business;
- dealing with construction permits;
- getting electricity;
- registering property;
- enforcing contracts;
- getting credit;
- protecting minority investors;
- paying taxes;
- trading across borders;
- resolving insolvency.

These business regulation areas measure the administrative burden associated with an area of doing business, such as the number of administrative tasks, the time necessary for them, and associated monetary costs. Data on actual performance are gathered and transformed to a 0–100 scale, where the maximum number of points is allotted to the best performer. Further important information is also gathered, but not included in the scores, such as labor market regulation and contracting the government (tackling the procurement process).

## “ TRUTH BE TOLD, THE DOING BUSINESS REPORT HAS LOST A SIGNIFICANT PART OF ITS EXPLANATORY POWER, AT LEAST FOR COUNTRIES IN TRANSITION

*Doing Business* of the World Bank clearly states in its methodological section that there exist several misconceptions about it. This being said, there are other notable problems with this survey, which makes its results dubious – especially for transition countries. These are as follows:

- 1) DB is not a comprehensive measure of a business environment;
- 2) focusing on increasing the DB ranking is a relatively easy task;
- 3) DB envisages that all regulation is fully and impartially implemented;
- 4) focusing on the major city only may give biased results.

Furthermore, the DB also implies that legal stipulations are fully and impartially implemented in areas where legal documents are used as a data source, which can be a far cry from the actual situation in countries historically plagued with weak institutions. There is also the problem of using the nation's capital

as a proxy for regulatory environment. Due to all these constraints, which will be further elaborated on, the widespread use of the *Doing Business* scores and rankings should be used with great caution, since it presents the regulatory environment in countries in transition in a more positive light than actually is the case.

#### NARROW FOCUS OF DOING BUSINESS: TREES IN A FOREST

Measuring the character of business regulation is not an easy task. When international benchmarks that try to evaluate the character of business regulation in a country are taken into account (such as *Economic Freedom of the World* by the Fraser Institute, *Index of Economic Freedom* by the Heritage Foundation, *Doing Business* by the World Bank or *Global Competitiveness Report* by World Economic Forum), it becomes clear that they use either hard data (such as a duration or costs of a procedure, level of tax rates etc.), perception of business people and experts, or a mix of both. Objective data are more reliable, but they are narrower since they can be used to depict a situation in several areas only; on the other hand, perception of business people regarding business regulation they face in their everyday activities is more general in scope, but also almost impossible to describe the situation in detail. The former approach cannot see the forest since it focuses on individual trees, while the latter cannot see individual trees from the forest.

The DB uses exclusively objective parameters. This means that it had to restrict its coverage of regulatory environment, in order not to lose itself in too many details that may not be too relevant for the overall character of the regulatory framework at hand. This narrow view, however, leaves out a lot of regulatory areas which may also be important since the regulatory framework

## “ THE WIDESPREAD USE OF THE DOING BUSINESS SCORES AND RANKINGS SHOULD BE USED WITH GREAT CAUTION, SINCE IT PRESENTS THE REGULATORY ENVIRONMENT IN COUNTRIES IN TRANSITION IN A MORE POSITIVE LIGHT THAN ACTUALLY IS THE CASE

in modern countries is measured in tens of thousands of pages. For example, the *acquis communautaire* or the common EU legislation is considered to be nearing 170,000 pages, while the recent total survey of business regulation in Serbia has recently been estimated to be more than 80,000 pages [See Table 1].

At the same time, the regulation assessed by the DB is several thousand pages in length at the most. For example, the “Paying Taxes”

Table 1: Scope of business regulation in Serbia

Area	No. of regulations	No. of pages
Government system	41	327
Defense, military, and internal affairs	250	2 891
Judiciary, penal legislation, and litigation	57	1 034
Public revenues	338	3 940
Monetary system, financial organizations, and financial business	247	5 135
Property and obligations, family and marital relations	241	3 684
Labor relations and employment	187	2 765
Development	557	5 800
General economy regulations	358	3 719
Goods of general interest and environment	711	8 361
Retail, tourism, and hospitality	112	1 685
Construction, land, and communal utilities	255	13 602
Agriculture	470	5 840
Transportation, networks and energy	635	10 726
Public institutions, science, education, culture and media	368	3 467
Social insurance, healthcare, social care	420	8 882
Total	5 247	81 858

Source: National legal database. Available [online]: <https://www.pravno-informacioni-sistem.rs/SIGlasnikPortal/reg/content>

segment covers only the total number of payments per year, the number of hours necessary to administer them, total taxes and contributions as a % of profit, and post filing index covering tax audits and refunds. These well may be the most important parts of tax regulations, but this hardly covers the almost 4,000 pages length of tax regulations in Serbia.

Therefore, since the DB is rather narrow, it means that regulation outside of its scope can still be very burdensome, but this will not have an impact on a country's rank in the report.

**INCREASES IN DB SCORE:  
IF MEASURED – REFORM IT,  
IF NOT – LET IT BE**

Since the DB is both narrow and transparent, and relies on objective data only, it is easier to implement regulatory reforms that would boost a country's score and improve its ranking, compared to other international indices that also measure business regulation. Furthermore, the DB does not have an ideological flair that some other benchmarks do, so it is politically more appealing to use it as a policy measure. But this also means that there is a danger of over focusing only on the DB indicators, at the detriment of other important measures of regulatory quality. A clear example of this could be found in the names of several government working groups that are active in the field of regulation improvements: instead of being called *working groups for improvement of business regulation*, they are often named *working groups for improvement of DB ranking*, as was the case in Serbia.

Local reform initiatives in the field of reforming business regulation can also support partial moves that would increase a DB score. The most important reasons for this are DB transparency: it is easy to identify areas in which reforms are necessary, and

people responsible. For example, in the area of building licenses, the minister for infrastructure, head of the cadaster office etc., so it is possible to incentivize politicians and civil servants to take over the responsibility for it, since they could be easily blamed for failures but could also reap accolades if successful – which is almost impossible in the case of other, more general benchmarks.

The role of international financial institutions, most notably the International Monetary Fund (IMF), can also have an impact on preferring the DB over other benchmarks. In case of an IMF-backed program, the local IMF office also usually supports measures that would improve the local business climate, which would be attested by improvement in international indices. However, these programs are usually not long (up to three years) so results need to be reached relatively quickly, and they include a quar-

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SINCE THE DB IS RATHER NARROW, IT MEANS THAT REGULATION OUTSIDE OF ITS SCOPE CAN STILL BE VERY BURDENSONE, BUT THIS WILL NOT HAVE AN IMPACT ON A COUNTRY'S RANK IN THE REPORT

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**THE DB DOES NOT HAVE AN IDEOLOGICAL FLAIR THAT SOME OTHER BENCHMARKS DO, SO IT IS POLITICALLY MORE APPEALING TO USE IT AS A POLICY MEASURE. BUT THIS ALSO MEANS THAT THERE IS A DANGER OF OVER FOCUSING ONLY ON THE DB INDICATORS**

Table 2: Results of Serbia in selected benchmarks

	2012	2013	2014	2015	2016	2017	2018	2019
<b>DB rank</b>	92	86	93	91	59	47	43	48
<b>GCR</b>	2.4	2.3	2.2	2.2	2.4	2.4	2.6	2.8
<b>SCM</b>	3.5	-	3.46	-	3.26	-	-	-

Source: *Doing Business* (2012-2019) Global Competitiveness Report, and Business Enabling Project

terly screening in order to evaluate improvements. For these kinds of programs, the DB is the ideal benchmark: it is easy to create lists of measures that need to be taken, and it is possible to follow if and when they are actually implemented. It is also possible to make a model that would predict improvement in score and rank that would be brought by an individual reform.

These DB characteristics could explain why some countries have had a significant improvement in their DB score or rankings, but not so stellar results in other regulatory benchmarks. One of these countries is also Serbia, which has, in recent years, significantly improved its DB position.

Since 2014, the country has substantially increased its DB rank, but at the same time its score in the “Burden of Government Regulation” from the *Global Competitiveness Report* (GCR) has increased only slightly [See Table 2]. Furthermore, the data from the US Aid Business Enabling Project, which quantified administrative burden in the percentage of GDP on the economy by using the Standard Cost Model (SCM), showed that there was also only an incremental decrease in the overall administrative burden in 2016 compared to 2014, even though this was the time in which Serbia made the unprecedented leap in its history in the DB rankings.

### FULL AND PARTIAL REGULATION IMPLEMENTATION: “WE'RE NOT IN KANSAS ANYMORE”

Living in countries in transition, one often encounters a proverb that “good laws are not the problem, but their actual implementation in practice”. This statement is not only uttered in circles of political or NGO activists, but also in those of legal scholars and business people and are even written into EU progress reports or other publications that cover the legal or business environment in respective countries. This lackluster implementation of rules and regulations stems mostly from weak institutions and the absence of rule of law, due to the political control that governments and other important stakeholders exert over judiciary and civil services. In transition countries, this may be legacy of the authoritarian regimes before the 1989 that kept a firm grip on all three branches of power, including over media and the economy as a whole, but also of different political views of constituencies in these countries, compared to Western Europe, or even cultural differences.

This different situation regarding the way in which judiciary and civil service operate in countries in transition compared to other advanced economies is clearly visible when international benchmarks that measure corruption perception, rule of law, and government effectiveness are taken into account.

### RULE OF LAW

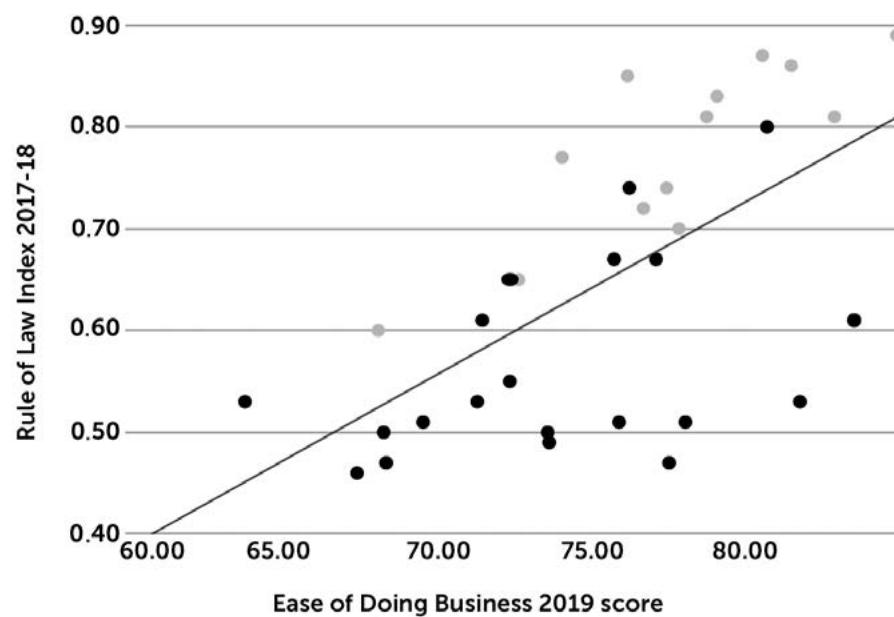
*Oxford English Dictionary* defines ‘rule of law’ as “the authority and influence of law in society, especially when viewed as a constraint on individual and institutional behavior; (hence) the principle whereby all members of a society (including those in government) are considered equally subject to publicly disclosed legal codes and processes”. In the case of business environment, the presence of rule of law would entail that all business entities are subject to the same

“  
**ON AVERAGE, COUNTRIES IN TRANSITION REPORT A HIGHER PERCEPTION OF CORRUPTION COMPARED TO THEIR EU15 COUNTERPARTS**

rules and regulations, no matter who their owner/manager may be. However, partial implementation of business regulations in practice can be often used to gain competitive advantage – for example, if the authorities turn the blind eye should a selected company not implement costly regulations, while they are very efficient in making other companies follow these rules. This situation does not cover the cases in which regulations are discriminatory per se, as long as they apply to all entities, which can also advance the interests of those with ties to high-ranking government officials, as in the recent cases of working hours regulations of retail store chains in Poland, which favored small local shops in domestic ownership over big retail chains mostly in foreign ownership, and trade unionists.

Figure 1 shows the connection between *Doing Business* 2019 score of the World Bank and the *Rule of Law Index* 2017-18 of the World Justice Project. Transition countries are in black, while the EU15 are in gray. Notice that there is a clear connection between

Figure 1: Doing Business versus Rule of Law Index



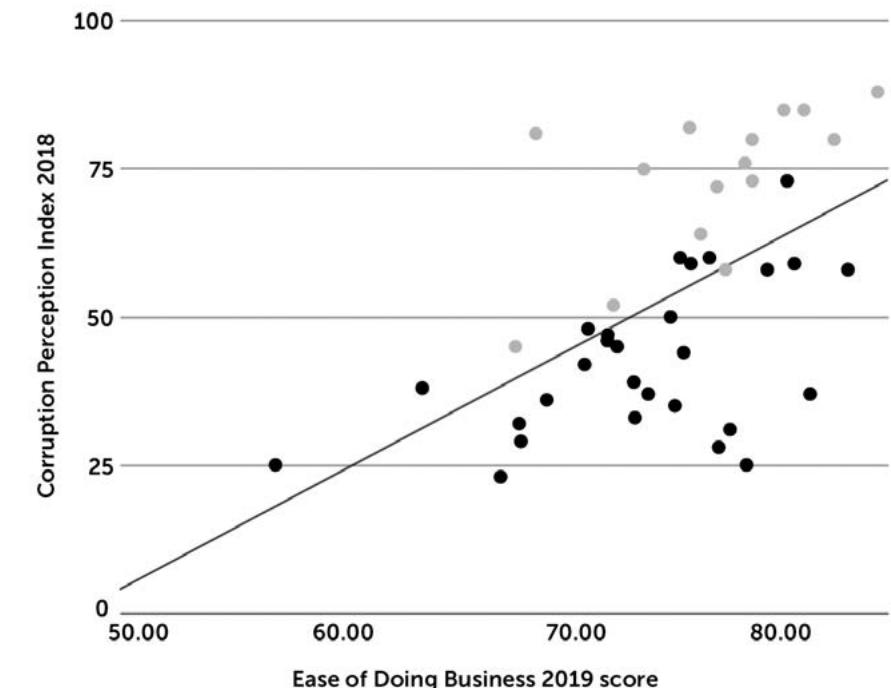
these two variables, although on a small sample (the Pearson correlation coefficient being 0.63), but that most transition countries have a much lower score in the rule of law segment than would be expected by their DB score alone.

#### CORRUPTION

A similar situation is also visible in the field of corruption. On average, countries in transition report a higher perception of corruption compared to their EU15 counterparts. Figure 2 shows the connection between the *Corruption Perception Index* (CPI) of the Transparency International and the *Doing Business* score (once again, EU15 in gray, and transition countries in black). There is a strong correlation between these variables (correlation coefficient of 0.56), but once again most transition countries score better on the DB than would be expected on their CPI results alone.

“  
VIEWING BUSINESS ENVIRONMENT IN THE NATIONAL CAPITAL ONLY AS A PROXY FOR BUSINESS ENVIRONMENT IN THE WHOLE COUNTRY HAS ITS SHORTCOMINGS

Figure 2: Doing Business versus Corruption Perception Index



#### GOVERNMENT EFFECTIVENESS

Once again, we face a similar situation [See Figure 3]. When government effectiveness data from the *World Governance Indicators* (WGI) of the World Bank are considered, we encounter once more a similar pattern: countries in transition (in black) have on average a lesser degree of government effectiveness than the EU15, but also many of them have higher DB score than their governance indicators would make us suspect.

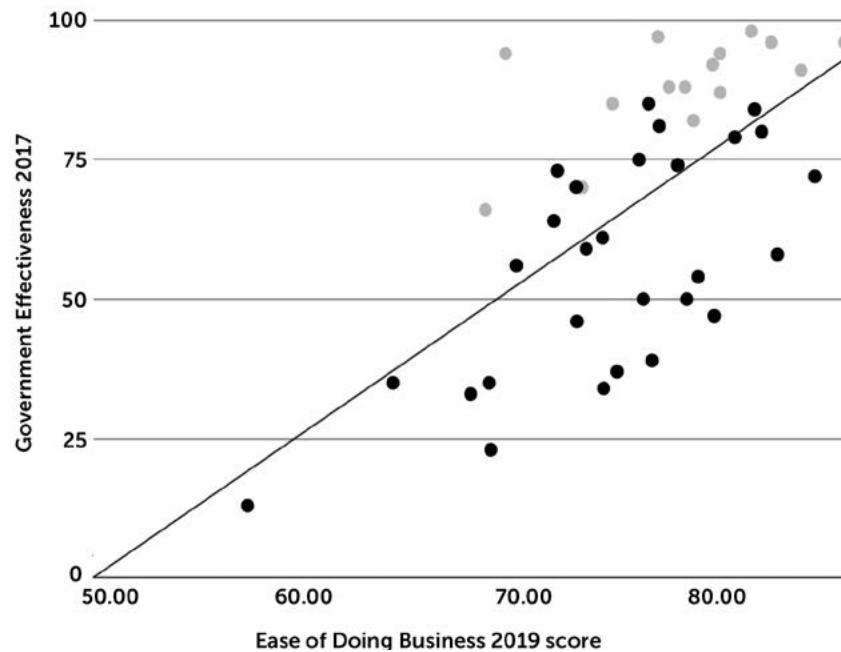
These three small overviews of the *Doing Business* scores for transition countries all point to the same conclusion, that the DB scores in some transition countries are significantly inflated, since these scores are not followed by high scores in rule of law and government effectiveness, as well as low perception of corruption.

#### REGIONAL DISPARITIES IN REGULATORY ENVIRONMENT: 50 SHADES OF GRAY

One of the reasons why the *Doing Business* report should be taken with caution in all countries it covers is due to the existence of regional disparities. The DB is calculated on the basis of data coming from the biggest city in the country (usually the nation's capital) and only in the cases of the most populous countries (such as China, Russia, India, the United States etc.) data from the second biggest city in the country is also used. This brings out the question whether the situation in the nation's capital or its most populous city is a good representation for the situation in the country as a whole.

A partial answer may be derived from the DB data itself, since there is special research regarding regional regulatory environment

Figure 3: *Doing Business* versus "Government Effectiveness", World Governance Indicators



in some countries. Over the years, these special surveys were implemented in seventeen countries, as well as in two stand-alone publications covering seven more countries, but not all of them had the aggregated DB rank calculated. Therefore, the national ease of doing business was calculated for thirteen countries in total.

These data show mixed results: in countries such as India, Pakistan, Spain, Colombia, and Czechia, capital cities have better business regulation than the country average, while in Russia, Poland, Mexico, Kazakhstan, Croatia, Portugal, and Slovakia the capital city fares worse than the national average. This disparity shows that viewing business environment in the national capital only as a proxy for business environment in the whole country has its shortcomings since administration resources and quality can vary substantially between different parts of a country.

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MORE BUSINESS-FRIENDLY REGULATION HAS A POSITIVE EFFECT ON ECONOMIC ACTIVITY, AND THE DB CAN GRASP REGULATORY CHANGES AND EVALUATE THEM

### IS DOING BUSINESS STILL RELEVANT?

After having a look at these problems, one question arises: Is the *Doing Business* report still relevant for describing the business environment in a country? It depends on the way it is used. The DB is still useful, but – as mentioned above – it has to be used with a grain of salt.

For example, the introduction of a new procedure for obtaining a construction permit in Serbia, whose implementation began in January 2016, led to a significant increase in the total number of licenses that were given. After the 2008 recession, the number of new building permits soared to half of its pre-crisis peak [See Figure 4] and remained at this level for several years. It started slowly growing in 2015, when the first waves of deregulation in this area began, but it truly bore fruit the next year.

This soar in building activities was mostly due to the excess liquidity stemming from the European Central Bank's monetary policy, but these resources would not have been employed in the real estate construction had it not been the regulatory loosening that allowed it, by cutting red tape and lowering costs. In order to do so, the government in Serbia decreased the number of procedures from 16 to 11, the time in days from 264 to 110, and total costs as a percentage of the object from 25.7% to only 1.8%. Serbia thus earned the 11<sup>th</sup> place in the DB 2019, after its deplorable 186<sup>th</sup> place it had in the DB 2015. As may be seen, more business-friendly regulation has a positive effect on economic activity, and the DB can grasp regulatory changes and evaluate them.

Nevertheless, at the same time, although the DB does provide a good brief overview of the key business legislation in a country at stake, it is not enough to make a good nuanced view of the whole regulatory framework and its actual implementation in prac-

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THE DB SCORES IN SOME TRANSITION COUNTRIES ARE SIGNIFICANTLY INFLATED, SINCE THESE SCORES ARE NOT FOLLOWED BY HIGH SCORES IN RULE OF LAW AND GOVERNMENT EFFECTIVENESS, AS WELL AS LOW PERCEPTION OF CORRUPTION

tice, since it implies high standards in rule of law, which may not really be in place.

One of the best examples of the low level of rule of law in Serbia is the Savamala affair, that took place in May 2016. Under the cover of the night, a group of masked men demolished a quarter in the center of Belgrade, razing down a group of business buildings using heavy machinery. They even kidnapped passers-by as potential witnesses, and employees, and were assisted by the local city utility companies which cut the power while both the national and community police did not respond to calls of citizens in distress, stating that this is not

their jurisdiction. After a couple of days, this now cleared land was given through legal appropriation to a controversial residential building project, Belgrade Waterfront. After a wave of citizen protests, Prime Minister Aleksandar Vučić accused top city authorities as culprits.

However, no one was ever tried for this crime, the Prosecutor's Office is still managing the introductory investigation, and the mayor is now the Minister of Finance. This affair even earned a resolution of the Euro-

Table 3: Subnational *Doing Business* scores

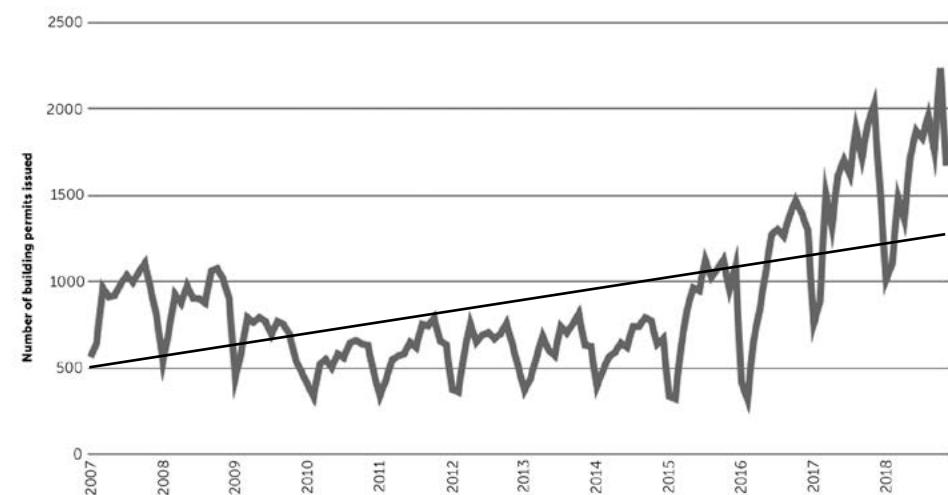
Country	Data reference	No. of cities	Rank of the capital
Morocco	DB 2008	8	-
India	DB 2009	17	6
Pakistan	DB 2010	13	4
Russian Federation	DB 2012	30	30
Spain	DB 2015	19	2
Poland	DB 2015	18	17
Mexico	DB 2016	32	31
Colombia	DB 2017	32	3
Kazakhstan	DB 2017	8	8
Croatia	DB 2018	5	4
Czechia	DB 2018	7	1
Portugal	DB 2018	8	6
Slovakia	DB 2018	5	5

Source: World Bank (2009-2018) *Doing Business Subnational Reports*. Available [online]: <http://www.doingbusiness.org/en/reports/subnational-reports>

pean Parliament, which asked for its swift resolve and penalties for the perpetrators, but this all fell on deaf ears. No matter how efficient the process of obtaining a building permit is, if affairs such as Savamala happen, it means that business environment in the country at stake is a far cry from being business friendly. In cases like these, the DB can provide a false picture of the situation.

In order to account for its weak points, the *Doing Business* report should therefore be accompanied with other important interna-

Figure 4: Number of construction permits in Serbia [2007–2018, monthly]



Source: Serbian National Statistical Office. Available [online]: <http://www.stat.gov.rs/en-US>

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MIHAJLO  
GAJIĆ

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# When Bureaucrats Cut Bureaucracy (A Slovak Example)



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RADOVAN  
ĎURANA



\*  
MARTIN  
VLACHYNSKY



\*  
JAKUB  
ZEMAN

**N**owadays, it is rather complicated to find a country where the role of an entrepreneur in the economy is explicitly contested. Thanks to media outreach, these exceptional occasions are pretty well known, and recent humanitarian catastrophe in Venezuela is a cautionary example of what may happen when a government (or an army) takes over the burden of entrepreneurial planning and decision making. Therefore, not surprisingly, most of the countries officially declare the efforts to improve the entrepreneurial environment. This is true even for countries where governments prefer market interventions, price regulations, or building state owned national business champions.

Besides the pressure from international organizations like the International Monetary Fund, or World Bank, governments have their own purely pragmatic reasons for such a commitment. According to available data, a 25% decrease of the administrative burden should lead to a 1.6% GDP increase in European Union (EU) member states<sup>1</sup>. At the level of 40–50% in tax burden, this represents a significant increment for the state budget. In addition, politicians who are familiar with the mathematics of compound interest and the relevance of economic growth emphasize the fact that in the EU administrative costs represent up to 4% of GDP. These are wasted resources which are worth of decreasing even if the private sector should produce just one-third of GDP of any country.

Therefore, expert committees are being established in each country. They conduct analyses of entrepreneur environment and publish long-term strategies with ambi-

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MOST  
OF THE COUNTRIES  
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TO IMPROVE  
THE ENTRE-  
PRENEURIAL  
ENVIRONMENT

tious goals. Governments propose radical reforms, and shifts in the international business ranking have been observed. However, real economic convergence is slower than its participants wish it. Despite the identification of best practices, described measures, and strategies of these practices, many countries do not see the improvements. It is a rather complex process to enhance the entrepreneurial environment. Red tape is not only the number of forms to be filled out by the entrepreneur; it is also a scope of power applied by the omnipresent government over entrepreneur, which must be given up. It is also unfair advantages of various interest groups, or, even hidden interests of regulatory bodies.

But why do policies for entrepreneurial environment improvement often fail? And how difficult is it to reach the goals? Let us take a look at Slovak as an example of an attempt to improve the entrepreneurial environment.

<sup>1</sup> Gelauf, G. and A. Lejour (2006) Five Lisbon Highlights: *The Economic Impact of Reaching These Targets*, CPB Netherlands Bureau for Economic Policy Analysis.

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RED TAPE IS NOT ONLY THE NUMBER OF FORMS TO BE FILLED OUT BY THE ENTREPRENEUR; IT IS ALSO A SCOPE OF POWER APPLIED BY THE OMNIPRESENT GOVERNMENT OVER ENTREPRENEUR, WHICH MUST BE GIVEN UP

#### HOW SLOVAKIA...

The new Slovak government was elected in the spring of 2016<sup>2</sup>. Fundamental commitments regarding improvements of the business environment appeared also in *Government Manifesto* announced in April 2016. The document listed in this area two ultimate goals:

<sup>2</sup> The government coalition included the winner of the election – SMER-SD (a Slovak national party), Most – HÍD (a party mostly representing the Hungarian minority), and #SIEŤ, a party which had dissolved soon after the election. In 2006, Prime Minister Robert Fico started already his third term. The coalition considers itself a left-leaning, favoring socio-democratic values.

1) The government will continue to take complex measures to decrease the bureaucracy burden for business and entrepreneurs.

2) The government will create the room for systemic improvements of Slovakia's position towards OECD and EU countries in international business rankings (e.g. its ranking in *Doing Business*).

These commitments were further specified by more detailed descriptions:

1) The government will decrease the bureaucracy burden related to social insurance.

2) The government will improve the compliances for businesses by abolishing the unjustified regulatory barriers and bureaucracy, which represent additional financial and time costs for entrepreneurs.

3) A simplification and time reduction of construction permits, improvement of an information system on realized constructions by introducing the unified forms for construction permits and final building approvals.

After that, still in 2016, the quantified and very ambitious goal to improve Slovakia's ranking to 15<sup>th</sup> position in *Doing Business* by 2020 was approved. This was challenging for two reasons: first, there are either very developed or very reformist countries in TOP 10; and, second, Slovakia was ranked 33<sup>rd</sup> in 2016. This goal made it even to the National Reform Plan,<sup>3</sup> which

<sup>3</sup> <https://www.finance.gov.sk/sk/financie/institut-financnej-politiky/strategicke-materialy/narodny-program-reforiem/narodny-program-reforiem.html>

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EVEN DESPITE POOR GOVERNMENT ACTIVITY PRIOR TO 2016, BUSINESSES AND NON-PROFIT ORGANIZATIONS WERE VERY ACTIVE IN THIS FIELD

describes structural measures to be implemented by the government during the upcoming years. The program was based on *Country Report* issued annually by the European Commission. Every member state is required to submit a reform program to the Commission rooted in report findings.

The National Reform Plan mentioned above contains the *Action Plan*. In this document, strategic goals are transformed into specific measures. The government committed itself to adopt a complex scheme for diminishing the administrative and regulatory barriers for the business sector<sup>4</sup>. This plan was materialized in the form of pro-business packages, which are the subject of this analysis.

Naturally, the Ministry of Economy became responsible for these changes. Its agenda of systemic and conceptual decrease of administrative and regulatory burden has been publicly communicated

for a long period of time. For this purpose, the Ministry of Economy constituted an interdepartmental working group for *Doing Business*. The goal of the working group is to create a precondition – at the highest level – for systemic improvement of Slovakia's position compared to OECD and EU countries in business environment evaluation rankings. The working group had its initial meeting just a few months after 2016 elections.

At the same time, in Slovakia there have been organizations operating which cultivate the business environment and evaluate the impact and effects of regulations. One of them is the Slovak Business Association, which (in the form of public-private partnership) aims to support small and medium enterprises (SMEs). Already in 2015, the analytical unit named Better Regulation Center was formed within the association. The mission of this center was the quantitative evaluation of the impact of regulation on the business environment with a special emphasis on SMEs. The Better Regulation Center evaluates and quantifies the impact of both proposed and existing legislative measures on the business environment via cost-benefit analysis. Evaluation of EU directives transposition to Slovak legislation with a goal to assess the level of gold plating is part of the process. The Center has also prepared proposals for decreasing SME regulation burden.

Subsequently, these proposals are submitted to the Ministry of Economy. Then, the implementation process takes place.

The commitment of Ministry of Economy to submit a strategic document of better regulation "RIA 2020" to the government by the end of 2016 was also a sign of an effort of a systematic approach towards

<sup>4</sup> <https://rokovania.gov.sk/RVL/Material/22167/1>

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## THE LONGEVITY OF GOVERNMENT PROGRAMS IN TRANSITION COUNTRIES LIKE SLOVAKIA IS TYPICALLY ONE ELECTION TERM

the business environment. As can be seen from its title, the document was to contribute to the better evaluation of the impact of new legislation on the business sector.

It is important to make a note that the agenda for improving the business environment did not appear in 2016 from anywhere. Previous governments had also had similar initiatives, although rather symbolic. The period of 2012-2016 was characterized by public finance consolidation. This was rooted mainly in tax hikes, new taxes introduction, and broadening existing tax bases. Administrative duties were added up and payments grew up as well. Not surprisingly, this led to a decrease of Slovakia's ranking in international indexes.

Even despite poor government activity prior to 2016, businesses and non-profit organizations were very active in this field. In 2013, the businessfriendly.sk webportal was launched by employers' associations and Ministry of Economy. This communication platform allowed entrepreneurs to

join the public discussion about constraining legislation and to submit proposals for new legislation. During the period of three years since its inception, more than six hundred suggestions on how to improve business environment were submitted via this platform.

Unfortunately, the last one is dated from 2016. The longevity of government programs in transition countries like Slovakia is typically one election term.

Two projects operated by non-profit organizations occupy a specific position in Slovak public debate related to the business environment.

The first is the **Bureaucratic Nonsense**, an annual chart of absurd bureaucracy duties and regulation imposed on businesses and entrepreneurs. It is an open contest in which anyone can submit a within a set time frame. All proposals are analyzed by experts. Then public voting assigns the winner [See Table 1]. The contest has a considerable media coverage and even political parties pick measures from the chart directly to their election programs, or for their legislative initiatives in the parliament, respectively. Bureaucratic nonsense<sup>5</sup> was awarded European Enterprise Promotion Award in 2015<sup>6</sup>.

The second non-profit organization initiative is **The Bureaucracy Index**<sup>7</sup>, which has been calculated by Institute of Economic and Social Studies (INESS) since 2016. The index represents a direct tool for assessment of bureaucracy burden for a small-model company. According to the data, in 2018, an average Slovak manufacturing

<sup>5</sup> <https://www.byrokratickynezmysel.sk/>

<sup>6</sup> [https://ec.europa.eu/growth/smes/support/enterprise-promotion-awards\\_sk](https://ec.europa.eu/growth/smes/support/enterprise-promotion-awards_sk)

<sup>7</sup> <http://byrokratickyindex.sk/>

Table 1: The Bureaucratic Nonsense winners

Year	Measure
2018	General ban to bring a dog to catering establishments.
2017	A duty to submit an application form, if an employer wants to give a redundant palette or a barrel (trash) to the employee. The application must be submitted, along with all documents and a valid EUR 11 duty stamp to the district court.
2016	An entrepreneur is fined if his supplier employs workers illegally.
2015	A duty to report every foreigner's stay via a paper form delivered by post or personally at the Foreign Police Bureau.
2014	A duty for an entrepreneur to pay an advance payment for expenditures of the preliminary administrator of the bankruptcy assets (up to EUR 1,659.70), if the company bankrupts.

company spent 222 hours with activities required by legislation, which are not a direct company business activity. The index inspired non-profit organizations in other countries and in 2018 it was calculated in four countries as an international initiative<sup>8</sup>.

Both initiatives play an important role in a public discussion related to cutting red tape burden. The Bureaucratic Nonsense can be considered a public knowledge-based identification of worthless regulations that made it through legislation process without proper attention of official regulatory bodies. *The Bureaucracy Index* represents an understandable non-disputable and non-governmental measure of real bureaucracy burden, which enables annual evaluation of the real impact of the governmental effort focused on cutting administrative costs of entrepreneurship.

In general, preconditions for improving the Slovak business environment have been fulfilled. The government officially signed over a specific quantified commitment. The ministry responsible for submitting the legislative measures was assigned. Analytical organizations accountable for proposal preparations have existed along with active non-governmental organizations – both employers' associations and non-profit organizations. On top of it, the government had at its disposal extensive financial resources from the EU funds for digitalization of the public sector (processes which simplify the administrative costs for entrepreneurs from the political perspective).

### FIRST PACKAGE

The first pro-business package was proposed after months of negotiations and preparations and announced in June 2017. It contained thirty six measures, which can be divided into the following categories:

<sup>8</sup> <http://bureaucracyindex.org/>

- decreasing the number of duties to comply with in order to start a business;
- stabilization of legal environment;
- e-Government services extension;
- introduction of more flexibility into hiring, especially in case of first employment;
- promotion of state services for entrepreneurs;
- better informing on obligations and possibilities for entrepreneurs.

If a direct impact on an entrepreneur is considered, however, only half of the measures (eighteen) represented a decrease of either administrative costs, or abolishing the barriers in doing business. The second half consisted of measures devoted to analyzing the business environment or improving the availability of information provided by public sector. [See Table 2].

Surprisingly, one would never expect certain measures to appear on the list aimed to improve Slovakia's ranking in *Doing Business* – for instance, better informing of entrepreneurs on available public sector services at Single Point of Contact, or introduction of taxation subjects evaluation based on their reliability. Promotion of the government services toward general public should be a regular and obligatory part of the public sector activities and not a proposal in a specific

pro-business package. Any evaluation of tax-behavior of companies brings potential value only to the Tax Office, while it represents mostly a risk to business sector due to potential miscalculations of the tax officers. Nevertheless, it shall be emphasized that useful measures, like proposals for simplifying construction permit procedures – the Achilles heel of Slovakia's ranking in *Doing Business* – also appeared on the list.

The measures of the first package have brought some improvement in the business environment. Based on the *Business Environment Report for 2017*, we know that only nineteen measures were implemented in the course of the year and 2017, of which seven analyses were carried out. As of the end of the year 2018, four measures were not met at all; seven measures were still "in progress". The most important measures concerning obtaining the building permit have been already submitted to the legislative process.

### SECOND PACKAGE

In March 2018, Peter Pellegrini was appointed as the new Slovak prime minister. Before that, he served as the deputy prime minister responsible for digitalization and, unofficially, as the main fighter against bureaucracy. He joined the Office of Prime Minister for other reasons, such as

Table 2: The measures of the first pro-business package

Measure	No. of measure
The decrease in bureaucracy costs of doing business	18
Conduct of analysis	11
Better informing	5
Improvement of public sector services quality	2

improving the business environment, but the public expected more courageous steps in this area and their easier passage. Not one thing happened.

The second package was negotiated by the government in May 2018. It contained twenty eight measures. While only a half of the measures of the first package had a direct effect on the reduction of bureaucracy and the measurable improvement of the business environment, the latter was even worse. It featured such measures to "improve" the business environment as, for example:

- approving the Agreement between the United States of America and the Slovak Republic and its inclusion in Annex 1 and Annex 2 of the Agreement between the United States of America and the European Community on cooperation

in the management of civil aviation safety (related to the export of aircrafts and their parts to the USA);

- creating a supportive tool to handle generational exchange in family businesses;
- adding the professional interpretation of the provisions of Act no. 315/2016 Coll. on the register of public sector partners;
- issuing guidelines for addressing the misunderstandings that arise under Government Regulation no. 396/2006 Coll. on minimum safety and health requirements for the building site;
- introducing targeted system tools aimed at supporting the enhancement of employees' skills in the area of information and communication technologies.

Out of the said twenty eight measures, only eleven have the actual potential to

### OCCUPATIONAL HEALTH SERVICE

The employer duty to ensure health surveillance through Occupational Health Service (OHS) was introduced on August 1, 2014. Each company, entrepreneur or self-employed, which was employing at least one person (including oneself) had to pay for services of external supplier – a health worker with the qualification of a medical doctor. The task of such an individual was to evaluate health risks on behalf of the protection of health at work. This duty represented new expenses without any real value added for most employers doing business out of risky fields (like mining, metal production, work at heights, etc.). Many ascribed the introduction of this duty to the market service-providers lobbies. OHS for all employers marked also a breakthrough

in the 2014 Bureaucratic Nonsense. Reevaluation of this institution appeared in the first pro-business package as well.

Initially, risk rate assessments for individual work positions were subject to the standard provision of Occupational Safety and Health Protection. Entrepreneurs were appealing for a return to this status, which represented less administrative procedures – especially for companies with "office work". However, this proposal did not succeed. An amendment to this law adopted by the parliament changed the regulation on OHS only in minor part. The annual risk rate assessment is not required for a shop assistant at staples, but still, the work positions defined as "office work" must be assessed every eighteen months. The only achieved success

was that a duty of entering into a long-term contract (with monthly payments) with an OHS supplier was abolished.

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## LISTING A MEASURE IN A PRO-BUSINESS PACKAGE AND THE FOLLOWING CHANGES IN RELEVANT LEGISLATION DO NOT NECESSARILY MEAN ADEQUATE IMPROVEMENT OF THE BUSINESS ENVIRONMENT

This example clearly shows that listing a measure in a pro-business package and the following changes in relevant legislation do not necessarily mean adequate improvement of the business environment. Different interest groups (whether the unions or health service providers) have a significant influence, and even the Ministry of Economy is

not strong enough to weaken them. Licensed companies providing OHS had a strong word at the Ministry of Health, which is responsible for the legislation. The government bureaucrats cooperating with trade unions representatives usually try to account for their position to international obligations resulting from ratification of International Labor Organization (ILO) agreements or EU directives. These, however, usually do not specify concrete tools that should be implemented in the governance of the health surveillance. It is the role of individual countries to search for the most effective approaches.

Regarding the OHS, the government prescribed to employers also another obligations and costs. For example, every employee working with the computer must be inspected in the regular interval with an ECG machine. In the case of positions requiring intensive mental load, the law requires specific blood checks, which have no direct connection to mental work. Moreover, those employees who drive vehicles (e.g. taxi drivers) on the job have to pass the psychological inspection – while the majority of citizens who drive (not as a profession) do not. Finally, the government requires specific inspections for the employees exposed to noise – although these inspections have no clear connection to the impact of noise on the organism.

Waiting rooms of doctors are places of meeting of numerous group of people who simply must go for check-ups because it is prescribed by the law to their employers. The time and capital of doctors cannot be used for treating sick patients but for ineffective scan-

ning of thousands of people. Therefore, the healthcare system requires additional personnel, what increases the costs of financing this system. Should the employers ignore these obligations, they would face significant penalties. As a result, they rather pay their employees visiting doctors during working hours and cover the fees related to the inspections required by the state.

In addition to regular check-ups, another ineffective state measure is the obligation to provide reconditioning stays for employees who work in noise. Gradually evolved noise induced hearing damage is irreversible and permanent and staying in the spa does not help an employee with this disability<sup>1</sup>.

Creating regulations should lead to efficiency and effectiveness. The exact purpose of introducing the abovementioned requirements by the Ministry of Economy remains, however, unclear. When evaluating legislation in this area, one encounters typical shortcomings in the regulatory process. How many of the occupation-related diseases have been avoided by examinations? How many diseases have been iden-

<sup>1</sup> Currently, no established clinical treatments exist to reverse the effects of permanent NIHL. See Oishi N, and J. Schacht (2011) "Emerging Treatments for Noise-Induced Hearing Loss", [in]: Expert Opinion on Emerging Drugs, Vol. 16(2), pp. 235–45.

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WAITING ROOMS OF DOCTORS ARE PLACES OF MEETING OF NUMEROUS GROUP OF PEOPLE WHO SIMPLY MUST GO FOR CHECK-UPS BECAUSE IT IS PRESCRIBED BY THE LAW TO THEIR EMPLOYERS

tified thanks to occupational health check-ups? No such answers can be found. The employer should not be responsible for diagnosing any disease of the worker. For this purpose, there are regular preventive surveys covered by public health insurance – which should differ on the basis of a person's risk exposure.

reduce the regulatory burden and administrative costs of entrepreneurs. Although in the introduction to the package the Ministry of Economy writes: "Better results in international evaluations can only be achieved through significant reform steps", these are missing in the document.

There were five further analyses proposed, and it may seem from the content of the other measures that the Ministry of Economy has reformulated its role. Instead of reducing the bureaucratic burden and simplifying the business environment, the ministry has created a list containing any

ideas to support economic activity in Slovakia. How else can we interpret a measure designed to provide better information on regional investment aid in the least developed regions<sup>9</sup>?

However, some positive examples may also be found in the list of measures. In particular, the introduction of an obligation for the state to use the information already provided by business entities and individuals should be highlighted. Nonetheless, this measure has long resisted implementation and has only come into effect in 2019. A second positive example is the abolition of the obligation to pay the VAT guarantee payment. Formerly, it had to be paid by new companies that became VAT payers. The amount of this guarantee used to be determined by the Tax Office, and the rules were very unclear and could be misused by officials. The purpose of this guarantee was to prevent VAT fraud, but it turned out that this tool is ineffective and inappropriately burdening particularly tax-responsible firms.

After a year since the introduction of the second package, the evaluation of the implementation of these measures is still not possible as the Ministry of Economy is yet to submit its official assessment. Needless to say, many of the measures or analyses are still ongoing.

### THIRD PRO-BUSINESS PACKAGE

Contrary to two previous packages, with the composition of measures closely resembling the German "Eintopf", the third pro-business package approved by the government in February 2019 contains numerous measures that consistently focus on the business environment. The package consists of thirty seven measures, out of

<sup>9</sup> <https://rokovania.gov.sk/RVL/Material/22933/1>

which twenty four should have a measurable impact on the entrepreneur.

Truth be told, there is only one measure that requires an analysis; seven measures are targeted at introducing better provisions of information to businesses; four measures are devoted to the domain of construction permits and related legislation, which could lead to shortening of the length of issuance of this approval in the near future.

A change in the approach to selecting measures for this package was also observed. Not only it contains proposals for ad-hoc cancellation of some obligations or administrative costs for entrepreneurs, but also first signs of a systemic approach to the problem may be identified. A general change in the relation of state and the entrepreneur can be detected.

For example, the Slovak Trade Inspection (STI) should have a right to give a "second chance" to the entrepreneur instead of automatically imposing a fine. Agencies performing various controls of entrepreneurs will have to inform one another about ongoing inspections in order to eliminate duplicity of controls. Their initiation should reflect the previous behavior of entrepreneurs so that repeating inspections of responsible companies will be eliminated. First, clear-cut checklists for entrepreneurs identifying relevant obligations should be created. Fulfilling all of these obligations, the company owner will have assurance that really all of them have been met. Eliminating the possibility of omitting one of the requirements by mistake would therefore help avoid misunderstandings that often stem from chaotic and unclear regulations. Additionally, the Public Health Authorities (PHA) should, on

certain days, provide a free consultation to entrepreneurs.

One of the shortcomings of this package is the fact that two proposed measures were already listed in the previous packages – namely, the changes in the Act on Illegal employment and the analysis of the register of the size of companies. In this regard, the second measure is bizarre as it had been already reported to be fulfilled as a proposal from the first package.

The symptom of inefficient government's attempt to improve the business environment can be shown by the fact that as late as in 2019 the obligation to submit to the public authorities extracts from the Letter of Ownership, the Commercial Register, the Trades Licensing Register, together with extracts and write-offs from the Criminal Records Register ceased to exist. These are the information that the state is creating and collecting for natural and legal persons. Billions of euros earmarked for development of digital registers can be finally, after many years of false promises, enjoyed by both entrepreneurs and individuals. The change is based on the new Act on Some Measures to Reduce Administrative Burdens by Using Public Administration Information Systems, which has been dubbed "the Law against Bureaucracy". It also introduces a general rule that public authorities may not require information that the citizen has already provided. According to official government estimates, since its introduction in September 2018, the Law against Bureaucracy has saved citizens and entrepreneurs more than 80,000 hours' worth of paperwork along with cutting travel costs, which together amounted to more than EUR 1 million<sup>10</sup>. Currently, an amendment to this

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WITH THE COMPOSITION OF MEASURES CLOSELY RESEMBLING THE GERMAN "EINTOPF", THE THIRD PRO-BUSINESS PACKAGE APPROVED BY THE GOVERNMENT IN FEBRUARY 2019 CONTAINS NUMEROUS MEASURES THAT CONSISTENTLY FOCUS ON THE BUSINESS ENVIRONMENT

law aimed at further eliminating additional eleven forms is being prepared.

Noteworthy, the Law against Bureaucracy contains several measures that were not listed in the pro-business packages. In addition to these packages, the Slovak

## BUSINESS PREMISES: A COMPLEX APPROACH

A positive sign of the third package is attempting complexity. The Ministry of Economy presented a series of measures to simplify the agenda of opening the business premises. This is a kind bureaucracy which almost every entrepreneur has to fight with, except for online companies. It is particularly challenging for restaurant/food entrepreneurs who want to open new premises as Public Health Authorities (PHA) may delay the opening even for several months.

Currently, every entrepreneur must ask the PHA for permission to open a shop, regardless of whether it is a business with potential risks for a customer. As a result, the opening of the office of the insurance agent requires a personal visit of a specialist officer, form filling, payment of a EUR 50 fee, and a 30 days' waiting period for issuance of a permit.

parliament adopted several new amendments to laws that have further improved the business environment (for instance, in the Value Added Tax Act and in the Corporate Income Tax Act)<sup>11</sup>.

## COUNTERFLOW

Nevertheless, efforts to improve the business environment in Slovakia are not a cross-cutting priority of the current government and parliament. In the period under review, the parliament enacted several laws, which, on the contrary, significantly

This obligation shall change to the notifying obligation for non-risk operations, thus removing the payment and the time limit. This will apply when not only opening, but also transferring the premises to another person. PHA will also not approve the operating order of all establishments anymore, but only those where there may actually be serious health damage.

A positive step is the introduction of an obligation for PHA to clearly define relevant legislation and the list of attachments needed to open the business premises (at this time for four most frequent types of businesses; ie. restaurants, offices, non-food retail shops, gyms). This step will not only reduce the number of attachments required (which will save the business sector around EUR 1.3 million), but may also be regarded as the first move in the desired direction of state regulation of business. Regulation that is explicit, eliminating officials acting on a whim, and without the need for expensive business advisors to

undermined the business environment. Following these changes:

- 1) the premiums for night and weekend work have increased;
- 2) a separate levy of 2.5% on turnover of retail chains was introduced;
- 3) employers with over fifty employees have a new obligation to pay annually 55% of the costs of a holiday stay in tourist premises in Slovakia to every employee (maximum EUR 275)<sup>12</sup>;

<sup>11</sup> The amendment to Act on VAT changes the double payment of tax on retail purchases made by entrepreneurs and reduces the rate applied on tourist services to 10%. The Corporate Income Tax Act Amendment introduced reduced paper work and more extensive electronic communication with Tax office.

<sup>12</sup> Although these payments are exempt from taxes and levies, and from the employees' point of view, this is a form of an increase in net income. For employers, however, there is an increase not only in direct costs but also in an extensive administrative agenda related to this.

ensure that the entrepreneur fulfilled all the requirements.

Hoteliers and operators of sports facilities should also benefit from these improvements. Currently, they have to meet many formal and, at times, rather funny terms. For instance, as pertains to operators of saunas, the following examples are quite telling: *space for footwear of customers in the dressing room must be separated from other areas; and the capacity of the dressing room must be at least twice as high as the number of seats in the sauna*. The package measures reduce the level of regulation to ensure lighting, the location of showers in the sauna, the minimum frequency of basic repairs of all coatings and paintings in human body care facilities. Complete requirements for showers in massage parlors, workers' floor areas in

parlors or waiting rooms requirements in saunas will be fully discharged.

The complexity of these measures also lies in the fact that it does not look at the operation of premises only from the point of view of one inspection body, but a few more. Thus, the duties of the operator do not decrease only in relation to the PHAs, but also to the Slovak Trade Inspection (STI).

STI has also the task of drawing up checklists regulating the opening of premises, requirements during the inspection, or after inspection. The information on the establishment of the facility will be announced by the entrepreneur only once, other relevant authorities and municipalities will have to share this information.

- 4) all entrepreneurs who receive sales in cash now have to be connected online to the financial administration systems and record all their sales there. Expenditures for entrepreneurs for this purpose amount to EUR 80-280 for new entrepreneurs;
- 5) from 2019, the employer is obliged to report a job vacancy with details to an appropriate Labor Office in a particular territorial district in which the place of employment is located;
- 6) a non-life insurance tax of 8% (which applies also to contracts signed in previous years) entered into force. The tax is paid by the insurance company, but if the entrepreneur wants to be insured abroad, the tax is directly passed on to them.

This list of measures is worrying if the costs related are taken into account. According to the estimations of the Minis-

try of Economy, the benefits or savings related to thirty-seven measures of the third pro-business package are estimated to EUR 72 million. Overall, direct costs of the six measures listed above amount to several hundred million of euros, whereas indirect costs would add another tens of millions of euros.

## THE STORY OF ONE FAILURE

As noted above, Slovakia has set itself the goal of moving to the 15<sup>th</sup> place in the *Doing Business* rankings by 2020. For three years, since first announcing their efforts, the Ministry of Economy has been trying to improve the business environment. But is Slovakia any closer to the goal now than it was before? On the basis of the existing *Doing Business* data [See Figure 1], the current trend shows that the 15<sup>th</sup> place in the ranking is unachievable as Slovakia is constantly descending in the ranking. If one looks at Lithuania, which

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ACCORDING  
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ITS INTRODUCTION  
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SAVED CITIZENS  
AND ENTREPRENEURS  
MORE THAN 80,000  
HOURS' WORTH  
OF PAPERWORK  
ALONG  
WITH CUTTING  
TRAVEL COSTS,  
WHICH TOGETHER  
AMOUNTED TO MORE  
THAN EUR 1 MILLION

can be considered as an exemplary case, the country managed to move up to the 14<sup>th</sup> place despite its excellent position (20<sup>th</sup>) in the 2016 ranking. Even though several other countries have also dropped in the rankings, but Slovakia the most significantly.

The drop in ranking does not necessarily mean that the business environment in the country is getting worse. The differences in the actual score among the countries at the top of the ranking are relatively small, so the ranking provides slightly distortive information about the actual status of the environment in the country. *Ease of doing business score* indicates that Slovakia has improved slightly. Still, the improvement rate for Slovakia over three years is one of the smallest when compared with other examined states<sup>13</sup>.

A similar story is also visible in the development of the value of the *Bureaucratic Index*. Over the past three years, its value (ie, the time required for the enforced administration) has not changed for Slovakia. The deterioration in rankings of the country occurred also in the *World Competitiveness Ranking*<sup>14</sup>, whereas a slight improvement was noted in *Global Competitiveness Index*<sup>15</sup>.

#### WHERE THE PROBLEM IS

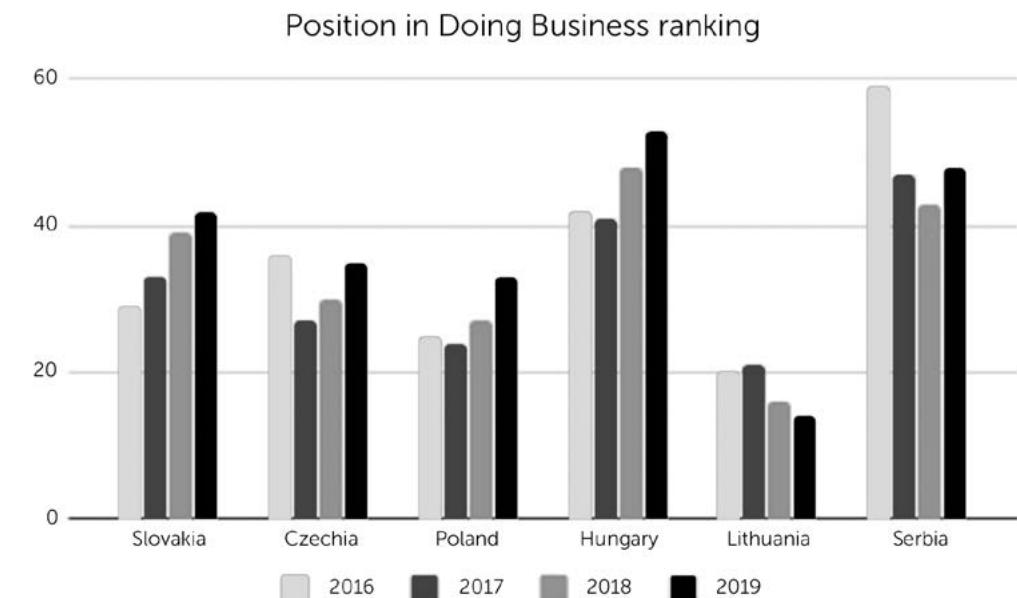
There are six crucial factors that stand behind the failed attempt to improve entrepreneurial environment. These include: sectorialism, bureaucratism, ineffective public sector, control fetish, the absence of deregulatory tools, and law enforcement. Let us discuss each of them in a smaller or greater detail.

<sup>13</sup> Even though all the examined countries have improved their scores, Serbia leads as the biggest reformer. Then, Lithuania, which has greatly outpaced residual countries. Slovakia, Poland, and the Czech Republic have experienced only minor changes, which is ultimately reflected in their rankings – the countries that reformed more have gone ahead. Yet, it has already become clear that Slovakia will not reach its target to take the 15<sup>th</sup> place in the Doing Business ranking by 2020.

<sup>14</sup> <https://www.imd.org/wcc/world-competitiveness-center-rankings/world-competitiveness-ranking-2018/>

<sup>15</sup> <http://reports.weforum.org/global-competitiveness-report-2018/country-economy-profiles/#economy=SVK>

Figure 1: The Evolution of the *Doing Business* ranking



Source: *Doing Business Index 2019*

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AND PARLIAMENT

#### SECTORIALISM

The Slovak Ministry of Economy collected hundreds of suggestions on how to improve the entrepreneurial environment – covering red tape, expenditure, regulation, and tax burden of doing business. Despite this initiative, only less than a hundred measures appeared in pro-business packages within the period of two years. Out of this hundred, many represent analyses or improved informing on public sector services. Why are real measures decreasing the burden of doing business missing?

Every pro-business package was a subject of inter-departmental review. Proposed measures were consulted with all ministries. Admittedly, they could stop questionable measures in the process of preparing the packages. For example, the

Table 3: Ease of doing business score<sup>14</sup>

	Slovakia	Czechia	Hungary	Poland	Lithuania	Serbia
<b>Ease of doing business score 2019</b>	75.17	76.1	72.28	76.95	80.83	73.49
<b>The change in the score observed between 2016-2019</b>	0.6	0.36	1.41	0.58	1.9	4.1

Source: *Doing Business Index 2019* [methodology 2017-2019]. Note: The higher the score, the better the result

Ministry of Finance was not willing to support an increase in the limit for income tax prepayments, which is needlessly low. Another example is the Social Insurance Agency, which was not willing to cut a load of information required from employers accordingly.

These authorities often argue that the inability to reduce such problematic measures stems from either a possible drop in public sector revenues or insufficient IT systems' preparedness. This is an instance of a situation when the business environ-

ment improvement had not become the government priority, but just one of many tasks of a single sector of the government (in this case, the Ministry of Economy). All the remaining ministries are willing to adopt only those measures proposed by the Ministry of Economy that 1) have zero impact on public finance; 2) do not withdraw their control power, or; 3) require no additional investments. Therefore, it becomes evident that the main retarder of improving the status quo is an absence of interdepartmental agreement guaranteeing the willingness for compromise.

#### BUREAUCRATISM

If the improvement of the business environment is not a generally accepted political priority, the process will be taken over by bureaucracy apparatus. Bureaucrats, hence, the employees of public sector, will find the problems, drawbacks, reasons to oppose every suggested improvement. The chairman of the Supreme Audit Office of the Czech Republic, Miloslav Kala<sup>16</sup>, recently pointed out the mightiness of the bureaucratic apparatus. According to his critique, new committees, working groups,

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<sup>16</sup> [https://www.lidovky.cz/domov/desive-cteni-stat-jepod-tlakem-ekonomickych-skupin-napsal-sef-nku-prezidentovi.A180725\\_110212\\_ln\\_domov\\_jho](https://www.lidovky.cz/domov/desive-cteni-stat-jepod-tlakem-ekonomickych-skupin-napsal-sef-nku-prezidentovi.A180725_110212_ln_domov_jho)

or a multitude of analyses are being introduced with one major goal: to postpone solving the problem and to avoid the pains and risks of implementing much-needed measures. As such, the bureaucracy system focuses on minor, annoyingly insignificant issues is in place. In turn, such a system cannot deal with fundamental strategic decisions. Mr. Kala also criticized a formalism creating opportunities for many stakeholders – not for the citizen, but, instead, for dozens of lawyers, consultancy firms, or various other interest groups. These agents are the real beneficiaries of the current system. In certain cases, these pressure groups govern the state instead of the public sector governing them. It can only be possible thanks to the conditions set by existing legislation.

The sluggish process that exists in Slovakia is a shiny example of such a paradox. Despite seemingly good intentions, regulation is still abundant. However, it is a systemic problem, which retards every reform attempts. It is an inherent feature of the welfare state, which regulates every triviality of social course of events.

#### INEFFECTIVE PUBLIC SECTOR

Even though the World Bank's *Ease of Doing Business* methodology for CEE countries evaluates the processes duration in capital cities, in one of its analyses, the World Bank also considered the processes' duration in other cities in selected countries<sup>17</sup>. If the processes in the capital had the same duration as in other regions of Slovakia, the country would leap by nine positions in *Doing Business* rankings.

One may identify the reason in the incompetence of state sector managers (the

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IF THE IMPROVEMENT OF THE BUSINESS ENVIRONMENT IS NOT A GENERALLY ACCEPTED POLITICAL PRIORITY, THE PROCESS WILL BE TAKEN OVER BY BUREAUCRACY APPARATUS

same applies to municipalities) to ensure the same duration for handling with applications, especially for construction permits. For example, the duration of the VAT registration process for Bratislava accounts for ten days, but only five days in Žilina (northern Slovakia). Moreover, if an entrepreneur wants to start a business in Žilina, the electricity will be supplied twenty-three days sooner than in Bratislava. The contract enforcement in Košice (eastern Slovakia) is one hundred and forty days shorter than in the capital, where it lasts for 775 days. Meanwhile, opening a business in Prešov (north-eastern Slovakia) is eleven days faster than in Bratislava.

In light of these differences, unwillingness to manage the public sector as a whole may be identified as the root cause of the problem from a country-wide point of view. In Slovakia, a regional approach clearly dominates. A director of local authorities is a local king. The spare capaci-

<sup>17</sup> <http://www.doingbusiness.org/en/reports/subnational-reports/eu-croatia-czechrepublic-portugal-slovakia>

**“**

## NEW COMMITTEES, WORKING GROUPS, OR A MULTITUDE OF ANALYSES ARE BEING INTRODUCED WITH ONE MAJOR GOAL: TO POSTPONE SOLVING THE PROBLEM AND TO AVOID THE PAINS AND RISKS OF IMPLEMENTING MUCH-NEEDED MEASURES

ties across the regional authorities are not shared for the sake of regions dealing with more agenda.

### **CONTROL FETISH**

The state authorities do not like giving up control over regulated subjects. The example of Occupational Health Service demonstrates that the control strictness and regulation is rather a lag than a justified evidence-based risk. However, the attitude towards control of regulated subjects and its shift from “we must control you before you do anything” to “you are responsible for the consequences of your deeds” anticipates a paradigmatic change

in running the public sector and its mission. The progress can be hardly expected if debureaucratization has not become a priority.

### **ABSENCE OF DEREGULATORY TOOLS**

The absence of political will to systematically improve the business environment is causing the lack of application of functional mechanisms supporting the delivery of this goal.

Be it a “sunset clause” (regulation with “expiry date”), or “one in – one out” principle (or, ideally two regulations out), the legislative process itself should be a subject of stricter provision. Not only ministries’ legislative proposals, but also MP’s legislative initiative should be a subject of impact assessment, the new legislation regulating doing business should always become effective on January 1, the EU directives’ transposition should always be evaluated in terms of gold plating and double banking<sup>18</sup>. Also, the government should establish an independent agency which would keep an eye on the quality of preparing RIA clauses.

### **LAW ENFORCEMENT**

Law enforcement is a key factor in business environment quality. A long duration of starting a business may be annoying, but the inability to enforce for overdue payments can easily mean going out of business. For many years, Slovakia ranked at the bottom<sup>19</sup> in terms of the duration of civic and business lawsuits. This can be ascribed to the absence of specialization at courts (most of the courts do all judiciary agenda), the lack of competition in judiciary profession, and a significant

<sup>18</sup> [http://iness.sk/sites/default/files/documents/pdf/INT/2017/int\\_7-2017\\_lepsie\\_zakony.pdf](http://iness.sk/sites/default/files/documents/pdf/INT/2017/int_7-2017_lepsie_zakony.pdf)

<sup>19</sup> <https://www.coe.int/en/web/cepej/cepej-work/evaluation-of-judicial-systems>

rate of nepotism in the country. The reform to fix the status quo in this area is one of the most needed and necessary. Nevertheless, only a little attention is paid to law enforcement in pro-business packages.

### **CONCLUSIONS**

Despite the ambitious goals of the Slovak government in the field of business environment improvements set in 2016, it can already be stated that they will not be fulfilled by 2020. Although most of the technical prerequisites were in place already back in 2016 (including a reference in the government’s programming document, the existence of regulatory control bodies, the existence of the RIA mechanism, cooperation with employers representatives and the third sector), it is not enough to achieve the set objectives. Three pro-business packages approved by the government to this date (submitted between June 2017 and January 2019) were a rather isolated effort of a single ministry (Ministry of Economy) instead of the government’s strategic priority. Despite (or perhaps thanks to) unique economic times with unprecedented decrease in unemployment rate powered by a decade-long strong economic growth, the government did not find the courage to push a significant change in regulation of entrepreneurship, in taxation, or the judiciary. The results can be seen not only in a lower ranking in *Doing Business*, but also in the lower interest of foreign investors to import capital to Slovakia.

Hopefully, the time will come when such pro-business packages will not represent highlights for entrepreneurs, but rather a daily routine for ministries. Nevertheless, currently, in order to reverse a backslide, it is necessary to:

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## THE ABSENCE OF POLITICAL WILL TO SYSTEMATICALLY IMPROVE THE BUSINESS ENVIRONMENT IS CAUSING THE LACK OF APPLICATION OF FUNCTIONAL MECHANISMS SUPPORTING THE DELIVERY OF THIS GOAL.

- make business environment improvement a political priority – one that is worth of tax revenues sacrifice;
- impose the responsibility for quantifiable improvements of this goal to all ministries and relevant authorities;
- apply anti-red tape tools, such as a “sunset clause”, or “one in – one out” principle;
- reduce the influence of interest groups supporting bureaucratism of the public sector;
- implement the philosophy “recommend first, control second” instead of “control first and penalize”;

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SO FAR, THE SLOVAK ECONOMY THRIVED MAINLY THANKS TO SUCCESSFUL PROJECTS OF FOREIGN INVESTORS. CARS PRODUCTION WITH ITS EXTENSIVE SUPPLIER'S CHAIN IS THE LEADING INDUSTRY OF THE SLOVAK ECONOMY, WHICH BECAME ONE OF THE MOST OPEN ECONOMIES IN THE EU

- reform a public sector to shorten the time spent with state-imposed bureaucratic activities and to ensure the same speed of processing the demands of companies across all regions of the country.

So far, the Slovak economy thrived mainly thanks to successful projects of foreign in-

vestors. Cars production with its extensive supplier's chain is the leading industry of the Slovak economy, which became one of the most open economies in the EU. Nevertheless, this situation creates huge dependence – either on foreign demand for Slovak products or type of jobs, which are often mechanical, with low value added. Therefore, the Slovak economy needs an environment which enables easy emergence of new businesses in various sectors so that it will become more resistant to fluctuations and create a chance for stronger economic growth and wealth creation. Opportunity costs of overregulation and too much administrative burden are too significant to be ignored. •



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# Government Strategy to Reduce Administrative Burden: Case of the Czech Republic



MICHAEL  
FANTA

**B**ureaucratic burden is one of the most discussed and topical issues. No wonder! Whatever we may want or not, each one of us meets bureaucracy and administrative obstacles almost every day – in our jobs, businesses, or personal lives. Sometimes, it is a routine, sometimes it takes a few seconds, and most of the times it is unbearably annoying. But unnecessary paperwork translates primarily (from the economic point of view) into costs. More paperwork means more time wasted. Time, which could easily be spent working or simply doing something fun.

The fact that administrative barriers are unpleasant, especially for entrepreneurs, and negatively influence overall competitiveness of the whole economy, has been realized by the Czech government about fourteen years ago and they decided to act. However, as it turns out, oftentimes, the intention of the government (although with noble purpose) does not match the desired effect. Yet governmental strategy to constantly reduce administrative burden and its regular *measurement* is not set completely wrong. There are clear objectives, a clearly defined path to the target and well-defined particular steps.

After its last measurement of the administrative burden in 2016, the Ministry of Industry and Trade of the Czech Republic (which is in charge of the project of Reducing Administrative Burden) reported that the burden had fallen by almost 31.5% since 2005. All right, but does the Czech society feel any relief from unnecessary and often irritating clerical nonsense? The entire process of reducing administrative burden in the Czech Republic started in 2007, and government has considered it a great success. The problem is that entrepreneurs and the public perceive the situation differently.

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UNNECESSARY PAPERWORK TRANSLATES PRIMARILY (FROM THE ECONOMIC POINT OF VIEW) INTO COSTS. MORE PAPERWORK MEANS MORE TIME WASTED. TIME, WHICH COULD EASILY BE SPENT WORKING OR SIMPLY DOING SOMETHING FUN

## THE YEAR 2007: A NEW HOPE

The idea for a long-term government strategy was developed in response to a short study titled *Report on Capacities of Regulatory Governance of the Czech Republic*, prepared earlier in 2007 by the SIGMA – Support for Improvement in Governance and Management, associating EU and OECD representatives. The report revealed four major recommendations in the field of regulation for Czechs:



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- 1) Facilitate the development of better regulation tools by providing clear political support for the implementation of the Government's Better Regulation Strategy.
- 2) To this end, appoint a Member of the Government responsible for achieving objectives of the government strategy within a pre-agreed timeframe.
- 3) Establish a "better regulation" for systematic promotion of a government committee or a high-level council composed of top officials from top management of

ministries and other central administrative authorities who will be responsible for promoting and developing government policy to improve the regulatory process within each sector.

- 4) At the same time, develop within the central state administration adequate capacities to improve the regulation process and to use appropriate tools for improvement.

At that time, the right-wing government headed by Prime Minister Mirek Topolánek (Civic Democratic Party) took these recommendations seriously and decided to act immediately. It all started with the creation of a document called *Reducing Redundant Regulation and Bureaucracy* in 2008. The purpose was, first, to analyze and evaluate the situation, and second, to identify a way to reduce administrative burden.

#### FULL COSTS OF BUREAUCRATIC BURDEN

In 2005, the value of administrative burden in the Czech Republic amounted to a total of CZK 86.4 billion (2.88% of GDP at that time)<sup>1</sup>. Although the most serious consequences lay on entrepreneurs, they are still experienced by the whole society. Administrative burden has therefore been identified as one of the major issues that need to be tackled effectively.

The abovementioned document also stated that a 20-25% reduction of the burden would bring a 1-1.5% increase in GDP growth rate. First of all, it was important to define concepts and divide the issue into as many particular groups as possible, which would enable a better targeting of concrete meas-

<sup>1</sup> Czech Ministry of Industry and Trade (2008) *The Government Approved a Plan to Reduce Administrative Burden by 2010*. Available [online]: <https://www.mpo.cz/cz/podnikani/regulace-podnikani-a-snizovani-administrativni-zateze/vlada-schvalila-plan-snizovani-administrativni-zateze-podnikatelu-do-roku-2010--43985/>

ures. Although bureaucratic and administrative burdens are closely related, they are not the same.

Administrative costs are those which are incurred by citizens, businesses, the non-profit sector, and public authorities by fulfilling the statutory obligations to provide information about their activities to public authorities or private individuals. The bureaucratic burden, on the other hand, is not only the administrative burden itself (i.e. the costs of fulfilling information obligations laid down by legal regulation), but also other costs associated with the implementation of the law. These include a whole range of other costs that are not obvious at the first glance, for instance:

- irritating costs are obviously annoying, hidden, and expended unnecessarily. These include waiting in a queue, filling out forms, etc.;
- costs of delays are the costs and loss of earnings incurred as a result of waiting for a mandatory decision of the competent government authorities before the intended operation can be carried out;
- costs of change are the costs resulting from changing the regulation of the system. Frequently, the costs incurred as a result of changes in legislation (such as a change in accounting systems, increased safety or hygiene costs or tightening any permit conditions);
- costs of uncertainty are the costs related to unforeseeable or difficult to deal with circumstances and facts. These include, for example, insufficient information from state authorities on major issues.

### BREAKDOWN OF LEGAL REGULATION COSTS

In addition to defining the issue, the Czech government has also provided a set of very limited approaches and recommendations to other state authorities about how to reduce the bureaucratic burden. According to

## “ALTHOUGH BUREAUCRATIC AND ADMINISTRATIVE BURDENS ARE CLOSELY RELATED, THEY ARE NOT THE SAME”

these, gradual digitization and computerization should play a major role in the whole process. However, these recommendations were very general and often empty principles, such as:

- a clear identification of sources of bureaucratic burden;
- a proposal for effective measures;
- removing unnecessary burdens;
- measurement.

The government was, obviously, very cautious about the complexity of the topic and therefore issued only a set of rather general recommendations. True responsibility was delegated to the Ministry of Industry and Trade.

### MEASURING ADMINISTRATIVE BURDEN

A number of methodologies have already been developed to evaluate administrative burden. The Czech government selected the three following models and recommended them for application in institutional analytical materials.

#### • SCM (Standard Cost Model)

The procedure is based on a relatively simple calculation, whereby the individual financial obligations under a particular legal regulation determine the financial costs which emerge to meet all the obligations (hourly costs x number of hours x number of stakeholders x frequency of fulfilment of duty). Let us consider the following basic calculation<sup>2</sup>:

An administrative operation takes 3 hours (time) and the hourly wage of the company's employee is CZK 150. The price will be  $3 \times 150 = 450$  CZK. If the requirement applies to 1,000 companies (range) that have to provide the information twice a year (frequency), the amount will be CZK 2000. The total cost of this administrative operation will therefore equal CZK  $2,000 \times \text{CZK } 450 = 900,000$  CZK.

Such an approach represents the macroeconomic point of view on administrative burden. It does not consider individual attitudes of citizens or entrepreneurs, just assumptions of government officers.

#### • Quick Scan

The main purpose of Quick Scan is to prioritize classical SCM measurements. Obviously, not all laws and areas of the legal framework contain obligations in the form of information reporting or at least do not contain significant burdensome information reporting obligation. Based on the experience of other countries, Pareto's principle usually can be applied.

20% of all legislation typically makes up about 80% of the administrative burden. The procedure of this instrument consists of, first, gathering the available data (all results of previous complex measurements,

surveys etc.) and, second, identifying the most burdensome areas that are measured by the SCM method.

#### • Route Map

A method based on monitoring bureaucracy (administrative burdens) which affects particular social groups. A typical representative of a chosen social group is monitored in order to identify which specific difficulties and obstacles he/she must face, what authorities and agencies he/she has to visit and how much time it takes.

The task of reducing the burden was delegated to the Ministry of Industry and Trade (thus a ministry which should also represent the interests of entrepreneurs), which considers this problem as one of the key issues and devotes itself to regular evaluation, measurement, and coordination of all activities that should lead to a constant reduction of the administrative burden.

**The first long-term strategy was established at the beginning of 2008. Six ministries – Finance, Labor and Social Affairs, Health, Agriculture, Environment and Industry, and Trade – were involved in the process.** This first plan envisaged reducing the burden by at least 20% by 2010. In addition, the Ministry of Industry and Trade committed to informing the government about the progress by preparing an official report at the end of March annually.

### THE YEAR 2010: THE FORCE AWAKENS

A standard SCM model was used to measure the administrative burden in the Czech Republic again. After less than two years of work, the Ministry of Industry and Trade declared that 117 obligations<sup>3</sup> were cancelled,

<sup>2</sup> Following methodology of measurement of administrative burden (2.1) by Ministry of Industry and Trade.

<sup>3</sup> This reduction included such obligations as providing unnecessary forms or the same kind of information for one institution in various forms, among others.

while another 165 obligations were reduced. Such a reduction should bring savings for entrepreneurs totalling to CZK 11.5 billion a year, which would mean the reduction of administrative burden by 15.6% (when compared to the 2005 data).

This first report of its kind positively evaluated the approach of all ministries. The value of administrative burden fell from CZK 86.4 billion to CZK 76.5 billion. At the same time, the government extended its planned target to reduce administrative burden not by 20%, but by 25% by the end of 2012, due to the initial success. The force had really awokened.

#### **THE YEAR 2012: FALLOUT**

The end of 2012 brought this ambitious project to the scheduled finish line. Were the goals achieved? Well, almost. Compared to 2005, the administrative burden dropped by 23.36% – down by CZK 17.2 billion, which means that the target was missed by 2%.

How did the Czech ministries cut off the administrative obstacles? A very comprehensive report<sup>4</sup> evaluating the entire project described all the specific steps of individual ministries (i.e., the six originally involved in the project). These were mainly amendments to the laws and regulations unifying information systems, simplifying submissions of various types of applications and forms, but also, above all, eliminating unnecessary and harassing information obligations (e.g. enclosing a criminal record to a trade license application, etc.). The possibility of submitting forms in electronic format also improved considerably. Finally, a number of other ministries (Education, Transport, Interior, and Culture) and gov-

ernmental institutions (such as the Czech Statistical Office, the Cadastral Office, the Office for the Protection of Economic Competition or the Czech Telecommunication Office) were also additionally involved in the project, since majority of administrative obligations imposed by them were identified as unnecessary.

The end of the first phase also brought a new methodology for measuring the administrative burden (version 2.0). For the sake of clarity, all information obligations monitored were divided into twelve areas: (1) entry into business, (2) business law, (3) issuing permits, (4) employment conditions, (5) tax payments, (6) property registration, (7) consumer protection, (8) environmental requirements, (9) producer requirements, (10) internal market, (11) public procurement, (12) and statistics. The methodology also refined the SCM model, which was a key quantitative indicator. At the same time, a qualitative assessment indicator was added, in the form of a feedback assessment (RIA). This separation helped to divide fulfilled measures to particular areas and monitor which exact part of administrative burden was reduced the most. Basically, it was more of a clerical improvement.

#### **THE YEAR 2013: FIFTY-THREE SHADES OF ADMINISTRATIVE BURDEN**

Because the original project was considered to be very successful, the Czech government decided to continue in its praiseworthy activities. However, the goal was no longer numerical. A set of fifty-three concrete measures were identified and set at the beginning of the year to further reduce/eliminate administrative burdens.

Altogether, in 2013, an additional eighteen measures were set, thirty-four were fulfilled (out of seventy-one), while others were subject to a more complicated legislative

revision. After the evaluation conducted at the end of the year, administrative burden amounted to approximately CZK 65.3 billion. Since 2005, there had been a decrease of 24.4 %. The government also pledged that at least sixty measures will be accomplished by the end of 2015.

#### **THE YEAR 2014: EXPERT GROUP BEGINS**

According to the Ministry of Industry and Trade, the year 2014 was another fruitful one. Another ten measures were successfully implemented (forty-four out of seventy-one in total since the beginning of 2013). At the same time, another eight new measures were adopted (thus amounting to

seventy-nine measures). For example, the employer's obligation to have a certified copy of an employee's work contract in the event of a check was removed, whereas liability of registration of foreign tourists was reduced.

However, the biggest innovation occurred with the establishment of the so-called Expert Group on Administrative Burdens – with the Ministry of Industry and Trade at the helm which consists of representatives from the following institutions:

- Association of Small and Medium Enterprises and Tradesmen of the Czech Republic,
- Chamber of Commerce of the Czech Republic,
- The Confederation of Industry of the Czech Republic,
- The Trade and Tourism Union of the Czech Republic,
- Confederation of Employers' and Entrepreneurial Associations of the Czech Republic,
- University of Economics, Prague,
- The Association of Entrepreneurs and Tradesmen of the Czech Republic,
- Union of the Czech Republic,
- The Association of Private Agriculture of the Czech Republic,
- Party of Privateers of the Czech Republic.

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**THE BIGGEST INNOVATION OCCURRED WITH THE ESTABLISHMENT OF THE SO-CALLED EXPERT GROUP ON ADMINISTRATIVE BURDENS – WITH THE MINISTRY OF INDUSTRY AND TRADE AT THE HELM**

Involving the abovementioned institutions was to ensure the participation of business and academia (besides the government) in the problem-solving process.

The Expert Group meets regularly once every three months. Its main task is to create and assess measures with positive impact on the business environment, especially in the field of administrative burden, which are proposed by the business community. The

<sup>4</sup> Ministry of Industry and Trade (2012) Report on the Implementation of the Plan to Reduce the Administrative Burden by December 31, 2012. Available [online]: <https://www.mpo.cz/assets/dokumenty/49031/55233/602979/priloha001.pdf> [in Czech]

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## A NEW SPECIFIC TARGET WAS SET FOR THE FUTURE: A TOTAL OF FORTY MEASURES HAS TO BE COMPLETED BY THE END OF 2020

novelty also consisted in a new website<sup>5</sup> via which anyone can send their incentive to reduce administrative burden. Every incentive is subsequently evaluated. However, another administrative burden measurement was scheduled for 2016.

### THE YEAR 2015: THE GOAL IS MET! LONG LIVE THE GOAL!

During the year 2015, an additional thirteen new measures were proposed. Thus, the total number of measures monitored increased to ninety-two. Altogether, sixty-two measures were met by December 31, 2015, so the goal set by the government was met. But it was not the end. New mission updates for 2016 also added an interesting task for all the sectors concerned: to establish “anti-bureaucratic commissions”, with the Ministry of Industry and Trade serving as the coordinator. The newly created bodies were to serve as partners of the Expert Group, discussing issues within competence of relevant departments, and at the same time, taking measures to reduce the admin-

istrative burdens on entrepreneurs caused by their particular legislation.

### THE YEAR 2016: THE MEASUREMENT RISES

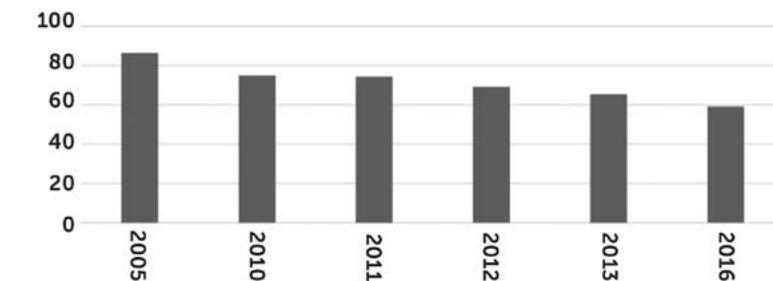
During the year 2016, a total of twenty-three measures were met by the involved ministries, for example:

- Public Procurement Act Amendment which has reduced the administrative burden for both contracting authorities (the possibility of documenting certain facts in the procurement procedure by a single European Certificate);
- simplifying notarial records and reducing fees;
- simplifying administrative burdens for small electricity producers (self-production and self-consumption of electricity without a licence).

There were at least another thirty measures planned for the future actions. However, the establishment of “anti-bureaucratic commissions” failed. All the related ministries refused to carry out this task because of insufficient staff capacity. Each institution therefore determined its contact person who should be ready to discuss every incentive to reduce administrative burden with the Expert Group, if necessary.

Furthermore, in terms of the long-awaited evaluation, the results showed that the total administrative burden dropped by 31.49% compared to 2005 [See Figure 1]. At the same time, the total number of information obligations decreased by 675 (to the current level of 1,493 information obligations). More than half of these still-existing obligations emerged from Czech national legislation, other obligations are connected with EU directives and regulations. The government also ordered the ministries to continue implementing all remaining measures to reduce administrative burden. A new specific

Figure 1: Value of Administrative Burden in the Czech Republic (billion CZK)



Source: Czech Ministry of Industry and Trade (SCM model of measurement)

target was set for the future: a total of forty measures has to be completed by the end of 2020. The next evaluation is set for 2021. All “easy” measures are to be completed, thus only those which require a longer, and more complicated legislative change remain. It should now be much harder to achieve the goal than in previous phases of the project.

### WHAT'S NEXT?

The planned path remains the same for the future. For each additional year, some specific measures are devised to concrete

sectors, and their implementation should reduce administrative burden. All completed steps should always be reviewed, and new measures set on a yearly basis.

In 2017, the Ministry of Industry and Trade declared that eighteen other measures were completed (103 measures completed out of 123), and it is now necessary to focus on the digitalization of public administration in order to meet the needs of Industry 4.0. Promoting more effective data sharing between state institutions, eliminating duplication of required information and controls, and continuously assessing the tax burden, especially for small and medium size businesses – those are currently the primary goals to achieve. To meet the current target (fulfilling 40 measures by the end of 2020) at least twenty-two measures still remain to be met. But would it not be better to see the result of measurement of administrative burden divided at least by each ministry instead of only a general number? Indeed, it would be rather interesting to see which ministries build the administrative wall around themselves.

Not surprisingly, not all entrepreneurs agree that administrative burden is decreasing. For the year 2018 the *Bureaucracy Index* reported that a small company spends on average 233 hours a year on necessary paperwork,

<sup>5</sup> <https://www.businessinfo.cz/cs/online-nastroje/administrativni-zatez.html>

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## BUREAUCRACY IN THE CZECH REPUBLIC DOES NOT DECREASE; ON THE CONTRARY, IT GROWS, AND IT IS NOTICEABLE

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## THE ASSOCIATION OF SMALL AND MEDIUM-SIZED ENTERPRISES AND TRADESMEN OF THE CZECH REPUBLIC PRESENTED A FAIRLY SIMPLE PROPOSAL FOR A SOLUTION: ONE MINISTRY – ONE ENTREPRENEUR – ONE APPLICATION FORM – ALL OBLIGATIONS

which is thirty-three hours more than a year before. Questionnaires and testimonials of entrepreneurs also confirm it – bureaucracy in the Czech Republic does not decrease; on the contrary, it grows, and it is noticeable. But why are there such discrepancies between an official state measurement of administrative burden (which is decreasing) and real experiences of entrepreneurs (which are more negative)? There are two possible answers to this question:

- 1) Imagine that bureaucratic burden is a pie. The Ministry of Industry and Trade declares that more than 30% of this pie is

gone. In reality, probably only the crust has been removed. And frankly, who cares about the crust? True burden lies in the middle of the pie – which is still whole and full of administrative barriers. Thus, have real barriers been removed or only those which concern just a few industries?

- 2) Czech people are quite infamous for their constant dissatisfaction with almost everything. It is really difficult to change their subjective perception of a given phenomenon as well. Even if the administrative burden was really lower, their perception of it might not really change. People will still be angry about having to fill out their tax return form regardless of whether it takes only 30 minutes instead of an hour.

### CONCLUSIONS

So far, the Czech Republic has met over a hundred different measures. The government managed to reduce the administrative burden by 31.5%, thus making living in the country this much easier for businessmen. 675 information obligations were cancelled. Such catchy statements may be encountered when scrolling through governmental press releases. Yet, although the numbers indeed speak for the benefits of the Ministry of Industry and Trade, whose representatives undoubtedly strive to do a good job trying to tackle the administrative burden, public opinion does not agree with the declared 30% decrease in administrative barriers.

Although a number of minor information obligations were cancelled, there is a great number of newly imposed ones, which have already managed to completely dominate the Czech “administrative scene”. These include, for example, the two biggest and most burdensome ones: EET – an obligation imposed on entrepreneurs in selected segments to record all business transac-

tions and send them through the accounting application to the system of the Ministry of Finance (i.e. the acquisition of a special cashier, personnel training, and other related activities); VAT control report – an obligation imposed on VAT payers to report to the Ministry of Finance received and paid VAT amounts on a monthly or quarterly basis (depending on the size of turnover).

These two and many other new information obligations (including the GDPR) were not taken into consideration during the 2016 evaluation. Still, EET and VAT control report are regarded as really time-consuming and, on top of that, in the case of EET, also quite costly. Including these two obligations into the measurement would worsen the final score quite significantly.

What about the Czech entrepreneurs themselves? Do they really experience the claimed 30% reduction of administrative barriers? According to the Association of Small and Medium Enterprises and Tradesmen of the Czech Republic, which decided to map all the administration connected with the operation of a small make-believe business, (opening a small-scale confectionery), many of the burdens are still in place. Everything begins with attempting to obtain a rather excessive number of permits: for change of use of space, a statement of the hygiene station, a firefighters' statement, a monument care statement, environmental department statement, and a consent of the National Institute for the Integration of Persons with Reduced Mobility and Orientation. In addition to these permits, such an entrepreneur-to-be must report the planned activity to 15–20 state institutions and can expect 20–30 official controls from state authorities. This is the reality. The analysis concludes that despite the recent improvements in terms of reducing administrative burden in the country, there still exists a lack of clarity, paired with an extensive complexity and un-

predictability of state requirements, which largely complicate the business operations of small food producers so badly that most potential entrepreneurs often decide against opening their own businesses.

### ALL-IN-ONE SOLUTION

Suggestions? Not dozens of measures, not even hundreds. The Association of Small and Medium-Sized Enterprises and Tradesmen of the Czech Republic presented a fairly simple proposal for a solution: one ministry – one entrepreneur – one application form – all obligations. Each resort would have to deal with all its obligations and permits for entrepreneurs within a single application form and all organizations belonging under one ministry should perform their official controls in one day. The time needed for communication with all institutions would be reduced by half.

So which measurement should we trust more? A macroeconomic one evaluated by the Ministry of Industry and Trade, or microeconomic, calculated in *Bureaucracy Index*? Clearly, as the latter focuses on real experiences of entrepreneurs, this should be a proper way how to measure administrative burden. So how many more measures will the Ministry set and meet in the future? And will the existing irritating administrative burdens that really matter be finally cut? Well, let us see what the 2021 evaluation brings. ●



\*

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# How Much Red Tape Is Too Much Red Tape



\*  
PAVEL  
PETERKA

*The biggest barrier to the development of the Czech economy is the lack of workforce, increasing bureaucracy, poor transport infrastructure and also the increase in energy costs, increasing cost of credit in the shadow of Czech National Banks policies and the pressure on wages.*

— President of the Union of Industry and Transport Jaroslav Hanák

**T**he last time the Czech government conducted an analysis of how high and costly the bureaucratic burden was in the Czech Republic, the result was that the state required the business to meet almost 1,500 different information obligations. If this is not an example of excessive bureaucratic burden, then what is? How much regulation is too much regulation? And, by the same token, how much red tape is too much red tape?

When one neglects the actions of despotic rulers and governments that have introduced various rules and restrictions to fulfill their (often deplorable) goals, it is possible to pinpoint the beginning of regulatory theory in the works of scholars who tried to find the answer to the question that underpins so-called "market failures". These may be divided into the following categories:

- imperfect competition, such as the existence of a monopoly;
- neglect of externalities, which are mainly related to environmental issues;
- issues of public goods;
- information asymmetry.

Needless to say, general theory works with regulation within the economy primarily because of market failures. This is because of the situation where the market allocation of economic goods is not effective.

Many pages were written about plans for reasonable market regulation. Pareto optimum regulation, which implies an improvement in the position of some market

participants without any deterioration in the position of others, is an example of such a solution. By applying this measure, the regulator reaches a higher curve of social utility. The recipe is quite simple: In its infinite wisdom, the regulator discovers market failure and its (supposed) origin. The regulator then selects the most appropriate of its tools, whether it be different forms of tax-

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tion, licensing, bans, orders, customs, etc., and uses it to correct the situation. Simple, right?

Another example is that the aforementioned situation can be exacerbated by the fact that the regulators in all their wisdom tries to centrally plan the operation of the whole economy. However, the centrally planned economy cannot work because the central government simply does not have enough information about supply and demand in the markets and therefore has to collapse – as explained by F.A. Hayek in his works<sup>1</sup>. Clearly, the centrally planned economy does not win competition in popularity, also among “reasonable” leftist economists and other academics. Central planning is, therefore, opposed by the mainstream economy due to its dysfunctionality, which was proven by Nobel Prize winner James M. Buchanan<sup>2</sup>.

Let us mention examples of so-called “socialist paradises” such as Venezuela, Cuba, North Korea, and others where the central authority takes over the role of the market regulator and people suffer from a lack of basic goods such as food, toilet paper,

medication and much more. The experience with this “enlightened” practice was also present in the countries of the former Eastern Bloc, including the Czech Republic.

Nowadays, funny stories from the times of socialism, when dozens of people stood for hours in queues to buy one universal size jeans for their monthly wage, are fortunately not up to date, and therefore they shall be treated with a grain of salt. The Czechs are still paying the price for communists’ attempt to create one of the so-called “socialist paradises” between the years 1948 and 1989. As a result of socialist reforms, the Czech Republic is still being considered by some as a 2<sup>nd</sup> rate country – not only regarding economic issues.

In the developed world, regulation almost always comes with the best of intentions. The regulator is not necessarily a person who would use their power just to complicate the lives of others. The regulator, however, sometimes tries too hard to reach the set goals, using a combination of different tools. And when the forest is being cut down, the chips fly. Which is why even the smallest piece of regulation affects the entire economy and the business environment.

In *The Effects of Automobile Safety Regulation*<sup>3</sup>, Sam Peltzman proves that regulation almost always resolves in unintended consequences. He gives an example where the government decides to reduce the number of deaths in accidents on roads and therefore introduces a law that makes using safety belts mandatory. At first glance, this regulation makes sense and should lead to meeting the stated goal. Data clearly show<sup>4</sup> that

<sup>1</sup> Hayek, F. A. (1994) *The Road to Serfdom*, Chicago: University of Chicago Press.

<sup>2</sup> Buchanan, J.M. and G. Tullock (1962) *The Calculus of Consent: Logical Foundations for Constitutional Democracy*, Michigan: The University of Michigan Press.

the probability of surviving a car accident increases when using the seat belt. Alas, behavior of people on the roads is not that simple. Peltzman analyzed this phenomenon and found that the number of fatal accidents had not decreased with the introduction of mandatory seat belt use. And there is a perfectly good reason why.

The seatbelt gives the driver a signal that if they get into an accident, the consequences of the accident will be lower. The safety provided by the seatbelt encourages the drivers to drive less cautiously; hence, the increased appetite for taking risks, because of the reduced impact of a potential car accident on their health. The number of deaths of people that are transported inside the car will be lower due to security features. However, as a result of riskier driver behavior, the number of other road users who are not inside the car (such as pedestrians, cyclists and motorcyclists) will increase. The positive impact of the regulation is partly or fully offset by other factors resulting from the changed motivations of people. This mechanism is called the “Peltzman effect”.

In addition to an abstract example with a safety belt, a more practical example may be given. In the context of the so-called “methanol affair” in the Czech Republic in 2012 and 2013, forty-seven Czech citizens died, dozens were hospitalized, and others suffered a life-long deterioration of sight. The problem was caused by bad liquor manufacturing that led to dangerous methanol presence inside the product.

The seriousness of the situation forced regulators to act. Negotiations took place with a result of regulation coming in two waves. The first was emergency regulation from the Czech Ministry of Healthcare that temporarily put a ban on beverages containing more than 20% alcohol, which also damaged honest producers of spirits, who were

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not allowed to sell their products. Moreover, consumers’ behavior was distorted, including moving to the black market to purchase hard alcohol, where the risk of poisoning with methanol was significantly higher. The second wave was the introduction of mandatory, incredibly expensive, security measures for the production of spirits. The entire market was affected, even honest producers that showed no evidence of posing danger or other misconduct. The regulation cost over EUR 40 million. As usual, small busi-

<sup>3</sup> Peltzman, S. (1975) “The Effects of Automobile Safety Regulation”, [in]: *Journal of Political Economy*. Vol. 83(4), pp. 677–726.

<sup>4</sup> Edgar Snyder & Associates (2004) *Accident Statistics*. Available [online]: <https://www.edgarsnyder.com/statistics/>

**SIMPLICITY  
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ESPECIALLY  
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REGULATION**

nesses experienced the biggest blow of the falling hammer.

An anonymous owner of a liqueur factory with a tradition dating back to the beginning of the 20<sup>th</sup> century described that his family company has survived the world war, the Nazi occupation, the communist regime, but it is very unlikely to survive this regulation. Good intentions of regulators can come down resulting in bankruptcy of a family company that produces premium spirits, where negligence of production safety and poisoning of customers was never on the table.

Leaving these few examples of how regulation backfires, it is still impossible to overlook its macroeconomic impacts on national economies. Almost every regulation means:

- a) yet another form and additional paperwork for businesses;
- b) lost time and financial costs incurred by the entrepreneur to meet the set requirements (which translates into higher end prices for consumers);
- c) growth of the bureaucracy departments responsible for overseeing compliance, reporting, etc. (at a time of critical shortage of labor on the market);
- d) negative impact on efficiency within the economy.

Economists agree<sup>5</sup> that it is impossible to introduce regulation that would immediately result in the development of a prosperous economy. It is exactly the opposite that leads to prosperity. Simplicity in operating a business is the key – especially in the Czech Republic, where millions of people own small and medium-size businesses, which are the most affected by regulation.

**DEVELOPMENT OF REGULATORY  
BURDEN IN THE CZECH REPUBLIC**

The President of the Confederation of Industry and Trade, Jaroslav Hanák, together with the Department of Business Environment and Business Entrepreneurship, an anti-bureaucracy body operating within the Ministry of Industry and Trade, addressed the increasing volume of bureaucracy in the Czech Republic. They pointed to the harmfulness of the number of regulators' demands and frequent changes in the business environment. The entrepreneurs themselves, however, are most concerned [See: Figure 1]. A survey conducted by the Con-

<sup>5</sup> See, for example, Von Mises, L. (1966) *Human Action: A Treatise on Economics*, Chicago: Henry Regnery.

**AN INTERESTING  
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THUS, IT IS EQUALLY  
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TERM OVERALL  
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OF LEGISLATION**

federation of Industry and Trade in cooperation with the Czech National Bank attempts to identify how regulation is perceived. It

consists of a set of questions (including ones related to bureaucracy and overall quality of legislation, among others) that are being answered by enterprises on a scale from 1 to 5, where one means that the area does not cause any problems, and 5 that the category causes the most problems. After calculating the feedback, the Czech National Bank publishes the average of all responses.

Reasonable regulation and the resulting bureaucracy should be perceived as trouble-free. Yet, satisfaction with the quality of legislation and the resulting quality of the business environment did not change and oscillates around the value of 3.5 throughout the monitored period of 2011-2018. This indicator has the worst score among all indicators in the survey over the whole period. Although at first glance it may seem that the value of 3.5 out of 5 possible is a relatively good score, it should be borne in mind that the "normal" value – indicating no issues – is set not at 2.5, but at 1.

An interesting development is the perception of the bureaucracy in the Czech Republic. In the period under review, dissatisfaction with it has increased from the level of 3.1 in 2011 (which itself is not a good result), to 3.5 in 2018. Thus, it is equally bad as the long-term overall quality of legislation. A significant jump of two tenths of a percentage point in the upwards direction was recorded between the years 2017 and 2018. It was probably due to such recent developments as electronic evidence of revenues, GDPR, minimum wage, and others that will be discussed in the following sections.

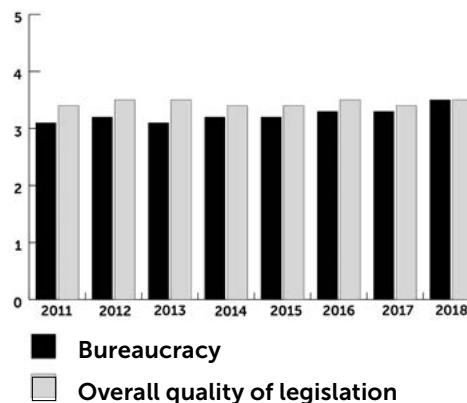
If nothing else happens, the bureaucratic burden should only fall in the context of technological progress. Various obligatory reports and forms could be simplified and digitized thanks to faster internet connection and other contemporary improvements. Even filling out forms is often easier

# LAUNCHING A BUSINESS IS A NIGHTMARE IN THE WHOLE OF EUROPE

thanks to digitalization. Computers and the internet simplify archiving, computing, communication, information retrieval, data transmission, etc. Compliance with the set rules should therefore be easier with every step forward that technology takes. If used properly, it would also make it easier for the bureaucrats.

It is clear that the requirements change over time, and that bureaucrats try to gather as much data as possible to create a stronger basis for more efficient decision making

Figure 1: Development of perception of regulatory burden in the Czech Republic



Source: Confederation of Industry and Trade in cooperation with the Czech National Bank

and monitoring of the fruits of their work. Or to more easily identify areas that are not yet "regulated enough". However, with the passage of time, it is appropriate to revise the requirements for fulfilling obligations. Some of them might already be pointless or unnecessary.

A reasonable increase in bureaucracy within a sensible institutional framework may be absorbed by technological progress, which would result in a reduction of the burden even with a growing number of duties. Instead, the bureaucratic burden is increasing, and the bureaucratic apparatus continues to expand. This is mainly due to a growing number of various demands. When does this stop? How much red tape is too much red tape?

While the Estonians crushed bureaucracy and digitized the entire public administration, in the Czech Republic, the entrepreneur does not have the time to do business because of the bureaucratic requirements.

Meanwhile, no one has yet promised Czechs anything resembling a fast, functioning, user-friendly, and digitized state like current Prime Minister Andrej Babiš. In his pre-election leaflet, he starts with a situation that many people in the Czech Republic know far too well: "I thought it was a joke, you need a new ID and a driver license, you have to stand in two queues because it is not possible to do it all at once". Even though his movement, ANO 2011, has been in power since 2014, Minister of Transport Dan Ťok has been in charge of issuing driver's licenses for years, and Babiš himself has been overseeing the tax system for years as a finance minister, nothing has changed. Merging state agendas does not take place, and the average citizen still has to take a day off at work to stand in queues at different government bureaus. The long-awaited project called Citizen's Internet Portal has

a minimum of users and Babiš's chief advocate for the digitization of state, Deputy Minister of Industry Ondřej Malý, was dismissed in November 2018. The agenda for the digitalization of the state has not moved forward since.

## RED-TAPE-ENHANCING REGULATORY CHANGES IN THE CZECH REPUBLIC

Electronic Evidence of Revenues (EET), often referred to as online revenues registration, is a way of tracking revenues. Data about each merchant transaction are sent online to the state administration. In 2016, the EET system was introduced in the Czech Republic. The Ministry of Finance promised a smooth start of the control reports, but it was not the case for many entrepreneurs.

One fifth of all entrepreneurs reported encountering some problems. EET hit small businesses and traders especially hard. It was a new duty that again increased the mandatory administration up to tens of hours annually. The cost of introducing EET for small business owners amounted to approximately EUR 400. The figure went above thousands of euros for bigger companies.

The Finance Minister originally estimated the annual contribution of this measure to the collection of VAT and the collection of income tax to amount to as much as EUR 473 million. According to an updated estimate, its expected contribution is as high as EUR 450 million. According to the Ministry of Finance, the promised results of collecting an extra EUR 473 million were achieved.

However, the method that has been used to make such a conclusion is controversial, according to experts from Czech Supreme Audit Office. The Ministry of Finance operates with the assumption that the introduction of the EET has a positive effect on VAT collection. This thesis is not further developed by

the Ministry, and it does not prove or justify it. The EET estimates work with an arbitrarily determined autonomous VAT revenue growth factor, and the rest is declared as the impact of the EET. When we expand the government's methodology for collecting VAT across the economy, the impact of EET would be reflected even in sectors where the EET was not introduced, as an increase of EUR 227 million, which is very unlikely.

Initial costs of introducing such a system start at EUR 400 and grow with the size of the business. Next to one-off purchase costs, there are additional operating expenditures. Every entrepreneur operating in catering or accommodation services, wholesale, retail, transportation, agriculture, or selected crafts pays at least EUR 20 in operating costs. The number may seem low and the actual costs are likely to be significantly higher, but let us see what comes out of this undervalued amount. If the entrepreneur pays EUR 20 per month, it amounts to an annual expenditure of EUR 240. There are about 600,000 entrepreneurs who are required to use the EET, so a simple multiplication shows that every year, entrepreneurs spend at least EUR 144 million. Millions that could have been used more efficiently.

General Data Protection Regulation (GDPR), a regulation of the European Union published in the *Official Journal of the European Union* on April 27, 2016, concerns public institutions as well as companies and companies dealing with the personal data of their customers or employees. The introduction of this regulation on personal data protection will cost Czech companies around EUR 1 billion; most companies, however, will pay up to EUR 2,000<sup>6</sup>. By contrast, more than

<sup>6</sup> Czech Chamber of Commerce (2018) *Účet za GDPR? Podnikatele nařízení vyjde na 25 miliard korun*. Available [online]: [https://www.komora.cz/tiskova\\_zprava/ucret-za-gdpr-podnikatele-narizeni-vyjde-na-25-miliard-korun/](https://www.komora.cz/tiskova_zprava/ucret-za-gdpr-podnikatele-narizeni-vyjde-na-25-miliard-korun/) [in Czech]

a fifth of large companies with more than 250 employees has spent over EUR 20,000 on these measures, according to Chamber of Commerce of the Czech Republic<sup>7</sup>.

### **SIZE AND DEVELOPMENT OF ADMINISTRATION IN THE CZECH REPUBLIC**

Almost one million people in the Czech Republic work for the state, state-owned enterprises, local governments and their organizations, which constitutes approximately one quarter of all employees in the Czech Republic. That many people worked last year for the state, state-owned companies, local governments, and their organizations, such as hospitals, schools, or cultural institutions<sup>8</sup>.

Most of the people who work for the state are paid directly from the central budget, that is, by the state. Last year, these employees accounted for almost 445,000 employees. Almost 30,000 more than five years ago. In 2019, according to an official governmental report, the number will increase by 16,300<sup>9</sup>. Their salaries will total to more than EUR 7.5 billion, which is 2 billion more than in 2013. In other words, after the decline in the public administration's size in the years of economic recession (2008–2010), when the number of people working for the state due to the budget cuts was falling, the Czech Republic is returning to the rising trend.

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<sup>7</sup> Ibid.

<sup>8</sup> Němc, J. (2017) *Provoz státu je stále dražší. Za pět let narostl počet státních zaměstnanců o 30 tisíc a náklady na jejich platy o 50 miliard*. Available [online]: <https://ekonom.ihned.cz/c1-66042180-urednici-a-ti-dalsi-pro-erar-pracuje-milion-lidi> [in Czech]

<sup>9</sup> ČTK (2018) *Počet státních zaměstnanců dal roste, stát dá příští rok na jejich platy 210 miliard*. Available [online]: <https://www.e15.cz/byznys/finance-a-bankovnictvi/pocet-statnick-zamestnancu-dal-roste-stat-da-pris-tirok-na-jejich-platy-210-miliard-1352581> [in Czech]

## **DUE TO BAD LEGISLATION, THE REAL ESTATE PRICE IS 10% HIGHER THAN IT WOULD BE WITH A PROPER LEGISLATIVE FRAMEWORK**

What do all these people working for the state, state-owned enterprises, local governments and their organizations do? The largest groups of employees are the teachers and other staff in the education system. In total, there were over 227,000 such employees last year, accounting for half of the people paid from the central budget. The second largest group are the policemen, customs officers, and prison staff, who in 2018 accounted for over 54,000 in the Czech Republic. Third place was occupied by professional soldiers: In 2018, the Czech army had about 24,000 soldiers. For comparison, the General Finance Directorate employed 16,300 tax collectors<sup>10</sup>.

The fact there are so many bureaucrats in the Czech Republic was also emphasized by Prime Minister Babiš, who addressed the issue at a press conference held on February 2, 2019, claiming that bureaucracy needs to

be reduced and digitalized<sup>11</sup>. At the beginning of February 2019, together with Finance Minister Alena Schiller, the prime minister said that it is necessary to start with budget cuts and reduce the number of state employees by 10%. Yet, neither of them has set any deadline<sup>12</sup>.

What remains unclear is whether the high number of bureaucrats is the reason behind the inefficient Czech legislation, or the other way around. It may well be a combination of both. For entrepreneurs, however, increasing number of bureaucrats is a symptom of inefficient systems that makes operating their businesses much more challenging..

### **THE CZECH REPUBLIC IN CONTEXT**

The Czech Republic holds 35<sup>th</sup> place in terms of the ease of doing business as estimated by the Doing Business Index. This section shows the breakdown of chosen indicators, such as ease of starting a business, getting a construction permits, getting electricity, paying taxes, etc. These internationally comparable factors indicate the overall quality of the business environment in different countries, thus allowing to compare business environment in the Czech Republic with that in neighboring and other countries in the world.

### **DOING BUSINESS INDEX**

According to the *Doing Business Index 2019*, the Czech Republic is the second worst country in terms of ease of doing business in the group of its neighbors (Germany, Austria, Poland, and Slovakia) [See Table 1]. None of the rankings mentioned in Table 1 displayed the Czech Republic as the best.

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<sup>11</sup> IDnes (2018) *Musíme šetřit, vyhlásily Babiš a Schillerová. Navrhli propouštění úředníků*. Available at: [https://www.idnes.cz/zpravy/domaci/schillerova-rozpocet-2020-statni-zamestnanci.A190201\\_161738\\_domaci\\_kop](https://www.idnes.cz/zpravy/domaci/schillerova-rozpocet-2020-statni-zamestnanci.A190201_161738_domaci_kop) [in Czech]

<sup>12</sup> Ibid.

All selected countries are doing "pretty well". They all, except Slovakia, got into the top forty of the examined states. Slovakia took 42<sup>nd</sup> place. However, as visible from the data, launching a business is a nightmare in the whole of Europe. Legally, it requires a lot of paperwork and visits to state offices. The *Doing Business Index* reveals that it is a big issue in all abovementioned countries.

The Czech Republic is not the best in any category, at the same time it ranked the worst in two categories within the region – obtaining construction permits and contract enforceability. When it comes to the former, the Czech Republic ranks 156<sup>th</sup> in the world. Only thirty-four countries are worse and most of them are developing countries, or ones affected by war. This position in the ranking really shows the true nature of the situation of bureaucracy in the Czech Republic. Building an office where employees can work or a small warehouse to store produced goods may appear to be a Sisyphean task. It takes a lot of time and resources, thus doing business becomes very difficult from the start.

It takes almost ten months to get a permit for building a production hall, over five years of waiting and handling for a block of flats. The length of the process in the Czech Republic is one of the longest in Europe. This is reflected in both a lower volume of investment and more expensive housing. Due to bad legislation, the real estate price is 10% higher than it would be with a proper legislative framework, according to Ekospol chief Evžen Koreček<sup>13</sup>. The first problem is the huge number of agents who can affect the proceedings. At present, the forty-six authorities concerned can express their

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<sup>13</sup> Němc, J. (2017) *Provoz státu je stále dražší. Za pět let narostl počet státních zaměstnanců o 30 tisíc a náklady na jejich platy o 50 miliard*. Available [online]: <https://ekonom.ihned.cz/c1-66042180-urednici-a-ti-dalsi-pro-erar-pracuje-milion-lidi> [in Czech]

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<sup>10</sup> General Finance Directorate (2018) *Annual Report: 2017*. Available [online]: [https://www.financisprava.cz/assets/cs/prilohy/fs-vysledky-cinnosti/VZ\\_FS\\_2017.pdf](https://www.financisprava.cz/assets/cs/prilohy/fs-vysledky-cinnosti/VZ_FS_2017.pdf)

Table 1: Comparison of *Doing Business Index* indicators for the Czech Republic, Germany, Austria, Poland, and Slovakia

Economy	Global Rank	Starting a Business	Construction Permits	Getting Electricity	Registering Property	Getting Credit	Paying Taxes	Enforcing Contracts
GER	24	114	24	5	78	44	43	26
AUT	26	118	42	28	32	85	40	10
PL	33	121	40	58	41	32	69	53
CZE	35	115	156	10	33	44	45	99
SVK	42	127	143	47	9	44	48	47

Source: *Doing Business Index 2019*

views on the process of obtaining a construction permit. If everyone has thirty days to respond, it is not surprising that the time it takes to get the permit is one of the longest in the world. No wonder that the authors of the *Doing Business Index* are shaking their heads in disbelief.

Similarly, Czech citizens are familiar with a cautionary tale in the area of enforceability of contracts (just to remind you, the Czech Republic was ranked as 99<sup>th</sup> out of the 190 countries surveyed). This fact also reflects the already mentioned poor opinion on the quality of the legislative environment in the country. Next to neighboring Austria sitting in 10<sup>th</sup> place, the Czech Republic looks like a representative of the wild east.

To summarize, obtaining construction permits and contract enforceability are clearly two categories where it is necessary for all public authorities (from ministries to courts) to improve their legal framework and efficiency.

#### BUREAUCRACY INDEX

Liberální Institut, in cooperation with the Slovak INESS, calculated how much bureaucracy costs the average small Czech com-

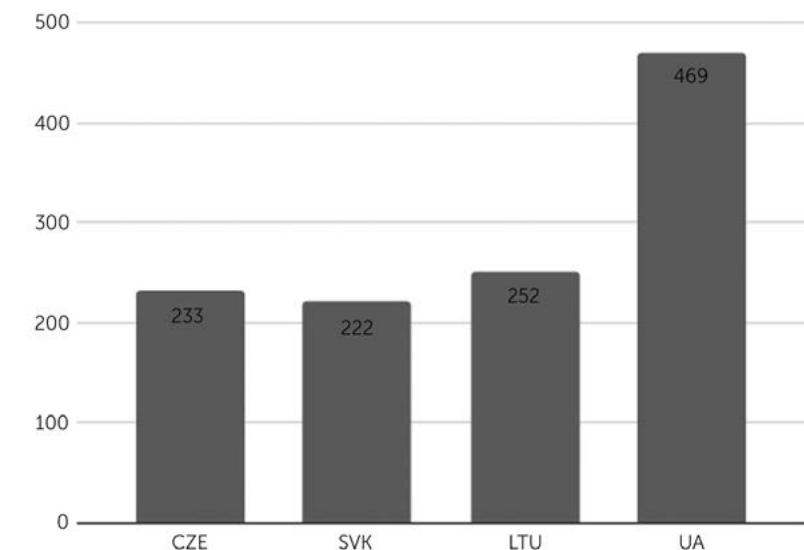
pany, thus creating the *Bureaucracy Index*<sup>14</sup>. This is an alternative view of reality regarding small entities, for which bureaucracy is often much more burdensome than for large multinationals<sup>15</sup>. The authors focused on all the familiar duties that a typical small Czech company has in one year's operation.

In the Czech Republic, an average small company spends 233 hours per year on paperwork, which translates in terms of an average wage to more than EUR 1,700. Needless to say, the state agenda costs businesses much more on compulsory levies, income tax, value added tax, etc. Among the four countries where the bureaucracy index is measured, the Czech Republic holds the 2<sup>nd</sup> place, after Slovakia, where companies spend 222 hours on paperwork, followed by Lithuania (with 252 hours), and Ukraine (469 hours) [See Figure 2].

<sup>14</sup> In the Czech Republic, the Ministry of Industry and Trade helped with the development of the Index, as it appreciated the possibilities of comparing the results of their sectoral measurement with the microeconomic model.

<sup>15</sup> The Bureaucracy Index uses a so-called "market test" in the methodology. This means that if the state imposes an obligation on the entrepreneur, which they would very likely perform even without the existence of the regulation, this activity is not considered bureaucracy.

Figure 2: Hours dedicated in a year to bureaucracy by small businesses in selected European countries (data for 2018)



Source: Peterka, P. (2018) *Index byrokracie 2018: V České republice stráví průměrná malá firma papírováním 233 hodin ročně*, [in]: libinst.cz. Available [online]: <https://libinst.cz/index-byrokracie-2018-v-ceske-republice-stravi-prumerne-mala-firma-papirovanim-233-hodin-roce/> [in Czech]

Although the Czech Republic is not doing the worst when compared to its neighbors, it is frightening that in a relatively small company, one person has to devote approximately five weeks just to finish the paperwork required by the state. Now, at a time of economic growth, we can get our hands on it. But worse times will come, and companies will need every resource to stay on the market. According to Director of Liberální Institut Martin Pánek, in order to address this challenge, the Czech government should adopt a courageous agenda to lower bureaucracy in our economy as soon as possible.

#### RECOMMENDATIONS

The business environment in the Czech Republic is far from perfect. Suggestions for improvement could fill up a national library. The recommendations listed below are selected on the basis of the weakest links in the

Czech system, and they can be understood as important tasks for the following years.

#### 1) Digitization and adherence to the "once-only principle"

The digitization of public administration and the possibility of solving requirements online would make life easier and save count-

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THE BUSINESS ENVIRONMENT IN THE CZECH REPUBLIC IS FAR FROM PERFECT

less mileage for many entrepreneurs. At the same time, the "once-only principle" – according to which, the entrepreneur fills the information required by public authorities (e.g. Trade Licensing Office, Tax Offices) only once and the relevant authorities share the data among themselves – should be in place. This principle would reduce bureaucratic burden and would improve the ranking of the Czech Republic in the *Doing Business Index*.

## 2) "1 in 3 out"

Following the example of the United Kingdom and other countries, a mandatory "1 in 3 out principle" shall be introduced. It assumes that with each new piece of regulation or a duty, three have to be removed. The principle helps get rid of the weeds in the business environment. Logically, the unnecessary business obligations should be phased out first. Introducing this principle would similarly, as in the case of the 1<sup>st</sup> recommendation, reduce the bureaucratic burden. Especially in the "Paying Taxes" and "Starting a Business" categories.

## 3) Proper use of RIA

The RIA (Regulatory Impact Assessment) is an integral part of the legislative process in the Czech Republic. Good RIA helps to improve governance efficiency, contributes to the performance of the economy, and strengthens the importance of consultations on prepared legislative and conceptual materials with the broad public. However, even though RIA is implemented in the Czech environment, it is not used properly. It is not being taken into account when certain regulations are evaluated and is considered by some as unnecessary work that keeps MPs from their duties. RIA is usually made to assess the original proposal; it is, however, not adjusted should any changes be introduced to the initial framework. Clearly, the importance of RIA in this regard is underestimated. It is, therefore, crucial that RIA account for

every such modification and thus gives relevant feedback to the decision makers, who can then evaluate whether the planned/employed measures are justified.

## 4) Simplifying the process of obtaining construction permit

The entrepreneurs consider making fundamental changes to the building law crucial because it is a major barrier in the growth of further investment. According to the Chamber of Commerce of the Czech Republic, a single authorization procedure should be introduced to accelerate the process. This new procedure would merge all the necessary procedures (territorial, construction, nature protection and others) resulting in one permit for construction. The Chamber also proposes precise deadlines for the bureaucrats and other authorities. They are too benevolent right now. Simplifying the process would be a huge relief for businesses in the Czech Republic and would also help move the country up in the Doing Business ranking (both in terms of its overall position and as regards construction permits).

## 5) The amendments will enter into force in one day

Introducing a unified date of efficiency of legislation impacting the business environment would greatly help entrepreneurs to prepare for planned changes. A growing number of demands imposed on entrepreneurs by public authorities goes hand-in-hand with the necessity to introduce this principle. There would be a great decrease in the confusion regarding changing legal framework.

## 6) Simplifying the employment of foreigners in the Czech Republic

The problem of labor shortage of 313,000 missing workers, described at the beginning of this article, is one of the biggest obstacles for the economy in the Czech Republic. Making it easier for workers from all around

the globe to come work to the Czech Republic should be one of the priorities.

It becomes clear that implementing the abovementioned recommendations would significantly improve business environment in the Czech Republic. As a result, these improvements might lead to an increased willingness of entrepreneurs, who constitute the backbone of the Czech economy, to start a business. In the countries where entrepreneurs must meet sometimes as many as 1,500 different requirements with regards to providing necessary information to the state, such a willingness is likely to be at a much lower level. After all, who would risk doing business in such an unwelcome environment? Thus, the proposed set of recommendations is the key to improving the current situation in the Czech Republic, and improvement is much needed. •



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# Small Is Not Always Beautiful, Especially When Aided by (Polish) Government



MARCI  
ZIELIŃSKI

The official rhetoric of Law and Justice (PiS) government is “to make it possible to develop micro enterprises into small, small into medium, and medium into large or even into international champions”<sup>1</sup>. However, the actual measures undertaken by the government were, in fact, to petrify the size of the companies. Since 2015, at least three pieces of regulation have been introduced that formally served to promote micro and small enterprises, regardless of their efficiency: a freeze on trade in agricultural land, (very heavy) restrictions imposed on new pharmacies, and a ban on Sunday retail trading. What they do is to render it unprofitable to develop into bigger companies. In addition to this, a new tax relief has been put forward, rendering company growth unprofitable. The conditions have not improved with the introduction of the so-called “Business Constitution”, i.e. a new law on business activity that was intended to improve the conditions of running a business in Poland. However, because of its general character, its effects are negligible in the light of the myriad of existing specific regulations.

## REGULATIONS PROMOTING SMALL AND INEFFICIENT COMPANIES

As mentioned, the official rhetoric of Law and Justice government is to facilitate growth of Polish companies. With regard to building (rather national than international) mostly state-owned champions, the government has at its disposal several instruments that serve to recapitalize them or provide them with preferential loans. However, the environment for smaller entities – especially those privately-owned –

<sup>1</sup> Premier (2018) Prime Minister Mateusz Morawiecki: We Are Developing an Environment Supporting Small and Medium Enterprises. Available [online]: <https://www.premier.gov.pl/mobile/en/news/news/prime-minister-mateusz-morawiecki-we-are-developing-an-environment-supporting-small-and.html>

“THE ACTIONS  
UNDERTAKEN  
BY THE GOVERN-  
MENT WERE NOT  
TO FACILITATE  
THE REGULATORY  
FRAMEWORK  
BY SOME  
DEREGULATORY  
MEASURES, BUT  
TO USE NEW  
REGULATIONS  
TO COMPENSATE  
FOR LOWER  
EFFICIENCY  
OF SMALLER  
COMPANIES

was not so favorable, because of two reasons. First, smaller companies are often less efficient than bigger ones, especially those foreign-owned. This is not to say that obstacles shall be put on small companies, but rather that the growth of potentially innovative small companies into bigger ones with economies of scale (let them disrupt the market) shall be enabled.

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## IN 2018, THE SHARE OF EMPLOYMENT IN AGRICULTURE WAS 10.3% – ABOUT 2.5 TIMES MORE THAN THE EU AVERAGE

Second, the regulatory and tax framework has been very complex, which makes it harder to operate for smaller companies. The actions undertaken by the government were not to facilitate the regulatory framework by some deregulatory measures (the so-called “Business Constitution” was not such a measure), but to use new regulations to compensate for lower efficiency of smaller companies.

In light of these developments, three pieces of regulation that were introduced in the last three years shall be discussed. All of them were implemented to favor small enterprises, or at least was claimed by their sponsors or supporters<sup>2</sup>. But by hampering the growth of companies, they also jeopardize the competition between bigger enterprises by making the market less contestable. Therefore, anti-growth tax relief (the so-called “small CIT”), and

<sup>2</sup> The restrictions against new pharmacies were supported by the Polish Pharmaceutical Chamber; the ban on Sunday retail trading, which was introduced as a result of a bill initiated by citizens, was sponsored by the “Solidarity” trade union, which collected signatures in its support.

“Business Constitution” shall be also closely examined.

### FREEZE ON TRADE IN AGRICULTURAL LAND

May 1, 2016 was the last day of a transitional period negotiated with the European Union (EU), during which acquisition of agricultural land by foreigners had been prohibited without permission from the Ministry of Interior. Because it was impossible to discriminate against the foreigners, still in 2015, the previous parliament almost unanimously voted for the law which seriously hampered the trade in agricultural land: It banned resale of agricultural land purchased from the Treasury for ten years.

Yet, in 2016, the PiS government introduced a new law, which increased the ban to fifteen years. Furthermore, it suspended the sale of agricultural property by the Treasury for a period of five years and required that the agricultural land of the Agricultural Property Agency would only be leased to the farmers. Moreover, it requires the purchasers of agricultural land to be, as a rule, individual farmers, with agricultural qualifications, holding agricultural property with an area of up to 300 hectares and residing in the commune (*gmina*) for at least five years.

As Civil Development Forum (FOR) noticed:

*[t]hese changes will lead to the freeze on trade in agricultural land. Meanwhile, Polish agriculture is among the least productive in the European Union (...). The main reason for that is the small average size of farms in Poland, which, according to Eurostat, in 2013, was 10 hectares to 16 hectares in the EU-28, 59 hectares in Germany, and 133 hectares in the Czech Republic.*

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## KEEPING SMALL BUSINESS SMALL IS A FEATURE OF PRESENT POLICY OF THE RULING PARTY

*(...) The share of agriculture in employment remains very high. According to Eurostat, in 2014, it amounted to 11.5% of the employed (fourth highest rate in the EU), compared to only 5% in the EU-28, 1.5% in Germany and 3.3% in the Czech Republic. At the same time, in Poland, productivity (measured by value added per worker) in agriculture is five times lower than in services (...). This means that the outflow of workers from agriculture to other sectors would be associated with a significant improvement in the productivity of the entire Polish economy.*

*Up to now, the process of quitting farming has continued successfully and spontaneously as a result of market forces (...). Thanks to improved productivity, agricultural production increased, despite the outflow of workers.*

*(...) In 2013, farms with an area of over 100 hectares employed 3% of all workers in agriculture, while producing 16% of the value<sup>3</sup>.*

<sup>3</sup> Trzeciakowski, R. (2016) FOR Communication: Politicians Want to Inhibit the Development of Polish Agriculture. Available [online]: <https://for.org.pl/en/a/3814.for-communication-politicians-want-to-inhibit-the-development-of-polish-agriculture>

Indeed, the problem of inefficient agriculture based on smallholding farms had been present at least since the beginning of transformation as a heritage after the Polish People’s Republic. Politically, it is highly difficult to implement reforms in this sector because farmers constitute a very powerful interest group. Nevertheless, some beneficial tendencies took place, which are currently being tested.

In 2018, the share of employment in agriculture was 10.3% – about 2.5 times more than the EU average. To be clear, incentives to keep smallholding farms were present before the passing of a new law. One such incentive are subsidies of over PLN 40 billion per year, among which are subsidies to pensions. Admittedly, there is a strong smallholding lobby against large agriculture in Poland, but keeping small business *small* is also a feature of present policy of the ruling party.

### RESTRICTIONS AGAINST NEW PHARMACIES

The so called “Pharmacy for the Pharmacist” law was supposed to stop the development of chain pharmacies. First, it prevents those who run at least four pharmacies from opening new ones. Second, only when there are less than 3,000 people per pharmacy in the commune and there is no pharmacy within the distance of 1 kilometer from it may a permit to create a new pharmacy in the area may be issued. This means that new pharmacies cannot be established in any Polish voivodship city. Third, a permit is issued only to pharmacists with the right to practice.

The pharmaceutical market had already been overregulated before the passing of the “Pharmacy for the Pharmacist” law. As observed by FOR “[t]he rigid prices of reimbursed medicines make it impossible to

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## THE PHARMACEUTICAL MARKET HAD ALREADY BEEN OVERREGULATED BEFORE THE PASSING OF THE “PHARMACY FOR THE PHARMACIST” LAW

compete on price. The ban on advertising restricts competition and also prevents the introduction of new services in the field of health promotion, prevention, and monitoring. The ban on internet sales limits the availability of medicines, including rural areas. The ban on issuing new permits to entities holding 1% of pharmacies in the voivodship limits competition instead of fostering it<sup>4</sup>. Such measures are, of course, beneficial to incumbents, but, at the same time, harmful to their challengers and – what is even more important – to customers (patients).

Despite the fact that the new legislation was introduced, it applies only to new pharmacies, so the already existing ones will keep running, unless they change location. On the face of it, it serves to protect small and independent but inefficient

pharmacies from the competition of big and efficient chains. However, according to a FOR analysis, “the foreclosure of pharmacy market will make independent pharmacies and small networks never grow<sup>5</sup>. Thus, it is a yet another measure to make an overregulated market even less contestable with the negative impact on challengers and customers.

The effects of the new law can already be seen. According to the recent study by Grant Thornton<sup>6</sup>, in 2018, the quantity of pharmacies in Poland dropped by 458 establishments (or 3.1% of the total of 14,911 pharmacies) as compared to a year before. Earlier, the number of pharmacies had been growing steadily every year – at least since 2001 (which was the first year taken into account by the study). Moreover, Grant Thornton predicts that in 2019 the number of pharmacies will drop by another 400<sup>7</sup>. As the study shows, the hitherto drop is due to a lower number of newly-opened pharmacies.

### BAN ON SUNDAY TRADING

The ban on Sunday trading came into force on March 1, 2018. Until the end of the year trading was allowed on two Sundays per month, and 2019, only on one Sunday per month. Beginning in 2020, the shops will be open only on seven Sundays per year.

There were two rationales for introducing the ban. First, the sponsors of the law (the “Solidarity” trade union) wished to secure free Sundays for retail workers. It could be partially accomplished with the change of

<sup>4</sup> Trzeciakowski, R., and K. Wąsowska (2016) *Analysis 20/2016: Pharmacies for Pharmacists – Contrary to the Interests of Patients and the Constitution*. Available [online]: <https://for.org.pl/5024.analysis-20/2016-pharmacies-for-pharmacists>

<sup>5</sup> Ibid.

<sup>6</sup> Grant Thornton (2019) “Apteka dla aptekarza” wywołała rewolucję w branży. Available [online]: <https://grantthornton.pl/publikacja/apteka-dla-aptekarza-wywola-la-revolucje-w-branzy/> [in Polish]

<sup>7</sup> Ibid.

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## THE BAN ON SUNDAY TRADING GRANTED A PRIVILEGE TO RETAIL WORKERS BUT DID NOT APPLY TO EMPLOYEES FROM OTHER BRANCHES – FOR INSTANCE, THOSE WORKING IN RESTAURANTS OR GAS STATIONS

the Labor Code guaranteeing, for example, two free Sundays for all employees. The ban on Sunday trading granted a privilege to retail workers but did not apply to employees from other branches – for instance, those working in restaurants or gas stations.

Second, the intention was to promote small family-owned stores. This is why over thirty exceptions to the ban were introduced. Many of them were formulated imprecisely, which allowed some retail chains to operate on Sundays, funny enough, post offices were exempt (e.g. Żabka and Freshmarket chains). Now, the ruling party is trying to patch the law by

extending the ban on those stores<sup>8</sup>.

After almost a year with the law being in force, the tendency of small shops disappearing from the market has not reversed. It has not even stopped. Many customers buy on Saturdays in advance, and the operating costs of big chain stores (supermarkets and discount stores) decreased because of free Sundays. The revenues of discount stores and gas stations increased, while those of small shops decreased<sup>9</sup>. It is another anti-market regulation that was aimed to help some groups at the expense of their competitors and customers. The goal of aiding small family-owned shops was not attained, and there is no reason to privilege some workers.

### SMALL CIT FOR SMALL TAXPAYERS

A very interesting example of a reform colliding with government’s declaration to help develop various businesses is the so-called “small CIT” for small taxpayers. To obtain the status of a small taxpayer, a company has to be either newly established, or show a revenue up to EUR 1.2 million in the previous fiscal year. In such a case, it will pay corporate income tax according to a reduced rate of 9%. In other cases, it will pay the standard rate of 19%.

<sup>8</sup> Wachowiec, P., and M. Zieliński (2019) *FOR Communication 1/2019: Amendment to the Law on the Prohibition of Trade on Sundays: Superficial Corrections to a Bad Law*. <https://for.org.pl/en/a/6428/for-communication-1/2019-amendment-to-the-law-on-the-prohibition-of-trade-on-sundays-superficial-corrections-to-a-bad-law>

<sup>9</sup> Biuro Analiz Sejmowych (2018) *Ocena prawnych skutków regulacji zawartych w poselskim projekcie ustawy o uchyleniu ustawy o ograniczeniu handlu w niedziele i święta oraz w niektóre inne dni* (druk sejmowy nr 2423); *Ocena skutków regulacji poselskiego projektu ustawy o uchyleniu ustawy o ograniczeniu handlu w niedziele i święta oraz w niektórych inne dni* (druk sejmowy nr 2423). Available [online]: [http://orka.sejm.gov.pl/rexdomk8.nsf/0/895F7128601895AEC125835A003913E1/%24File/12876\\_18.rtf](http://orka.sejm.gov.pl/rexdomk8.nsf/0/895F7128601895AEC125835A003913E1/%24File/12876_18.rtf) [in Polish]

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MANY CUSTOMERS BUY ON SATURDAYS IN ADVANCE, AND THE OPERATING COSTS OF BIG CHAIN STORES (SUPERMARKETS AND DISCOUNT STORES) DECREASED BECAUSE OF FREE SUNDAYS

Noteworthy, the government has not introduced typical tax progression, but instead introduced two flat income taxes depending on revenue. As a result, when a company does not pay to increase the scale of operation, a gap emerges. Simply put, in the case of an enterprise that has constant return on sales of 5%, if it has a revenue of EUR 1.2 million, it earns a gross income of EUR 60,000. After paying CIT of 9%, the company receives EUR 54,600 in net profit. But if it exceeds the revenue threshold by only 1 euro, it would have to pay 19% from its whole gross income next year. Assuming that the aforementioned company will not increase its operations in the next year, it will get only EUR 48,600 in net profit. It is an obvious disincentive to grow, which is even stronger when a company cannot know exactly what its future revenue will be (and

it is always the case because of market uncertainty).

Furthermore, such a measure discriminates against companies with low return on sales but high revenue. This does not mean that such enterprises are inefficient, because they can still show high return on equity because of high turnover. Nevertheless, the threshold of EUR 1.2 million in revenue may be too low for them to benefit from the small CIT. The last thing is that small CIT creates an incentive to divide operations between many entities with small revenue.

#### **“BUSINESS CONSTITUTION”**

As a remedy for overregulation in Poland, the government introduced a new law on economic activity, the so-called “Business Constitution”, dubbed by the lawmakers “the most important reform of Polish economic law for almost 30 years”<sup>10</sup>. Supposedly, the most relevant feature of “Business Constitution” is that it states many general rules of economic activity, for example that “everything which is not forbidden is allowed” (Article 8 of the Law of Entrepreneurs<sup>11</sup>).

The very construction of this rule (along with other general, similarly vague, rules) results in the fact that it cannot be applied in cases regulated by other, more specific, rules that prohibit something. Thus, it cannot reverse aforementioned regulations. In fact, such a rule was in force earlier, as it stemmed from the Polish Constitution (and so is the case in every liberal order). Its application by courts and state

<sup>10</sup> Ministerstwo Przedsiębiorczości i Technologii (2018) *Konstytucja biznesu i inne zmiany prawne dla firm*, p. 7. Available [online]: [https://www.mpit.gov.pl/media/56139/Broszura\\_o\\_KB.pdf](https://www.mpit.gov.pl/media/56139/Broszura_o_KB.pdf) [in Polish]

<sup>11</sup> Ustawa z dnia 6 marca 2018 r. – Prawo przedsiębiorców. Available [online]: <http://prawo.sejm.gov.pl/isap.nsf/DocDetails.xsp?id=WDU20180000646> [in Polish]

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AS A REMEDY FOR OVER-REGULATION IN POLAND, THE GOVERNMENT INTRODUCED A NEW LAW ON ECONOMIC ACTIVITY, THE SO-CALLED “BUSINESS CONSTITUTION”, DUBBED BY THE LAWMAKERS “THE MOST IMPORTANT REFORM OF POLISH ECONOMIC LAW FOR ALMOST 30 YEARS”

offices was and still is restricted by a myriad of detailed regulations, which in the legal system take precedence over general rules.

Another issue beside overregulation that

jeopardizes the growth of companies in Poland is legal uncertainty. And this problem was also to be remedied by “Business Constitution”, which introduces some rules of lawmaking. But in fact, it was the ruling party that added to the poor quality of law. As FOR stressed, “the current legislative practice of the PiS government, which is characterized by hasty adoption of important legal acts, abuse of the deputies’ legislative initiatives, poor regulatory impact assessments, and unjustified shortening of the duration and a lack of transparency of public consultations. In this situation, it rings hollow when the PiS government, having reduced unprecedentedly the quality of law-making, announces that its bill will introduce high standards of the legislative process in business law”<sup>12</sup>. Unfortunately, the new rules of lawmaking are too vague to solve the problem. It seems that such rules can be easily bypassed, when the political will to liberalize economy is lacking<sup>13</sup>.

#### **CONCLUSIONS**

Despite its declaration to promote economic growth and development of Polish companies of all sizes, the current Law and Justice government introduced numerous bad regulations (a freeze on trade in agricultural land, restrictions imposed on new pharmacies, and a ban on Sunday retail trading) that were intended to promote small companies and not their expansion. However, due to a multitude of factors working in different directions,

<sup>12</sup> Zieliński, M. (2018) Analysis 11/2018: “Business Constitution” – Propaganda Slogans Instead of Real Reform. Available [online]: <https://for.org.pl/en/a/6231/analysys-11/2018-business-constitution-propaganda-slogans-instead-of-real-reforms>

<sup>13</sup> For the general assessment of law-making in Poland, see periodical reports of Civic Legislative Forum at Stefan Batory Foundation. Available [online] [http://www.batory.org.pl/programy\\_operacyjne/przeciw\\_korupcji/przejrzystosc\\_w\\_procesie\\_stanowienia\\_prawa\\_1/obserwacje\\_rzadowego\\_procesu\\_tworzenia\\_prawa](http://www.batory.org.pl/programy_operacyjne/przeciw_korupcji/przejrzystosc_w_procesie_stanowienia_prawa_1/obserwacje_rzadowego_procesu_tworzenia_prawa) [in Polish]

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it is difficult to tell whether this goal was achieved in every case (for example, a ban on Sunday trading did not stop the dropping number of small shops, but still it cannot be excluded that to some extent it confirmed this tendency). Nevertheless, not only do these regulations restrict competition and hamper expansion, but they also hurt long-term prospects of Polish economy.

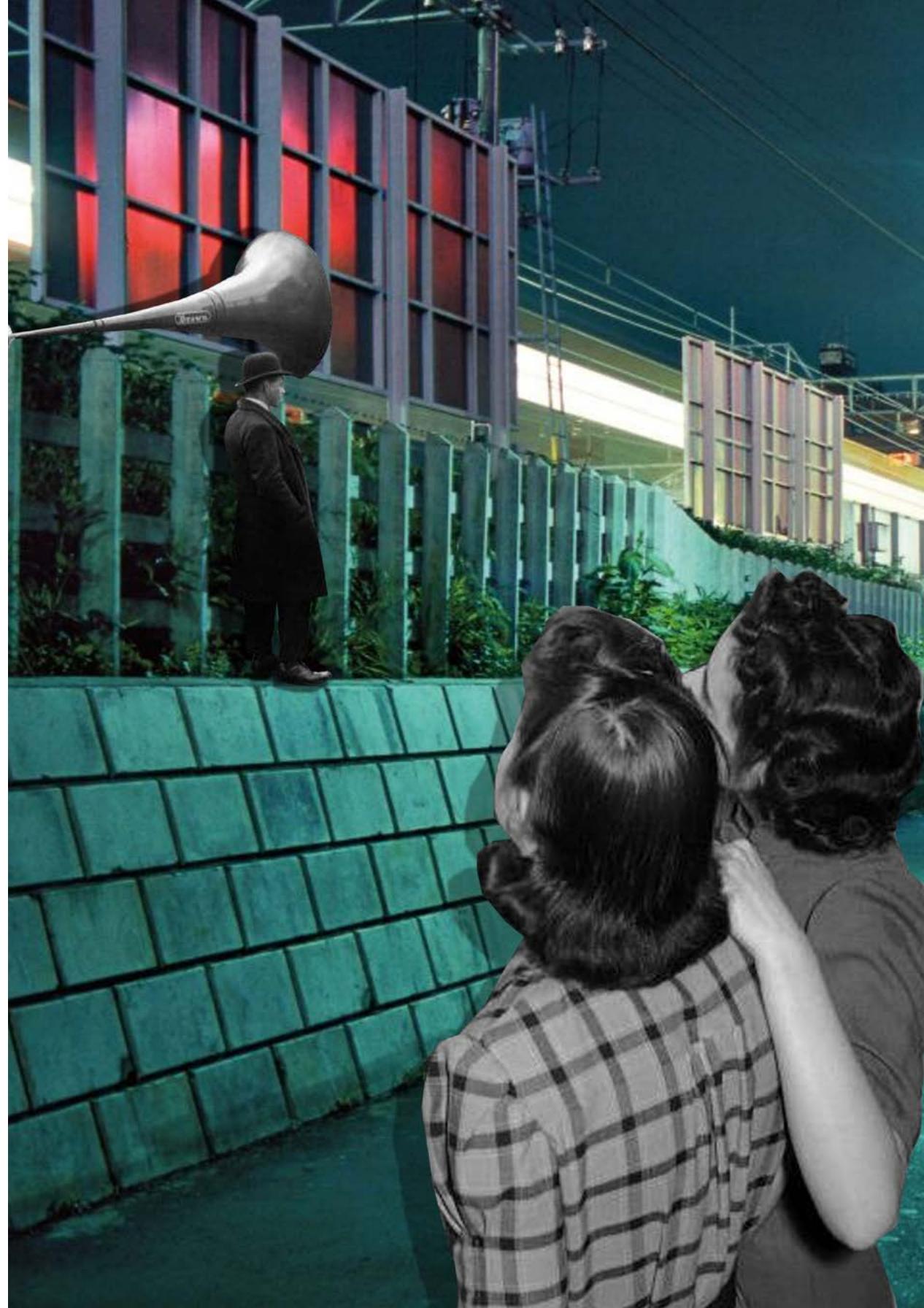
If we want Polish companies to grow, we need legislation that would not give privileges to small ones and petrify their size. What we need is pro-competitive legislation that would allow market forces to operate and challengers to contest the incumbents, and not specific regulations that make it unprofitable to expand the scale of operations. In case of agriculture, the pharmaceutical market and retail trading there was a space for market reform even before the new regulations were implemented by the current government. And market reform is the direction that should be taken by Poland, if it is to secure its long term growth. •



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MARCIN  
ZIELIŃSKI

Economist at Civil Development Forum (FOR)



# Retail Opening Hours: Regulation That Fails



\*  
GINTARĖ  
DERŽANAUSKIENĖ



\*  
ANETA  
VAINĖ

**O**ut of thirty European countries, sixteen allow retail trade on Sundays, whereas fourteen do not limit retail opening hours on public holidays.

The countries which regulate retail trade on Sundays and/or public holidays apply a range of exemptions, suggesting that navigating among the varying interests of workers, consumers, and businesses poses a challenge. In recent years, many European countries have chosen to deregulate, acknowledging that the regulation has failed to a lesser or greater extent.

Since 2012, nine European countries have taken measures to liberalize the regulation of retail opening hours: Denmark, France, Finland, Italy, the Netherlands, Portugal, Spain, and Malta. Meanwhile, Hungary and Poland introduced restricting regulations in 2015 and 2018 respectively<sup>1</sup>. Yet, in response to public backlash, Hungary removed its fresh restrictions on retail opening hours a year later.

The European Commission too is sounding the alarm bells and urging member states to abandon the regulation of retail opening hours before e-commerce destroys brick-and-mortar stores and forces their employees to protest on the streets. The European Commission has warned that a tightening competition between traditional retail and e-commerce is already challenging the labor market to adapt to rapidly changing conditions in the retail sector.

Lithuania has recently seen vigorous proposals to ban retail trade on Sundays and public holidays, seemingly trying to catch the train from which Europe is rushing to disembark. If retail companies were forced

<sup>1</sup> ESTEP (2018) *Mažmeninės prekybos įmonių darbo laiko reguliavimo poveikio vertinimo studija*. Available [online]: <http://estep.lt/index.php?id=1213> [in Lithuanian]

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to close one Sunday per month (thirteen Sundays) and on all fifteen public holidays<sup>2</sup>, this would make 28 days off per year. If the ban were extended to all Sundays and public holidays, the number of closing days would go up to 64. Opinion polls show that this would affect 75% of Lithuanian consumers

who do their shopping on Sundays and 70% who do their shopping on public holidays. The retail sector with 10,000 companies and 120,000 employees would have to bear its costs too.

In the meantime, data suggest that the regulation of retail opening hours has serious implications for consumers, workers, businesses, public finances, and the economy at large. Therefore, it is worth investigating what the implications are for all these agents.

#### **IMPLICATIONS FOR WORKERS**

An analysis of thirty OECD countries suggests that liberalization of retail opening hours contributes to a growth in the number of retail workers and creates additional possibilities to work part-time, e.g. for youth or people taking care of children<sup>3</sup>.

**A ban on retail opening hours on Sundays or public holidays would reduce jobs and wages in the retail sector.** If retail workers were prohibited from working on Sundays and public holidays, it is very unlikely that this working time would be transferred to other workdays. If Lithuania, for example, banned retail trade on one Sunday per month and on all public holidays (28 days per year in total and 2.5 days per month on average), the average number of hours worked per worker would decrease by 224 hours per year. The annual wage of a statistical average (full time) retail worker could go down by the amount of money that approximately corresponds to a 1.5-month salary, given the double pay rate applicable on public holidays as prescribed by the Labor Code. The number of job vacancies in the retail sector might fall by about 5%. 28 days a year account for 7.7% of the total working

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time, although it is likely that some Sunday workers would do less work than usual, or their working hours would be shifted to other days.

Research shows that the introduction of restrictions on retail opening hours in Lithuania would negatively affect more than 2,000 retail units and service providers, and

<sup>2</sup> Vilmorus (2018) *Retail Opening Hours on Sundays and Public Holidays*. A representative opinion poll was conducted in Lithuania on June 8-17, 2018.

<sup>3</sup> ESTEP (2018) *Mažmeninės prekybos įmonių darbo laiko reguliavimo poveikio vertinimo studija*. Available [online]: <http://estep.lt/index.php?id=1213> [in Lithuanian]

more than 6,000 employees (in pharmacies, hairdressing salons, repair shops, specialized stores, etc.)<sup>4</sup>. The regulation would particularly hurt the regional workforce. According to the 2018 data of the Lithuanian Labour Exchange, seventeen out of sixty Lithuanian municipalities reported a surplus of shop assistants<sup>5</sup>. Losing a job would make it even harder to find another one in the same sector.

**Reconciling family and work would become more difficult.** Those who work on Sundays have days off during the week. A rolling work schedule means that not all Sundays are workdays. For example, four consecutive workdays with 10 working hours a day may be followed by four consecutive days off. Under such work schedules, people work only half of all Sundays and not on all public holidays.

Some people appreciate rolling work schedules which allow them to have free days during the week and to better reconcile work and family or personal needs, e.g. taking children to extracurricular activities, going to the doctor, performing household chores, etc. If retail opening hours were restricted, workers would have to work longer hours on other workdays in order to maintain their usual level of income. This would diminish the benefits that rolling work schedules involve.

**The ban would only apply to some workers.** The retail sector in Lithuania employs 120,000 workers, but not all of them work on Sundays and public holidays. What's more, the share of people who do work

<sup>4</sup> ESTEP (2018) *Mažmeninės prekybos įmonių darbo laiko reguliavimo poveikio vertinimo studija*. Available [online]: <http://estep.lt/index.php?id=1213> [in Lithuanian]

<sup>5</sup> Lithuanian Labor Exchange (2018) *Profesijų žemėlapis*. Available [online]: [https://www.lbd.lt/Informacija/DarboRinka/Puslapiai/Profesiju\\_zemelapis.aspx](https://www.lbd.lt/Informacija/DarboRinka/Puslapiai/Profesiju_zemelapis.aspx) [in Lithuanian]

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SOME PEOPLE APPRECIATE ROLLING WORK SCHEDULES WHICH ALLOW THEM TO HAVE FREE DAYS DURING THE WEEK AND TO BETTER RECONCILE WORK AND FAMILY OR PERSONAL NEEDS, E.G. TAKING CHILDREN TO EXTRACURRICULAR ACTIVITIES, GOING TO THE DOCTOR, PERFORMING HOUSEHOLD CHORES, ETC.

on Sundays is considerably higher: 141,300 working people in Lithuania usually work on Sundays, while another 149,500 sometimes work on Sundays, according to Statistics Lithuania (2018)<sup>6</sup>. It should be noted that the

proportion of the working population who usually work on Sundays is steadily decreasing. It has fallen from 15% in 2015, to 10% in 2018 [See Table 1]. A ban on retail opening hours on Sundays and public holidays might act as a discrimination towards workers in other sectors.

**Students would have less opportunity to work and earn an income.** The regulation of Sunday work in the retail sector would make reconciling study and work more difficult. The possibility to work on weekends is particularly appreciated by students. According to the 2018 eurostudent.eu survey, almost half of Lithuanian students (47%) combine study and work and have jobs related to their field of study<sup>7</sup>. The situation is very similar in other European countries, with the EU average standing at 45% [See Figure 1]. Restrictions on retail opening hours may force lower-income students to switch to working on workdays, which may negatively affect their learning outcomes or even force them to drop out of education.

#### IMPLICATIONS FOR CONSUMERS

On average, seven in ten people in Lithuania go shopping on Sundays or public holidays. The majority of the population would not mind if stores were closed on four public holidays, including Christmas, Christmas Eve, Easter, and New Year, but they would want to be able to do their shopping on the other eleven out of fifteen public holidays [See Table 2]<sup>8</sup>. Additionally, only 4.3% of people in Lithuania think that retail opening hours should be regulated by politicians<sup>9</sup>.

<sup>6</sup> Statistics Lithuania (2018) *Population and Social Statistics/ Working Population/Atypical Forms of Work/Usually Work on Sundays and Sometimes Work on Sundays*. Available [online]: <https://osp.stat.gov.lt/>

<sup>7</sup> Eurostudent.eu (2018) *Combining Studies and Paid Jobs*. Available [online]: [https://mosta.lt/images/leidiniai/TR\\_paid\\_jobs.pdf](https://mosta.lt/images/leidiniai/TR_paid_jobs.pdf)

<sup>8</sup> Vilmorus (2018) *Retail Opening Hours on Sundays and Public Holidays*.

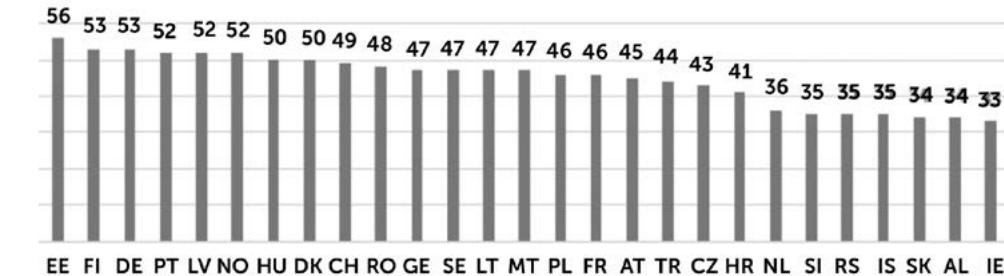
<sup>9</sup> Ibid.

Table 1: Dynamics of working population who work on Sundays (2014 to 2018)

Working population	2014	2015	2016	2017	2018
thousands	199.1	157.9	174.6	153.8	141.3
Usually work on Sundays	%	15%	12%	13%	11%
thousands	184.5	124.6	135.8	138.7	149.5
Sometimes work on Sundays	%	14%	9%	10%	11%
Total working population	thousands	1319	1334.9	1361.4	1354.8
					1368.4

Source: Statistics Lithuania (2018) *Population and Social Statistics/Working Population/Atypical Forms of Work/Usually Work on Sundays and Sometimes Work on Sundays*

Figure 1: Working students with jobs related to field of studies [in %]



Source: eurostudent.eu (2018)

**Regulation of retail opening hours would complicate everyday life.** According to Statistics Lithuania<sup>10</sup>, a total of 71% of the working population in Lithuania work full-time (40 to 44 hours per week). In larger cities – including the capital city of Vilnius, which accounts for 30% of Lithuania's population – going to shopping centers or stores at the end of a working day is quite problematic. Many choose to shop during the weekend. For some shopping centers, weekends make

up about 30% of the buyers' flow. A ban on retail opening hours on Sundays and public holidays would cause inconveniences in terms of the time it takes to shop due to increased customers flows.

**Merchandise on Sundays and public holidays would become more expensive.** Restrictions on retail opening hours usually come with a number of exemptions. In many countries that apply such regulations, some stores are allowed to operate on Sundays and public holidays, depending on retail surface area, number of employees, location and product range. With such exemptions in

<sup>10</sup> Statistics Lithuania (2018) *Population and Social Statistics/Working Population/Normal Hours Worked a Week (40-44 hours)*. Available [online]: <https://osp.stat.gov.lt/>

Table 2: The percentage of Lithuanian population supporting the closing of retail stores on public holidays [in %]

New Year's Eve (January 1)	83.5 %
Christmas Day (December 25)	82.4 %
Easter	80.5 %
Christmas Eve (December 24)	54.1 %
All Saints Day (November 1)	41.5 %
2 <sup>nd</sup> day of Easter	37.1 %
2 <sup>nd</sup> day of Christmas (December 26)	36.8 %
Restoration of the State Day (February 6)	31.7 %
Mother's Day (first Sunday of May)	28.3 %
Lithuanian Independence Day (March 11)	28.0 %
St. John's Day (June 24)	27.6 %
Father's day (first Sunday of June)	25.7 %
Virgin Mary Assumption Day (August 15)	25.1 %
King Mindaugas Coronation Day (July 6)	24.4 %
International Workers' Day (May 1)	22.9 %
Don't know	5.0 %

Source: Vilmorus (2018) *Retail Opening Hours on Sundays and Public Holidays*. A representative opinion poll was conducted in Lithuania on June 8-17, 2018

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A BAN ON RETAIL OPENING HOURS ON SUNDAYS AND PUBLIC HOLIDAYS MIGHT ACT AS A DISCRIMINATION TOWARDS WORKERS IN OTHER SECTORS

place, goods that can be sold on those days become more expensive, just like a bottle of water costs more at petrol stations than in regular stores.

**Consumers would tend to hoard products.** Restrictions on shopping hours may lead consumers to obtain and hold products in quantities greater than needed for one's immediate use, with a likelihood of increased waste and spending.

**A range of products would diminish<sup>11</sup>.** Commercial tourists and foreigners coming to Lithuania – mostly from non-EU countries (e.g., Belarus and Russia) – are estimated to constitute from 5 to 50% of buyers at weekends<sup>12</sup>. If Lithuania introduced a ban on Sunday retail hours, the country would become less attractive as a shopping destination. Stores which generate a significant share of revenues from commercial tourists would be likely to close down. This would

<sup>11</sup> Data provided by Gold Blue Lietuva.

<sup>12</sup> Ibid.

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ONLY 4.3% OF PEOPLE IN LITHUANIA THINK THAT RETAIL OPENING HOURS SHOULD BE REGULATED BY POLITICIANS

reduce the range of products available to consumers.

**More consumers would likely start shopping online, but not all have access to e-commerce.** Goods are available online 24/7, so some consumers would likely switch to online shopping. However, e-commerce would not solve the problem for all. Not all consumers have access to the Internet. In 2017, only 75% of Lithuanian households had access to the Internet. This is the sixth lowest indicator in Europe. Bulgaria ranked the lowest, with 67%, while Spain topped the ranking with 98%<sup>13</sup>.

### IMPLICATIONS FOR BUSINESS

There are 10,000 retail entities (excluding motor vehicles and motorcycles) in Lithuania<sup>14</sup>. This accounts for almost 10% of all operating entities. Regulation of retail open-

<sup>13</sup> Statista (2017) *Share of Households in Selected European Countries with Internet Access in 2017*. Available [online]: <https://www.statista.com/statistics/185663/internet-usage-at-home-european-countries/>

<sup>14</sup> Statistics Lithuania (2019) *Business Statistics/Operating Entities*. Available [online]: [https://osp.stat.gov.lt/documents/Turizmas-Lietuvoje\\_2017.pdf](https://osp.stat.gov.lt/documents/Turizmas-Lietuvoje_2017.pdf)

ing hours would have an impact on competition in this market judging not by the strength or efficiency of market participants, but by government intervention. In addition, it should be taken into account that retail stores compete not only in the traditional market, but also with e-commerce, while regulation only applies to traditional retailers. These circumstances will lead to unjustified distortions of competition.

**Shopping centers and stores in shopping centers would struggle.** Generally, larger shopping centers do not only contain grocery stores but also offer various services (such as beauty salons, cinemas, insurance companies, restaurants, banks, etc.). It is likely that entire shopping centers would have to close on the days falling under the ban of retail opening hours. This means that all other service providers would not be able to operate and would likely incur losses, even though the ban would not apply to them. Analysis (ESTEP, 2018)<sup>15</sup> suggests that a ban on Sunday retail opening hours in Lithuania would negatively affect more than 2,000 retail units and service providers (such as pharmacies, hairdressing salons, repair shops, specialized stores, etc.).

Even if businesses stayed open, their revenues would fall considerably due to lower customer flows. In such cases the payback period for businesses that rely on significant investment loans (such as cinemas or restaurants), would extend, affecting the ability to fulfil liabilities.

**Business income from commercial tourism would fall.** According to Statistics Lithuania<sup>16</sup>, 32% of foreigners come on same-

<sup>15</sup> ESTEP (2018) *Mažmeninės prekybos įmonių darbo laiko reguliavimo poveikio vertinimo studija*. Available [online]: <http://estep.lt/index.php?id=1213> [in Lithuanian]

<sup>16</sup> Statistics Lithuania (2017) *Tourism in Lithuania 2017*, P79. Available [online]: [http://www.tourism.lt/uploads/documents/Turizmas-Lietuvoje\\_2017.pdf](http://www.tourism.lt/uploads/documents/Turizmas-Lietuvoje_2017.pdf)

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day trips for shopping purposes. In 2017, same-day visitors to Lithuania spent EUR 297.1 million, which is by 3.0% more than in 2016. Almost half (49%) of this expenditure was for shopping purposes. The average expenditure of a same-day visitor totalled EUR 97 (EUR 95 in 2016). Most tourists who come and stay overnight are from Belarus (17%), Latvia (12%), Russia (10%), and Poland (9%)<sup>17</sup>. According to Global Blue Lietuva, UAB, commercial tourists who shop on Sundays make up 5-50% of a single store's turnover. If Lithuania banned retail opening hours on Sundays and public holidays, many commercial tourists would likely skip Lithuania in their travels. This would hurt not only retail trade companies, but also restaurants, hotels and other service providers, potentially pushing those who generate the lion's share of their revenues from foreign tourists out of business.

**Unfair competitive advantages would be granted to retail businesses unaffected by the regulation.** Evidence shows that a ban on retail opening hours on Sundays or public holidays usually comes with a number

of exemptions. After heated policy debates, Poland, for example, ushered in as many as thirty-two exemptions to their recent ban on retail opening hours on Sundays. If some types of products (e.g. bread, gas, flowers, tobacco, medication, household goods, etc.) or retail units (markets, petrol stations or family businesses) are exempted, they naturally enjoy more advantageous business conditions. For example, a pharmacy would be able to sell shampoos on Sundays and public holidays, while a store specializing in beauty products would not.

**IMPLICATION FOR PUBLIC REVENUES, ECONOMY, AND COMPETITION**

Restrictions on retail opening hours have negative implications for public revenues, foreign investment flows and the competitive environment.

**Investment attractiveness would diminish.** A ban on retail opening hours does not apply in sixteen – and, on public holidays, in fourteen – out of 30 European countries, including Latvia, Estonia, Bulgaria, the Czech Republic, Slovenia, Slovakia, Croatia, Romania, Finland, Switzerland, Ireland, Italy, and others. Countries that limit retail opening hours compete for foreign investments with those which do not. It is likely that restrictions on retail trade would reduce Lithuania's attractiveness, and divert foreign investments to the other countries.

**The competitive environment would be distorted.** Some retail companies welcome the idea of limiting retail opening hours. While concerns for the employees might be one of their motives, working hours can be negotiated regardless of whether any legal restrictions are in place or not. It is likely that a restriction on retail opening hours is seen as a means to weaken the position of stronger or more effective competitors. Political decisions rather than market forces

would cause competition distortions and affect performance outcomes of business players.

Stores and shopping centers can adjust their working hours according to consumer flows, which may vary on different days depending on circumstances (e.g. weather conditions, ongoing festivities or events). Shorter working hours in one supermarket would inevitably lead to larger consumer flows in other shopping units.

Just like any other business entity, shops and supermarkets make estimates of how shorter working hours would affect their performance in terms of consumer flows and financial outcomes. Such competitive mechanisms ensure the best price to quality ratio for the consumers. It is likely that restrictions on retail opening hours would help improve the financial situation of less efficient businesses, but this would come at the expense of better performing competitors and their consumers.

**Traditional retail stores would be discriminated against by e-commerce.** As e-commerce is bringing fundamental changes in shopping habits, traditional stores are now facing growing competition from e-commerce.

The growth of e-commerce in Lithuania is evidenced by a rapidly increasing number of postal parcels – since 2011, it almost doubled, reaching 12 million in 2016 (a 25.3% increase on year, according to the Communications Regulatory Authority of the Republic of Lithuania<sup>18</sup>).

<sup>17</sup> Ibid.

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Online shopping is not limited to one country, so applying analogous restrictions on e-commerce is impossible. A ban on retail opening hours would result in a growth of Internet buyers. It would discriminate against brick-and-mortar stores and undermine their competitiveness, pushing many stores out of business, together with jobs they create.

The European Commission notes that a ban on retail opening hours would be justifiable in conditions when all retail trade took place in traditional stores, but not online.<sup>19</sup> However, with the current trends, the introduction of such restrictions would bring disastrous consequences for competition and jobs. The ongoing market changes are much faster than the labor market could possibly adjust and reflect.

<sup>18</sup> Communications Regulatory Authority of the Republic of Lithuania (2016) *Lietuvos ryšių sektoriaus ataskaita 2016 m.* Available [online]: [http://www.rrt.lt/download/23025/lietuvos\\_rysių\\_sektorius\\_2016.pdf](http://www.rrt.lt/download/23025/lietuvos_rysių_sektorius_2016.pdf) [in Lithuanian]

<sup>19</sup> European Commission (2018) *A European Retail Sector Fit for the 21<sup>st</sup> Century*, Communication from the Commission to the European Parliament , the Council, the European Economic and Social Committee of the Regions, April 19. Available [online]: <https://ec.europa.eu/docsroom/documents/28681/attachments/1/translations/en/renditions/native>

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IT IS LIKELY THAT RESTRICTIONS ON RETAIL OPENING HOURS WOULD HELP IMPROVE THE FINANCIAL SITUATION OF LESS EFFICIENT BUSINESSES, BUT THIS WOULD COME AT THE EXPENSE OF BETTER PERFORMING COMPETITORS AND THEIR CONSUMERS

**Government revenue would experience shortfalls.** Non-EU citizens are eligible to VAT refunds on purchases above a certain required minimum [See Table 3]. While this money does not go into the state budget, commercial tourists make other expenses that are not subject to VAT refund (e.g., hotels, catering, and other services).

Statistics on VAT revenues<sup>20</sup> show that the balance from non-EU buyers in Lithuania

is positive. This means that every refunded euro attracts EUR 1.3 to the state budget, according to Global Blue Lietuva, UAB. A likely decline in commercial tourism would reduce budget revenue flows. A decline in retail trade would also cause a fall in profit margins and in government proceeds from corporate income taxes and labor taxes. In addition, contraction of retail businesses would increase the demand for unemployment benefits and put more pressure on public finances.

#### LEGAL ASSESSMENT OF THE PROHIBITION OF SUNDAY RETAIL TRADE

A ban on retail opening hours on Sundays and public holidays should be evaluated in the constitutional context. Article 46 of the Constitution of the Republic of Lithuania states that "Lithuania's economy shall be based on the right of private ownership, freedom of individual economic activity, and economic initiative". Freedom and initiative to engage in an economic activity refers to a set of legal possibilities that creates conditions for individuals to make independent decisions necessary to engage in an economic activity, as stated in a series of rulings of the Constitutional Court of the Republic of Lithuania<sup>21</sup>. Regulation of economic activity refers to the rules and conditions as well as restrictions of an economic activity<sup>22</sup>. Therefore, a ban on retail opening hours should be considered as a restriction on the freedom of economic activity and initiative in the jurisprudence of the Constitution and the Constitutional Court.

<sup>20</sup> Data provided by Global Blue Lietuva.

<sup>21</sup> Constitutional Court of the Republic of Lithuania, the rulings of May 13, 2005; May 13, 2006; March 5, 2008; and January 6, 2011.

<sup>22</sup> Constitutional Court of the Republic of Lithuania, the rulings of May 13, 2005; March 5, 2008; October 8, 2009; February 26, 2010; January 6, 2011; and June 21, 2011.

Table 3: Minimum Purchase Requirement and VAT Rate in Europe (2017)

Country	Minimum Purchase Requirement	VAT Rate
Austria	EUR 75.01	20%
Belgium	EUR 50.01	21%
Czech Republic	CZK 2.001	21%
Denmark	DKK 300	21%
Estonia	EUR 38.01	20%
France	EUR 175.01	20%
Germany	EUR 25	19%
Greece	EUR 50	24%
Hungary	HUF 54.001	27%
Iceland	ISK 6.000	24%
Ireland	EUR 30	23%
Italy	EUR 155	22%
Latvia	EUR 44	21%
Lichtenstein	CHF 300	8%
Lithuania	EUR 55	21%

Source: Odisseys Unlimited (2017) *Essential Knowledge: How to Claim Your European Vat Refund*. Available [online]: <https://odisseys-unlimited.com/essential-knowledge-european-vat-refund/>

The state cannot intervene in individual economic activity limitlessly: restrictions may not refute the core principles of freedom of economic activity, such as equal treatment and non-discrimination and free competition<sup>23</sup>. Freedom of economic activity may be

restricted when it is necessary to protect the interests of consumers, free competition, and other rights, freedoms, and values laid down in the Constitution<sup>24</sup>. The constitu-

<sup>23</sup> Constitutional Court of the Republic of Lithuania, the ruling of May 9, 2014.

<sup>24</sup> Constitutional Court of the Republic of Lithuania, the rulings of October 6, 1999; December 4, 2008; and September 29, 2010.



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THE EUROPEAN  
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NOTES THAT A BAN  
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WHEN ALL RETAIL  
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IN TRADITIONAL  
STORES, BUT NOT  
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tional principle of proportionality must be ensured too<sup>25</sup>.

It is important to evaluate any proposed restrictions on economic activity by all aforesaid criteria. Given that a ban on retail opening hours would limit consumers' rights, have adverse consequences for workers and businesses, distort competition, and undermine the labor market, it should not be considered as a justifiable and constitutionally legitimate policy measure.

The Lithuanian Constitution states that the state "shall regulate economic activity so that it serves the general welfare of the Nation". The welfare of the nation should not

<sup>25</sup> Constitutional Court of the Republic of Lithuania, the ruling of May 31, 2006.

be contrasted with the welfare, rights or legitimate interests of an economic entity to which a regulation is applied. Nor should it be contrasted with the welfare of founders or managers or other people associated with a regulated economic entity<sup>26</sup>. It is a constitutional principle that underlies the aims, directions, means, and limits of economic regulation<sup>27</sup>. No economic regulation which would restrict the rights and legitimate interests of a particular economic entity more than is necessary to ensure the public interest may be justified on the grounds of serving the welfare of the nation. Likewise, the welfare of the nation may not serve as a justification of a regulation which would create unfavourable and unequal conditions for economic entities or would restrain economic initiative<sup>28</sup>.

Accordingly, while regulating economic activity, the state must observe the principle of reconciling public and private interests<sup>29</sup>. The above analysis on the implications of a ban on retail opening hours shows that even though this regulation would protect the interests of some segments of employees, it would have negative consequences for many more members of the society – including consumers and employers. It would, therefore, violate the principle of reconciliation of public and personal interests.

Although a ban on Sunday work in the retail sector may formally be intended to ensure the employees' right to rest, analysis shows

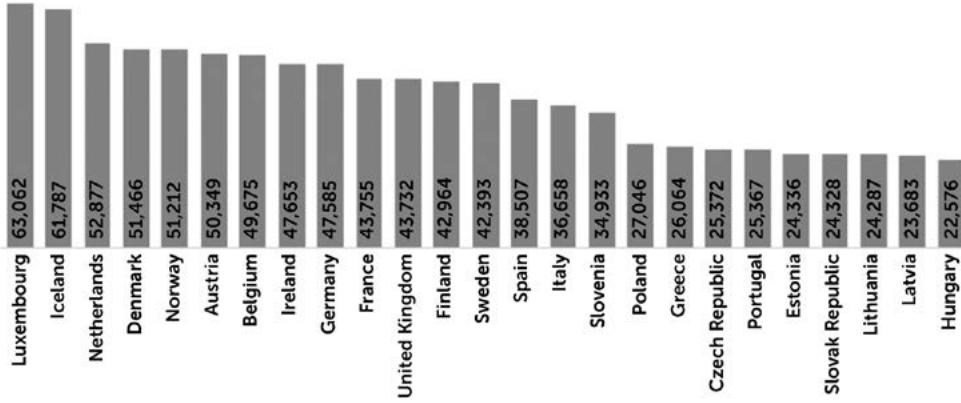
<sup>26</sup> Constitutional Court of the Republic of Lithuania, the rulings of September 29, 2010; January 6, 2011; and July 7, 2013.

<sup>27</sup> Constitutional Court of the Republic of Lithuania, the rulings of October 6, 1999; January 6, 2011; June 21, 2011; May 24, 2013; and July 5, 2013.

<sup>28</sup> Constitutional Court of the Republic of Lithuania, the rulings of September 29, 2010 and January 6, 2011.

<sup>29</sup> Constitutional Court of the Republic of Lithuania, the rulings of May 13, 2005; January 6, 2011; June 21, 2011; and May 24, 2013.

Figure 2: Gross average wages [in US dollars; data from 2017 or latest available]



Source: OECD (2017) *Employment and Labour Market Statistics: Average Annual Wages*. Available [online]: <https://data.oecd.org/earnwage/average-wages.htm>

that it would not only fail to provide a proper protection of the rights of some employees, but in certain respects would disproportionately limit those rights. It may also involve discriminatory consequences. Protection of workers' right to rest may be achieved by other means which are less restrictive with regard to freedom of economic activity and initiative and in line with the constitutional values and the principle of proportionality.

## REGULATION OF RETAIL OPENING HOURS IN EUROPE

Retail opening hours are regulated in fourteen out of thirty European countries [See Table 4]. Yet, regulation does not necessarily mean total prohibition. In most cases, countries apply exemptions by products, type of retail, retail surface area, etc. An outright ban on Sunday retail is a rather rare practice in Europe and in the world.

**Restrictions on retail opening hours are more common in wealthy countries with higher labor productivity.** Our analysis shows that a ban on Sunday retail trade is

more often found in countries with a higher level of gross domestic product in PPT per capita. GDP per capita in PPT stands at 78 in Lithuania, 79 in Estonia and 69 in Latvia, as compared to 164 in Norway, 181 in Germany, 128 in the Netherlands, and 105 in the UK (EU28=100)<sup>30</sup>.

**Restrictions on retail opening hours are more common in EU countries with higher wages.** If we look at wages, the same trend across countries may be observed. The countries that impose a ban on Sunday retail hours tend to have a higher level of average wages than those which do not. Wages in Lithuania are among the lowest in the whole European Union [See Figure 2]. In less wealthy countries, a reduction of revenues for retail businesses would have more severe consequences for wage-earners and may increase incentives to migrate.

<sup>30</sup> Eurostat (2017) *GDP per capita in PPS*. Available [online]: <https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00114&plugin=1>

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WHILE REGULATING ECONOMIC ACTIVITY, THE STATE MUST OBSERVE THE PRINCIPLE OF RECONCILING PUBLIC AND PRIVATE INTERESTS

Restrictions applicable in other European countries cannot just be copied, turning a blind eye on the local economic conditions and the level of wages or the number of part-time workers.

Since 2012, nine European countries have liberalized the regulation of retail opening hours: Denmark, France, Finland, Italy, the Netherlands, Portugal, Spain, and Malta. Hungary and Poland introduced regulations, in 2015 and 2018 respectively. Yet, in response to public backlash in 2016, Hungary lifted its one-year-old ban on retail trade on Sundays and public holidays. Finland's decision to revoke the restrictions in 2016 was driven by the intention to better satisfy consumers' interests and to counteract the competitive pressure from Sweden's regulation-free retail sector that had attracted a lot of weekend buyers from the neighbouring countries, including Finland. The European Commission notes that Finland's decision has had a positive effect on competition and the country's labor market<sup>31</sup>.

<sup>31</sup> European Commission (2018) *A European Retail Sector Fit for the 21<sup>st</sup> Century*, Communication from the Commission to the European Parliament , the Council, the European Economic and Social Committee of the Regions, April 19. Available [online]: <https://ec.europa.eu/docsroom/documents/28681/attachments/1/translations/en/renditions/native>

The European Commission has put forward explicit recommendations to lift bans on retail opening hours<sup>32</sup>. It is considered as one of three key recommendations for strengthening competition in retail trade and providing incentives for a more open single retail market. It is emphasized that restrictions on retail opening hours place a heavy burden on businesses and have adversely affected productivity. Reduced competitiveness is found to be one of the main reasons for low productivity in comparison with e-commerce. Unregulated retail markets have shown positive effects on the labor market, stimulating job creation in functioning and new retail entities<sup>33</sup>.

## CONCLUSIONS

- A ban on retail opening hours on Sundays and public holidays is not advisable as such regulation is incompatible with the constitutional values and principles of freedom of individual economic activity and initiative. It is unjustifiable with respect to workers in the retail sector. It would negatively affect wages and job creation, possibilities to reconcile family and work, and employment opportunities for students. Importantly, in European countries, all legal prerequisites are in place for workers to negotiate working hours with their employers. It would hurt consumers as it would likely result in price increases, changes in shopping

the European Economic and Social Committee of the Regions, April 19. Available [online]: <https://ec.europa.eu/docsroom/documents/28681/attachments/1/translations/en/renditions/native>

<sup>32</sup> European Commission (2018) *Strengthening the Competitiveness of the European Retail Sector*, Press Release, April 19. Available [online]: [http://europa.eu/rapid/press-release\\_IP-18-337\\_en.htm](http://europa.eu/rapid/press-release_IP-18-337_en.htm)

<sup>33</sup> European Commission (2018) *A European Retail Sector Fit for the 21<sup>st</sup> Century*, Communication from the Commission to the European Parliament , the Council, the European Economic and Social Committee of the Regions, April 19. Available [online]: <https://ec.europa.eu/docsroom/documents/28681/attachments/1/translations/en/renditions/native>

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## THE EUROPEAN COMMISSION HAS PUT FORWARD EXPLICIT RE-COMMENDATIONS TO LIFT BANS ON RETAIL OPENING HOURS

habits, and the derailing of everyday routine. It is not justifiable with regard to retail companies, shopping centers and service providers operating in shopping centers as it would likely aggravate their financial results, would cripple the competitive environment for traditional stores compared to e-commerce, would undermine economic competitiveness and investment attractiveness for countries competing for foreign investors, would result in government revenue shortfalls, and would put an additional strain on public finances.

Moreover, it shall be noted that:

- fourteen out of thirty European countries restrict retail trade on Sunday and seventeen countries limit retail opening hours on public holidays. Such regulations are more often applied by wealthier countries with higher wage levels. A number of European countries have lifted bans on retail opening hours on Sundays in order to prevent their negative consequences.

- the European Commission has recommended deregulation of retail opening hours on the grounds of the need to protect free competition and jobs.

The main goal of regulating opening hours is to protect the rights to rest of some employees. If such protection is truly necessary, it can be achieved by other means. A ban on retail opening hours on Sundays or public holidays can do more harm than good. More and more countries now recognize that this regulation fails to bring desired results, and many have chosen to remove it. There seems to be little rationale for replacing them. •



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Table 4: Regulation of retail stores and retail opening hours in Europe (March 2017; May 2018 for countries marked with an asterisk \*)

Countries	Sunday and public holidays
AUSTRIA	REGULATED <ul style="list-style-type: none"> <li>• maximum opening time per week is 72 hours.</li> </ul> Exemptions are allowed in tourist areas.
BELGIUM	REGULATED Exemptions: <ul style="list-style-type: none"> <li>• if a retailer chooses an alternative closing day;</li> <li>• all retail stores open from 8:00 to 12:00 am;</li> <li>• furniture and gardening shops open on forty Sundays per year from 6:00 am to 8:00 pm;</li> <li>• food chains with fewer than five employees, butchers, bakers, newsagents and tobacconists, florists, petrol stations open from 6:00 am to 8:00 pm;</li> <li>• on certain conditions shops can open on six Sundays of their own choice per year;</li> <li>• tourist areas: Sunday opening May 1 to September 30, on Christmas and Easter holidays, and a maximum of thirteen other Sundays;</li> <li>• night shops selling food and household goods can work only from 6:00 pm to 7:00 am;</li> <li>• in other cases, shops can open only on Sunday morning between 8:00 am and 12:00 pm.</li> </ul>
BULGARIA	UNRESTRICTED <ul style="list-style-type: none"> <li>• some supermarkets/hypermarkets are open 24/7;</li> <li>• it is a common practice to close on January 1.</li> </ul>
CROATIA	UNRESTRICTED The Trade Act prescribes that opening hours are not restricted as long as the rights of workers are ensured. It is a common practice for all stores to close on New Year's Day, Easter Sunday and Christmas Day.
CYPRUS	REGULATED <ul style="list-style-type: none"> <li>• Shops are allowed to open from 5:00 am;</li> <li>• Retail opening hours in tourist areas are prescribed by regulations issued by the Council of Ministers.</li> </ul> The list of tourist areas is also determined by the Council of Ministers.  Exemptions: <ul style="list-style-type: none"> <li>• unrestricted for bakeries, pastry shops, convenience Stores;</li> <li>• flower shops close at 10:00 pm;</li> <li>• shops selling alcoholic beverages and tobacco products close at midnight;</li> <li>• Christmas period December 1 – December 31 opening hours are 5.00 am to 8.00 pm;</li> <li>• on Christmas Eve and New Year's Eve shops close at 6:00 pm;</li> <li>• Easter Period – 10 days before Easter;</li> <li>• opening hours 5:00 am to 8:00 pm;</li> <li>• on Good Friday and Holy Saturday shops close at 6:00 pm.</li> </ul>

Countries	Sunday and public holidays
CZECH REPUBLIC	<p><b>REGULATED</b></p> <p>Retail opening hours are regulated by the Act on Opening Hours in Retail and Wholesale.</p> <p>Retail and wholesale trade are prohibited on the following public holidays and other holidays:</p> <ul style="list-style-type: none"> <li>• January 1 – Date of Restoration of the Independent Czech State and New Year's Day;</li> <li>• Easter Monday;</li> <li>• May 8 – Victory Day;</li> <li>• September 28t – Czech National Day;</li> <li>• October 28 – Date of the Establishment of the Independent State;</li> <li>• December 25 and 26 – Christmas Days;</li> </ul> <p>Retail and wholesale trade are prohibited on December 24, Christmas Eve Day, from 12:00 pm until 12:00 am.</p> <p>Exemptions:</p> <ul style="list-style-type: none"> <li>• stores with retail surface area below 200 m<sup>2</sup>;</li> <li>• petrol stations;</li> <li>• pharmacies;</li> <li>• stores at locations with higher concentrations of passengers at airports, railway stations and bus stations;</li> <li>• retail at healthcare facilities, retail and wholesale at times when a state of emergency, crisis situation national state of alert or state of war4 is in effect.</li> </ul>
DENMARK	<p><b>UNRESTRICTED</b> on Sundays</p> <p>Public holidays:</p> <ul style="list-style-type: none"> <li>• Shops close at 3:00 pm on public Holidays, Constitution day, Christmas Eve and New Year's Eve.</li> </ul> <p>Exemptions:</p> <ul style="list-style-type: none"> <li>• unrestricted for the sale of bread, dairy produce, newspapers, flowers, plants, cars, ships, fuel, household items and DIY centers;</li> <li>• unrestricted for stores with turnovers below 33.1 million Dkr selling DIY products, bakeries, grocers, household articles and gardening appliance.</li> </ul>
ESTONIA	<b>UNRESTRICTED</b> on Sundays
FINLAND	<p><b>UNRESTRICTED</b> (from January 1, 2016)</p> <ul style="list-style-type: none"> <li>• sale of alcohol is restricted from 9:00 pm until 9:00 am.</li> </ul>
FRANCE*	<p><b>REGULATED</b></p> <p>Retail stores are closed on Sundays. Shop owners are allowed to work on Sundays.</p>

Countries	Sunday and public holidays
	<p>Exemptions:</p> <ul style="list-style-type: none"> <li>• food stores bigger than 400 m<sup>2</sup> can stay open until 1:00 pm if the employees are paid a 30% premium;</li> <li>• non-food stores can open with mayoral permission, but not more than twelve Sundays a year and provided the employees are paid double salaries;</li> <li>• other exemptions for retail food or non-food retail apply in touristic areas, commercial tourism areas and some stations;</li> <li>• exemptions apply to florists, tobacco shops, DIY and garden appliances.</li> <li>• weekly rest can be given by shift to all or some staff;</li> <li>• voluntary staff can work on Sundays.</li> </ul> <p>Collective agreement must be signed at the branch, company group or factory level. Collective agreements automatically specify wage aspects.</p>
GERMANY	<p><b>REGULATED</b></p> <p>Retail opening hours are regulated by lands. Exemptions apply in case regulations of retail opening hours on Sundays and public holidays.</p> <p>Exemptions:</p> <ul style="list-style-type: none"> <li>• bakery products, flowers, newspapers, dairy products, and museums;</li> <li>• railway and petrol stations, airports, resorts and places of pilgrimage;</li> <li>• in some federal states, shops may open to meet the public interest or in specific circumstances.</li> </ul>
GREECE	<p><b>REGULATED</b></p> <p>Regulations of retail opening hours may differ for the summer (May 16 to September 30) and winter seasons (from October 1 to May 15).</p> <p>Exemptions:</p> <ul style="list-style-type: none"> <li>• convenience stores, pastry shops;</li> <li>• photography shops, florists, antiquaries and nut-selling shops;</li> <li>• petrol stations;</li> <li>• local prefects may allow small shops under 250 m<sup>2</sup> to open;</li> <li>• all shops are open two Sundays before Christmas, on the first Sunday of every sales period (four in total), and on Sunday before Easter.</li> </ul>
HUNGARY*	<p><b>UNRESTRICTED</b> on Sundays</p> <p><b>REGULATED</b> on public holidays.</p> <p>Exemptions:</p> <ul style="list-style-type: none"> <li>• petrol stations, florists;</li> <li>• restaurants and bars;</li> <li>• small retailers.</li> </ul>

Countries	Sunday and public holidays
ICELAND	UNRESTRICTED on Sundays REGULATED on public holidays.  Sundays: <ul style="list-style-type: none"><li>• shops generally close on Sundays but stores in shopping centers open from 10:00 am until 5:00 pm.</li></ul> Public Holidays: <ul style="list-style-type: none"><li>• stores close from 4:00 pm on December 24 to 6:00 am on December 25.</li></ul>
IRELAND	UNRESTRICTED Restrictions apply to retail trade in alcohol: <ul style="list-style-type: none"><li>• Sundays – from 12:30 pm to 10:30 pm;</li><li>• closed on Christmas Day and Good Friday.</li></ul>
ITALY	UNRESTRICTED Sale of alcohol is prohibited from 10:00 pm until 6:00 am at petrol stations and from 12:00 am until 6:00 am in stores.
LUXEMBOURG	REGULATED Sundays: <ul style="list-style-type: none"><li>• shops can open from 6:00 am to 1:00 pm.</li></ul> Once a year every shop owner can obtain authorization to stay open 24 hours.  Exemptions: <ul style="list-style-type: none"><li>• derogations for specific local areas can be adopted;</li><li>• bakeries, butchers, cake shops, kiosks, and souvenir shops can open from 6:00 am to 6:00 pm.</li></ul>
MALTA	UNRESTRICTED <ul style="list-style-type: none"><li>• shops can open on Sundays provided they close on any other day;</li><li>• lottery tickets can be sold 24/7, subject to permission from gaming authorities;</li><li>• employers may not have their employees to work on Sundays unless stipulated in job contracts.</li></ul>
SLOVAKIA*	REGULATED The basic rule applies that employers cannot force their employees to work on the following dates: January 1, January 6, on Good Friday, Easter Sunday, Easter Monday, May 1, May 8, July 5, August 29, September 1, September 15, November 1, November 17, December 24 after 12:00 pm, December 25, and December 26.  Retail at petrol stations, pharmacies, airports, ports, public transport locations, hospitals, sale of transport tickets, and souvenir shops; <ul style="list-style-type: none"><li>• shop owners can open their stores if they work as self-employed individuals;</li><li>• retail sale of flowers is allowed on May 8, September 1, and November 1.</li></ul>



Countries	Sunday and public holidays
LITHUANIA*	UNRESTRICTED Sale of alcohol is allowed on Sundays only from 10:00 am to 3:00 pm. It is common practice for small shops to close on public holidays, but bigger shopping centers open.
LATVIA	UNRESTRICTED on Sundays
NETHERLANDS	REGULATED Closed with exemptions: <ul style="list-style-type: none"><li>• local authorities can allow Sunday openings;</li><li>• stores may not open on Good Friday, December 24, and May 4 after 7:00 pm.</li></ul>
NORWAY	REGULATED Closed with exemptions: <ul style="list-style-type: none"><li>• groceries smaller than 100 m<sup>2</sup>;</li><li>• petrol stations smaller than 150 m<sup>2</sup> and stores in camping site during season.</li></ul>
POLAND	REGULATED New regulations enforced on March 1, 2018.  All retail shops and retail units may not open on most Sundays and public holidays.  A total of thirty-two exemptions apply: <ul style="list-style-type: none"><li>• petrol stations, vending machines, bars, taverns and restaurants, post offices, pharmacies, florists, newsagents, premises where cultural, sports or educational activities take place (e.g. stadiums, schools, theaters), shops located in hotels, public transport stations, and self-proprietor's shops;</li><li>• shops and premises may open until 2:00 pm on two consecutive Sundays before Christmas, Sunday before Easter, and last Sundays in January, April, June, and August, on December 24 and on Saturday before Easter (Holy Saturday).</li></ul> In 2018, all shops and premises could open on the first and last Sunday of every month. In 2019, retailers can open on the last Sunday of every month. From 2020 onward, no Sunday openings will be allowed.
ROMANIA	UNRESTRICTED on Sundays
SLOVENIA*	UNRESTRICTED on Sundays <ul style="list-style-type: none"><li>• The sale of alcohol is prohibited from 9:00 pm until 7:00 am, with the exception of hotels and restaurants where alcohol can be sold until the closing time but cannot be sold from the opening time until 10:00 am.</li><li>• Closed on public holidays: January 1, February 8, Eastern Sunday, Eastern Monday, May 1, Pentecost Sunday, June 25, August 15, November 1, and December 25.</li></ul>

Countries	Sunday and public holidays
SPAIN*	REGULATED  According to federal government law, sixteen autonomous regions prescribe Sundays and public holidays on which retailers can open. C. de Madrid applies no restrictions.  Shops that are completely free to determine their opening hours: <ul style="list-style-type: none"><li>• shops under 300 m<sup>2</sup>;</li><li>• shops selling cakes and pastries, bread, precooked dishes, newspapers, fuel, flowers, and plants;</li><li>• shops operating in railway stations and on overland, sea and air transport terminals;</li><li>• convenience stores;</li><li>• shops located in areas with a large tourist population.</li></ul>
SWEDEN*	UNRESTRICTED Restrictions apply only to night work, from 12:00 am until 5:00 am. Employers and trade union can sign collective agreements and envisage flexible terms of night work. Night work is generally allowed at gas stations, convenience stores, etc.
UNITED KINGDOM*	REGULATED Labor law in England and Wales allows shop-workers to refuse to work on Sundays and to require premium for overtime and work on public holidays.  Sundays: <ul style="list-style-type: none"><li>• England and Wales – unrestricted opening hours for shops smaller than 280 m<sup>2</sup>. Stores larger than 280 m<sup>2</sup> may open from 10:00 am to 6:00 pm;</li><li>• Northern Ireland – opening hours restricted for shops larger than 280 m<sup>2</sup>. They can open from 1:00 to 6:00 pm;</li><li>• Scotland does not restrict retail opening hours.</li></ul> Public holidays: <ul style="list-style-type: none"><li>• England, Wales, and Northern Ireland – UNRESTRICTED.</li></ul> Exemptions: <ul style="list-style-type: none"><li>• stores larger than 280 m<sup>2</sup> may not open on Easter Sunday and Christmas Day.</li></ul>

Sources: Euro Commerce (March 2017). Updated by the Lithuanian Free Market Institute (May 2018)



# Power Market Liberalization in Bulgaria: A Decade Old Problem



KALOYAN  
STAYKOV

The liberalization of the Bulgarian power market has been characterized by constant external (the European Commission) and internal (private stakeholders) pressure. Regardless, the government has shown prevailing reluctance to take any serious actions that might deliver effective structural improvements to the market, making changes only on paper. In short, it may be described as "reform at gunpoint" – doing anything it takes to make the problem go away, while obstructing efficient market functioning..

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THE ROAD TO MARKET LIBERALIZATION IN BULGARIA BEGAN DURING THE COUNTRY'S PRE-ACCESSION PERIOD TO THE EUROPEAN UNION (EU) AND THE GOVERNMENT'S DECISION TO TAKE A STEP-BY-STEP APPROACH

The road to market liberalization in Bulgaria began during the country's pre-accession period to the European Union (EU) and the government's decision to take a step-by-step approach. The process began in 2004, when high voltage power consumers were required to secure their power consumption from the wholesale supply of electricity at freely negotiated market prices, followed by medium voltage consumers in 2013. Although there was a formal liberalized power market, it soon became obvious that it was characterized by low competition and a high degree of concentration. This was due to the fact that three state-owned enterprises (SOE), organized in a holding company – Bulgarian Energy Holding (BEH), also owned by the state, supplied the majority of the power for the liberalized market (around 85%) and were taking advantage of their position. This led to an antitrust procedure against BEH and the implementation of commitments on behalf of the holding to remedy the situation.

One of these commitments included establishing an organized power exchange (Independent Bulgarian Electricity Exchange – IBEX), which began working in early 2016 – nine years after the country's accession to the EU, thus marking the beginning of the first real steps taken towards market liberalization. And while the government was dragging its feet with regard to some reforms (for example to power exchange), other decisions – for example obligatory power trading on IBEX, effectively banning over-the-counter (OTC)<sup>1</sup> trading – were finalized in less than a week. Judging from the country's experience with deregulating the power market, it would seem that the government is deliberately delaying decisions that can improve market functioning and

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<sup>1</sup> Over-the-counter or off-exchange trading is done directly between two parties, without the supervision of an exchange.

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THERE ARE,  
PERHAPS, TWO MAIN  
DIFFERENCES WHEN  
CONSIDERING  
BULGARIA'S  
AND THE REST  
OF THE EU'S  
EXPERIENCE IN POWER  
MARKET DE-  
REGULATION –  
THE PROCESS  
STARTED MUCH  
LATER IN BULGARIA  
AND THE POLITICAL  
“ENTHUSIASM”  
ABOUT IT WAS  
BORDERLINE  
NONEXISTENT

only making them when there is no other option due to the mounting pressure – both from external and internal parties.

The current result is that Bulgaria has a liberalized power market, which is highly concentrated, essentially monopolized, and thus it is inefficient and non-transparent. Some reforms that could improve market

operations are being delayed (deliberately, it would seem), while others, which fundamentally change the market, are fast forwarded with little to no prior preparation – sometimes leading to greater uncertainty and higher risks for both traders and consumers. Perhaps what is most shocking, is that while market inefficiencies may be the result of government policy, it is state-owned enterprises, not private stakeholders, that are the beneficiaries, and ultimately are distorting the market.

#### **MARKET COMPETITION AND CONCENTRATION**

Traditionally, the power sector in Bulgaria operated as a vertically-integrated company, as was the case in the rest of Europe, in a completely regulated market. There are, perhaps, two main differences when considering Bulgaria's and the rest of the EU's experience in power market deregulation – the process started much later in Bulgaria and the political “enthusiasm” about it was borderline nonexistent. During the country's pre-accession period the companies being a part of the vertically-integrated company were uncoupled, which was one of the first steps in the liberalization process. In 2008, just over a year after Bulgaria joined the EU, the government reversed that step by transferring ownership of the state-owned energy companies (which are also the largest generating companies in the sector) to a state-owned holding company.

This move alone practically guaranteed that the power market liberalization process was put in reverse as the vertically-integrated company of the pre-accession period was replaced by a new vertically-integrated company. This was also the conclusion came to by the European Commission (EC) in its antitrust procedure against the holding:

*“BEH has wide-ranging powers to decide on questions within the competence of the*



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BEH HOLDS AROUND 85% OF THE WHOLESALE SUPPLY OF ELECTRICITY AT FREELY NEGOTIATED PRICES

*general assemblies of BEH's subsidiaries. BEH appoints and dismisses the members of the boards of directors of BEH's subsidiaries, it approves decisions concerning the dismissal of the CEOs, it is informed of the agenda of the meetings of the boards of directors of BEH's subsidiaries and receives the minutes of these meetings, and it approves the business plans of BEH's subsidiaries. In addition, a number of persons have, since 2008, at one time or another been a member of both the board of directors of BEH and the board of directors of one or more of BEH's subsidiaries. Under the successive articles of association of BEH's subsidiaries in force between 2008 and 2014 and BEH's internal rules, BEH's subsidiaries have, in addition, been required to submit to BEH for approval all transactions above certain thresholds and to provide BEH with information concerning contracts that they intend to enter into<sup>2</sup>.*

While market participants' coordination can distort free market functioning, the problem can be mitigated if the market in question is characterized by a high degree of com-

petition. However, this is not the case with regard to the energy SOEs, which have a monopoly-like presence on the Bulgarian market. As the Bulgarian energy regulator constantly points out in its annual reports to the European Commission, BEH holds around 85% of the wholesale supply of electricity at freely negotiated prices. This means that the market share of all its competitors is around five times smaller, removing any competitive pressures.

There are some inherent circumstances leading to this situation. One is that some privately-owned generation companies supply electricity to the transmission system operator for ancillary services<sup>3</sup> and cold reserves, which limits the quantity of electricity they can sell on the free market. The obvious solution is to increase imports of electricity; however, two problems emerge – BEH has lower marginal costs (nuclear and hydro production) pricing out imports, and there is limited capacity for imports in terms of interconnections between electricity transmission systems with neighboring countries. As a result, the market share of imports varies between 3% and 8%, which is over ten times lower than the market share of BEH. As a consequence, the SOE holding company retained its monopoly-like function even after the liberalization process had started.

Despite the high concentration on the liberalized power market, one could argue that this does not necessarily lead to market malformations – if the BEH does not take advantage of its dominant position. However, that was not the case, which was the reason behind the antitrust procedure from the EC. The Commission came across two major problems. One was that the majority

<sup>2</sup> European Commission (2015) Case AT.39767-BEH ELECTRICITY, Antitrust Procedure Council Regulation (EC) 1/2003.3.

<sup>3</sup> Ancillary services are the specialty services and functions provided by the electric grid that facilitate and support the continuous flow of electricity so that supply will continually meet demand.

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THE SHORT AMOUNT OF TIME (LESS THAN TWO YEARS) IT TOOK BEH TO SET UP THE POWER EXCHANGE CLEARLY SHOWS THAT REFORMING THE MARKET HAS ALWAYS BEEN A QUESTION OF WILL AND NOT OF TIME OR RESOURCES

of the reviewed contracts contained provisions that stipulate where the electricity shall be consumed or where the electricity may be resold:

*"These contracts limit customers' freedom to choose whether to sell the purchased electricity in the territory of Bulgaria or to export it. These contracts also contain clauses which allow BEH's subsidiaries to monitor whether or not the electricity purchased in fact reaches the destination stipulated in the contract. In addition, customers who fail to comply with the destination clause may be subject to financial penalties or may have*

*their contracts terminated early, or both"<sup>4</sup>.*

The other was the unequal treatment of market participants – the majority of contracts included a destination clause, while others did not, which creates an uneven playing field.

The antitrust procedure was closed with BEH making commitments to set up a viable and independent power exchange and to supply a pre-determined minimum quantity of power at a price equal to its marginal cost. The power exchange received its license in March 2014 and started working in January 2016. The short amount of time (less than two years) it took BEH to set up the power exchange clearly shows that reforming the market has always been a question of will and not of time or resources.

Although the EC considered the introduction of an organized power market and the binding commitments of BEH to supply a pre-determined amount of electricity on that market as a necessary and sufficient condition to improve the efficiency of the market, the assumption proved to be unfounded. Less than two years after the IBEX was set up (during the autumn of 2017), tensions began to rise again, and industrial consumers began protesting. Their main complaint was that the OTC market for bilateral power contracts was not working properly, citing cases when power purchasing took place "over the phone" rather than as a result of a tender offer. At the root of this problem, not surprisingly, were the state-owned enterprises in BEH. The business demanded reforms that will ensure the proper functioning of the power market, and the politicians were quick to reply.

<sup>4</sup> European Commission (2015) Case AT.39767-BEH ELECTRICITY, Antitrust Procedure Council Regulation (EC) 1/2003.3.

The legislative changes that followed were fast and on the edge of the law coming into effect through the transitional and final provisions of the Safe Use of Nuclear Energy Act<sup>5</sup>. By doing so, politicians skip the obligation to hold consultations and gather opinions from stakeholders, as well as to prepare an impact assessment of the proposed changes. Experience from the rapid adoption of regulatory changes in the energy sector and the lack of consultations with the stakeholders show that the results of the changes often differ with the goals set. In this way, it enters a spiral of frequent regulatory changes that create serious difficulties for the functioning of the free market.

What is even more shocking, besides the non-standard way for the legislative changes, is the short time frame for proposing and voting on the changes – only six working days (December 6–13). Moreover, after the adoption of the changes in the Energy Act, which came into effect on January 1, 2018, on the second reading, their publication in the State Gazette took place on December 22, 2017. The changes were implemented on January 1, 2018. This left only three working days until the end of the year, which was a highly inadequate time for the subsequent amendments to the rules of the organized power market for bilateral contracts of IBEX. This, of course, made conducting a consultation and gathering opinions from stakeholders practically impossible.

With these amendments the government made power trading obligatory on the organized exchange, effectively banning the OTC market. The reasoning was that this will ensure transparent and fair market functioning. This decision created an outrageous paradox because the government essentially confirmed that it could not control the

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EXPERIENCE  
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ADOPTION  
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IN THE ENERGY  
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SET

dominant position of its state-owned enterprises and the only solution it found was the disciplining role of the free market. However, the logic behind the legislative changes was also unfounded as tensions related to the liberalized power market resurfaced again in the autumn of 2018.

The bottom line is that no matter the market structure, if there is sufficient concentration and lack of competition, market functioning can easily be compromised. Although there

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have been a lot of changes to the power market in Bulgaria since its accession to the EU, it may be safely assumed that their focus has never been improving the market; rather, it was liberalizing it on paper while keeping the monopoly position of the SOEs intact:

- the uncoupling of the vertically-integrated company of the fully regulated pre-accession market was overturned a year after the country's accession to the EU;
- in the following years, the new holding company dominated the market imposing so-called destination clauses, effectively restricting customer's freedoms and creating preferential treatment for some stakeholders;

<sup>5</sup> Instead of making amendment to the sectoral law, which is the Energy Act.

- setting up an organized power exchange was completed in less than two years, but it took nine years to start the process;
- even after the power exchange began its operations, tensions on the market (related to opaque deals and preferential treatment) persisted;
- eventually, the government completely closed off the OTC market, essentially admitting that it cannot prevent its energy companies taking advantage of their dominant position and made power trading possible only on the organized power market.

#### REGULATION AND LEGISLATION

Generally, there are two solutions to improving the efficiency of a monopolized market: regulation and competition. The preferable option is always the introduction of competition and ensuring a lower degree of market concentration. However, there are cases where this is not always possible. One example is the so-called natural monopolies<sup>6</sup>, where competition – given the current technological advancements and consumption structure – is almost impossible. Another example could be a temporal monopoly market, where competition is possible in the medium to long-term, after legislative or infrastructure improvements. Bulgaria's power market operates in the latter theorem – it is possible to increase the competition on the market, but it will take time. Until then, there should be adequate regulation, so as to ensure the efficient market functioning.

As it can be seen from the country's experience with market liberalization in the period 2007–2015, the only regulatory intervention introduced may be attributed to the European Commission's antitrust procedure. This development has led to the establishment

<sup>6</sup> A *natural monopoly* is a type of monopoly that exists due to the high fixed or start-up costs of conducting a business in a specific industry.

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THERE ARE TWO SOLUTIONS TO IMPROVING THE EFFICIENCY OF A MONOPOLIZED MARKET: REGULATION AND COMPETITION. THE PREFERABLE OPTION IS ALWAYS THE INTRODUCTION OF COMPETITION AND ENSURING A LOWER DEGREE OF MARKET CONCENTRATION

of the organized power exchange and the binding commitment from BEH to supply a pre-determined minimum quantity at a price equal to the holding's marginal cost on the power market. In the Commission's view, this should have been enough to guarantee the efficient functioning of the market.

As observed in the last two years, however, this assumption seems unfounded. Despite the current market structure – conducting power trading solely on the organized power

market – BEH's market share of the wholesale supply of electricity at freely negotiated prices remains around 85%, according to Bulgaria's energy regulator. In short, there is no change between 2012 and 2017 and one cannot expect anything different going forward. In 2017, generation companies (not owned by BEH<sup>7</sup>) produced just over 11.5% of total net generation for the year. Importing energy is also not an option, as the European Commission pointed out<sup>8</sup> – BEH has lower marginal costs (nuclear and hydro production) pricing out imports and there is limited capacity for imports in terms of interconnections between electricity transmission systems.

As power prices in Bulgaria are traditionally lower than those in the region (as pointed out above), it is difficult to determine the exact deadweight loss<sup>9</sup>, or the market premium Bulgarian consumers pay, due to the market concentration in the country. However, while power prices in the EU as a whole – and in the South East EU region in particular – have been on the rise in the past couple of years, they are increasing faster in Bulgaria, compared to the region as a whole. For example, in 2017, the price on the power exchange in Bulgaria was, on average, 20% lower than in Hungary, and 17% lower than in Romania. In 2018, Bulgarian prices continued to be the lowest;

<sup>7</sup> We are counting two privately-owned thermal power plants as part of BEH as they have long-term power purchasing agreements, and there still isn't a mechanism to integrate them into the market. Their annual production in 2017 was around 18.4% of total net power generation.

<sup>8</sup> European Commission (2015) Case AT.39767-BEH ELECTRICITY, Antitrust Procedure Council Regulation (EC) 1/2003.3.

<sup>9</sup> A *deadweight loss*, also known as *excess burden* or *allocative inefficiency*, is a loss of economic efficiency that can occur when equilibrium for a good or a service is not achieved. This may be caused by monopoly pricing in the case of artificial scarcity, an externality, a tax or subsidy, or a binding price ceiling or price floor such as a minimum wage.



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 THE ONLY REASON BEHIND THE LACK OF ENTHUSIASM ON BEHALF OF BOTH THE REGULATOR AND POLITICIANS APPEARS TO BE THE FACT THAT THE COMPANIES MONOPOLIZING THE MARKET ARE STATE-OWNED. IF THESE WERE PRIVATELY-OWNED COMPANIES, THERE WOULD HAVE BEEN SEVERAL REGULATORY REVIEWS AND AT LEAST A POLITICAL OUTCRY TO REVOKE THEIR LICENSES

however, the difference has shrunk to 17.4% and 12% compared to those in Hungary and Romania, respectively. As marginal costs for power generation in Bulgaria continue to be the lowest in the region and power markets were no more integrated in 2018 compared to 2017, this suggests that there are subjective factors at play. The most obvious explanation is that the SOE generation companies are indexing their prices to the regional market, but not as a result of market integration or increased regional competition, but rather because of their dominant position. Simply put – because they can.

In this situation, it is not only natural, but necessary, for the country's energy regulator to step in and establish some ground rules for the operations of BEH on the power market the same way the EC did as a result of its antitrust procedure. By now, it has become painfully obvious that the binding commitments of BEH to supply a predetermined quantity to the market are insufficient. The regulator can decide to increase the minimum commitments to be sold on the market at an adequate price – equal to the marginal cost of production of BEH, so as not to impose financial strain on the companies. This, however, is a temporary measure, while the end game should be increasing competition on the market. To this end, the process of integration of the Bulgarian market into the regional market should be accelerated so as to replace the temporary regulatory intervention. Nevertheless, not only is there no indication of such intentions, but, as if to add insult to injury, the regulator is extremely sluggish in regulating suspicious trading on the power exchange and is yet to produce a result from two inspections – one from the summer of 2017, and one from the autumn of 2018.

The only reason behind the lack of enthusiasm on behalf of both the regulator and politicians appears to be the fact that the

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 IF THERE WAS POLITICAL WILL TO IMPROVE THE POWER MARKET EFFICIENCY, ALL THE GOVERNMENT HAS TO DO IS TO APPOINT BETTER MANAGEMENT AND IMPLEMENT MARKET-ORIENTED BUSINESS PRACTICES

companies monopolizing the market are state-owned. If these were privately-owned companies, there would have been several regulatory reviews and at least a political outcry to revoke their licenses. This was precisely the case with regard to the three distribution system operators in Bulgaria – all privately-owned, which were subject to a battery of reviews, sanctions, and constant political criticism.

As mentioned above, a regulatory intervention would, in most cases, be a short-term solution; however, in the case of Bulgaria, this is not the case. The energy regulator has traditionally been under heavy politi-

cal influence and expecting a reasonable intervention in the case of BEH would be warranted only after improving its administrative capacity and its political independence, both of which could take years.

Another possible approach would be to have a very “clean” and sophisticated legislative process so as to:

- avoid, as much as possible, any pitfalls;
- hold public consultations and gather opinions from stakeholders;
- conduct a thorough regulatory impact assessment;
- implement best practices.

In reality, however, not only does the government shy away from such unnecessary complications, it goes out of its way to avoid them.

The absurdity of the situation is that improving the regulatory and legislative processes are second-best options, because the government is the sole owner of the energy companies that are distorting the market. If there was political will to improve the power market efficiency, all the government has to do is to appoint better management and implement market-oriented business practices. If politicians are short on willpower to improve the companies' management, then there certainly will not be any left in order to improve the legislative process, and certainly not so as to improve the regulatory independence.

Another possibility would be privatization; however, that is a flimsy option in Bulgaria's experience. Some of the smaller thermal and central heating plants in the country have been privatized by private investors with connections to the government. Although they are not competitive on the market and regularly violate environmental standards, they continue to operate due to providing

ancillary services to the system operator, regulatory decisions (including preferential prices for high-efficiency co-generation of heat and electric power), lax regulatory policy, lack of sanctions, and so on. There have been similar experiences in other sectors as well, including tobacco manufacturing and trade, as well as manufacturing of military equipment. The excess profits of the SOEs can be easily transformed into political dividends through (but are not limited to):

- lower prices for businesses close to the government;
- inflated company costs that translate into excess revenues; for example, through inefficient public procurements for companies close to the government;
- a form of social/regional policy – employing more people than the companies actually need.

Furthermore, no matter whether state-owned or private, BEH's energy companies will continue to dominate the market, so long as the market remains illiquid. The only way to effectively sever the political connections and improve market liquidity is the regional and EU market integration and letting market competition price out these practices. This way a generation company will not be able to increase the market price and sell some of its production on the side at a much lower price, because its market share would have shrunk considerably, and market consumers will be able to punish such a behavior.

#### **MARKET INTEGRATION**

As there is no political will to improve market efficiency (which is the norm, rather than the exception, in terms of power market reforms), no short-term solutions will occur, and all that is left are medium to long-term solutions. An intervention from the European Commission is thus considered as a medium-term solution at best, as it takes

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too much time and has limited impact on market efficiency.

The logical next step towards market liberalization would be the integration of the Bulgarian power market with the European one. Currently, there are two large market couplings in the EU – the Multi-Regional Coupling (MRC), which encompasses most of the EU, and the 4M Market Coupling (4MMC) regional group, including Romania, Hungary, the Czech Republic, and Slovakia. A natural prerequisite to join a market coupling group is for it to reach Bulgaria's border. For example, the country shares a border with Romania, which means it could join the 4MMC group and not the MRC group,

although Bulgaria is a full member of MRC since January 2016. This was actually one of the recommendations from the European Network of Transmission System Operators for Electricity (ENTSO-e) in its 2017 report *Enhancing market coupling of SEE Region*<sup>10</sup> that the 4MMC group should initiate the market coupling projects with Croatia, Serbia, and Bulgaria.

And here is the tricky part – “as a condition for any market coupling, Bulgaria should abolish its border tariff for export”, ENTSO-e explains<sup>11</sup>. Bulgaria is one of the last countries to abolish this tariff, which in effect increases the price of power purchased on the Bulgarian market and consumed outside the country. The presence of the export tariff has been a topic of heated debates in the country for several years and the question should finally be put to rest with a European Court decision stating that Member States may not impose a charge on the export of electricity generated in their own territory<sup>12</sup>. Should there have been no such decision, in light of all the government's efforts to preserve the Bulgarian power market in its current state, one may expect that the tariff would have remained for as long as possible, further delaying the integration with the regional and European power markets.

In the meantime, there are other ways to improve market liquidity, as the World Bank points out in a report to the government<sup>13</sup>. Although market coupling could take another year or two, the IBEX expects the inte-

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gration with the 4MMC group to be finalized by the end of 2019, there are interim steps that could have been taken in order to improve the liquidity on the market. One such mechanism was proposed by the World Bank in a 2016 report – creating import/export zones:

*“Import/export zones have been used as a transitional measure in other EU countries (Latvia, Poland, Nordics, etc.) for power trade with neighboring areas prior to coupling. For the import and export areas to work, the ESO has to give some amount of cross-border trading capacity to the DAM for implicit auctioning. Options for establishing import/export zones include Turkey (as a non-EU member), Greece (not fully implementing the EU target model), and FYROM”<sup>14</sup>.*

<sup>10</sup> European Network of Transmission System Operators for Electricity (2017) *Enhancing Market Coupling of SEE Region*.

<sup>11</sup> Ibid., p. 7.

<sup>12</sup> Court of Justice of the European Union (2018) Judgment in Case C-305/17 FENS spol. s r.o. v Slovak Republic – Úrad pre reguláciu sietových odvetví.

<sup>13</sup> World Bank (2016) *Bulgaria Power Sector: Making the Transition to Financial Recovery and Market Liberalization*, Summary Report, Ministry of Energy of Bulgaria.

<sup>14</sup> Ibid.

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THE PROCESS  
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In its 2017 report, ENTSO-e states that the market coupling project involvement with the export-import zone as an interim step has started at the beginning of the year; however, two years later the result is yet to be seen.

### CONCLUSIONS

The process of power market liberalization in Bulgaria is a textbook example of deregulation on paper, and no matter how much the market structure has changed in the past decade it is still characterized by a high degree of concentration and lack of competition. Moreover, 85% of the power supplied to the liberalized market is generated by state-owned enterprises, effectively preserving the government's monopoly on the market. In retrospect, it may be safely assumed that the focus of the power market reforms has never been improving the market, but rather on preserving it.

There is a plethora of solutions to the current situation with a varying degree of success. For instance:

- appointing better management to the energy SOEs and implementing market-oriented business practices; however, politicians will be forfeiting the influence they have gained through these companies, which seems unlikely;
- privatizing the companies and letting the problem solve itself; however, this would either lead to the abovementioned problem and a lack of political interest, or change a state-owned monopoly to that of a privately-owned one, by someone close to the government;
- introducing temporary regulatory interventions – setting an adequate minimum quantity of electricity to be sold by BEH on the power exchange at an appropriate price (the marginal cost of the holding); however, the regulator has been under strong political pressure to refrain from such measures due to the abovementioned reasons;
- accelerating the market coupling process, including abolishing the current export tax (which could actually happen as of July 2019) and introducing an in-

terim measure to improve market liquidity through the introduction of import/export zones.

The bottom line is that the introduction of a transparent power market in Bulgaria has been delayed for as long as possible (nine years after the country acceded to the EU) and the same applies to improving its liquidity and efficiency. Currently, there operates a market that is dominated by state-owned companies, which have an overabundance of mechanisms at their disposal to benefit from their dominant position.

The only solution to this problem is the integration of the Bulgarian power market into the European market. This will effectively reduce the market share of the three biggest power generation companies in the country, allowing for real competition and market forces to shape power trading. In such a scenario, a company (private or state-owned) will be unable to charge a premium to the market for its inefficiency – bloated expenditure or preferentially low prices for related parties. If a company tries to impose such a premium, the competition will simply price it out of the market. •



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# Economics Conjuncture and Regulatory Climate in Ukraine: Business Attitudes and Expectations



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OKSANA  
KUZIAKIV

**2**019 in Ukraine is the year of two elections: presidential (in March) and of deputies to the Verkhovna Rada of Ukraine (in October). This is exactly why analyzing the economic expectations of Ukrainian business is especially important – not only from an economic, but also from a political point of view.

International studies demonstrate that the more procedures a business needs to go through and the longer these procedures take, the more likely it is that the level of corruption in the country is high<sup>1</sup>. Ukraine is perceived to be a country with excessive regulation and a high level of corruption. According to the USAID-funded *Annual Business Climate Assessment (ABC)* conducted by the Institute for Economic Research and Policy Consulting (IER), in 2015, from 5% to 21% of business expenses comply with regulatory procedures were bribes<sup>2</sup>.

Creating a business-friendly environment through the introduction of deregulation measures (in particular, eliminating excessive administrative burdens on business and reducing excessive state control by simplifying procedures) is one of the key areas of the state's economic policy in accordance with the presidential 2020 Strategy<sup>3</sup>. Significant efforts to simplify the conditions for doing business have been made in the period of 2014-2018. The main achievements of de-

<sup>1</sup> World Bank (2009) *Investment Climate Research Study*. Available [online]: <http://blogs.worldbank.org/psd/restrictive-regulation-is-positively-correlated-to-corruption>

<sup>2</sup> Kuziakiv O., V. Bespalko, and I. Fedets (2016) *Annual Business Climate Assessment 2015*. Available [online]: [http://www.ier.com.ua/files/publications/USAID%20LEV/LEV\\_ABCA\\_report\\_Cost\\_of\\_doing\\_business.pdf](http://www.ier.com.ua/files/publications/USAID%20LEV/LEV_ABCA_report_Cost_of_doing_business.pdf) [in Ukrainian]

<sup>3</sup> President of Ukraine Decree "About the Strategy of Sustainable Development Ukraine 2020" 5/15, 12.01.2015. Available [online]: <https://zakon.rada.gov.ua/laws/show/5/2015>

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regulation in 2014-2017 were the reduction of the number of regulations and regulatory requirements, dropping the numbers, and increasing the availability of administrative services for both the general public and businesses.

In 2018, more attention was paid to the practical implementation of the previously adopted measures that dealt with the changes in approaches to state supervision and control. Inspections have traditionally been a problem for the Ukrainian business, because they required time and resources. According to the *Monitoring the Progress of Reforms in 2016*<sup>4</sup>, reducing the number and duration of inspections will save Ukrainian businesses UAH 0.5 billion a year, without taking into account fines and bribes.

It should be noted that in a complicated regulatory environment and with business aspirations to optimize tax burden, it was easy for the inspectors and businesses to come to an agreement. This "corrupt" tax

<sup>4</sup> National Council for Reforms (2016) *Monitoring of Reforms Progress*. [http://reforms.in.ua/sites/default/files/upload/full Ukr\\_20\\_02\\_2017.pdf](http://reforms.in.ua/sites/default/files/upload/full Ukr_20_02_2017.pdf) [in Ukrainian]

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2018 WAS NOT EASY ON THE UKRAINIAN ECONOMY. THE LATEST Ukrstat REPORTS SHOW THAT THE GROWTH OF ECONOMIC ACTIVITY HAS BEEN VERY SLOW

created a significant burden on business and distorted competition. From 2015 to 2018, a moratorium on inspections of small and medium businesses was in place. At the end of 2016, the legislative basis for the reform of state supervision was laid down. The changes to the regulations that took place in 2017-2018 were intended to prepare the business for work in a “no moratorium” environment –the key result was the introduction of a public database of complex inspections that allows businesses to track information about planned state inspections at the enterprise<sup>5</sup>. At the end of 2018, the reform of the state fiscal service and customs – both of which are equally important for business –has begun.

But what was the actual impact of the changes on businesses? Here, Business Tendency Survey (BTS) is a helpful tool.

<sup>5</sup> <https://inspections.gov.ua/>

BTS is the source of information about the state and future progress of selected economic indicators based on the enterprise managers’ opinions and expectations and can serve as a tool of monitoring. Throughout the years, IER has been using the BTS for tracing enterprises manager’s perceptions on different topics. Based on more than twenty years of experience in conducting business tendency surveys, several instruments allowing for monitoring the business perceptions, expectations, and attitudes toward the main economic issues as well as measuring the quality of regulatory and business climate including corruption related issues were developed. Obtaining “first-hand” information about the implementation of regulatory procedures, from entrepreneurs, is an important component of a complex analysis of regulatory climate that contributes to monitoring and evaluation of respective policies. It is business’ perceptions towards business climate (with the focus on regulatory climate and business conditions) that are based on various points of view of relevant managers and their actual experiences.

#### TRENDS IN BUSINESS ACTIVITY: UNSUSTAINABLE GROWTH IN ANTICIPATION OF ELECTIONS

2018 was not easy on the Ukrainian economy. The latest Ukrstat reports show that the growth of economic activity has been very slow. Thus, industrial production in January-October 2018 compared to the same period in 2017 increased by only 1.8%. This result is still better than it was a year before in the same period (the increase over the ten months of 2017 compared to the previous year was only 0.4%) but worse than what was expected and predicted in early 2018. The situation was mainly a result of worse than expected growth in the manu-

facturing industry due to a whole range of problems – including the logistic difficulties encountered by the blockade of ports in the Azov basin<sup>6</sup>.

In turn, the trends of economic activity based on the results of the BTS conducted among managers of enterprises indicate the instability of growth. Moreover, in addition to economic and geopolitical factors, the historical results of IER survey data show<sup>7</sup> that Ukrainian business is traditionally cautious in its plans during the years of possible political changes – such as, for example, the year of the presidential election [See Figure 6]. However, there are many trends indicating that despite external non-economic factors, businesses are optimistic about the future.

#### VOLUME OF PRODUCTION: SLOWDOWN AFTER ACCELERATION

The analysis of trends based on the seasonally adjusted *Index of Changes in Volumes of Production*<sup>8</sup> and the *Index of Expected Changes in Volumes of Production* indicate a slowdown in growth in the second half of 2018. It should be noted that during the last four years, the direction of change has altered several times, the tendency itself – to increase or decrease rates – did not last long. The IER data shows an increase

<sup>6</sup> A policy paper with a detailed analysis of the impact of the situation in the Azov basin on economic performance is currently being prepared by IER.

<sup>7</sup> According to the findings of the IER survey, in a pre-election period, the probability that business expectations towards improving business climate is lower than at any other time. See Kuziakiv O. (2006) “Impact of Pre-Election Situation on Business Expectations: A Survey Study of Ukrainian Managers”, 28<sup>th</sup> CIRET Conference proceedings. Available [online]: [http://www.iер.com.ua/files/publications/Articles/Kuziakiv\\_Oksana/\\_c28\\_KUZIAKIV\\_3.pdf](http://www.iер.com.ua/files/publications/Articles/Kuziakiv_Oksana/_c28_KUZIAKIV_3.pdf)

<sup>8</sup> For methodology of *Index of Changes in Volumes of Production* see: *Quarterly Enterprises Surveys* (2018) Quarterly Business Climate Assessment. Vol. 4(66). Available [online] [http://www.iер.com.ua/files//Regular\\_products/BTS/Industry/QES Ukr\\_03\\_2018.pdf](http://www.iер.com.ua/files//Regular_products/BTS/Industry/QES Ukr_03_2018.pdf)

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UKRAINIAN BUSINESS IS TRADITIONALLY CAUTIOUS IN ITS PLANS DURING THE YEARS OF POSSIBLE POLITICAL CHANGES – SUCH AS, FOR EXAMPLE, THE YEAR OF THE PRESIDENTIAL ELECTION

in production growth from the winter of 2015 through the spring of 2016, followed by almost a year of deceleration, which from July 2017 to April 2018 again returned to accelerate the growth of economic activity in enterprises. Moreover, the results of the two recent waves of the survey in 2018 (in July and October), when translated into a seasonally adjusted trend, again show a slowdown [See Figure 1]. However, it is too early to talk about the stability of the trend. In absolute terms (share of respondents), the situation appears to be somewhat different and looks better. The comparison of the share of respondents who indicated increased and decreased production in October 2018 versus

October 2017 shows significant improvement. Thus, in October 2018, whereas the share of respondents who indicated that the volume of production increased by 31.6%, 12.8% of respondents indicated that production volumes decreased in comparison with the previous quarter. The corresponding figures for October 2017 amounted to 29.9% and 20.5%. If the balance (that is, the difference between positive and negative estimates) is compared, then the indicator for October 2018 (+18.8) is better than for October 2017 (+9.4%). In other words, the economic situation is better than a year ago; alas, a slowdown trend, which is a signal that something is going wrong, may still be observed.

The trend-based analysis of expectations also suggests slowing down the growth rate, with the difference that expectations have only one turning point. The trend towards growth has been observed since the end of 2014 and peaked in February 2018, followed by a seasonally adjusted trend, showing a slowdown in growth [See Figure 1]. However, the analysis of absolute indicators (share of respondents) in the case of expectations, in contrast to the assessment of past changes, also indicates a slowdown in growth. In comparison, – in October 2017, 34.9% of respondents expected to increase production in the next quarter and 15.1% of respondents planned to reduce the production, and in October 2018, these shares constituted 27.8% and 12.2%, respectively. The balance (the difference between the shares of "optimists" and "pessimists") for October 2018 was + 15.6%, which is less than the figure for October 2017 + 19.8%.

Therefore, the trends in business activity based on short-term expectations are unstable – a tendency towards growth is very fragile and weak.

Next, to better understand the future economic condition in Ukraine, we shall look at the tendency that emerged on the basis of assessments of the financial and economic situation in the enterprise at the time of conducting surveys and forecasts on changes in the economic activity of the enterprise in the six-month perspective and the prospect of two years.

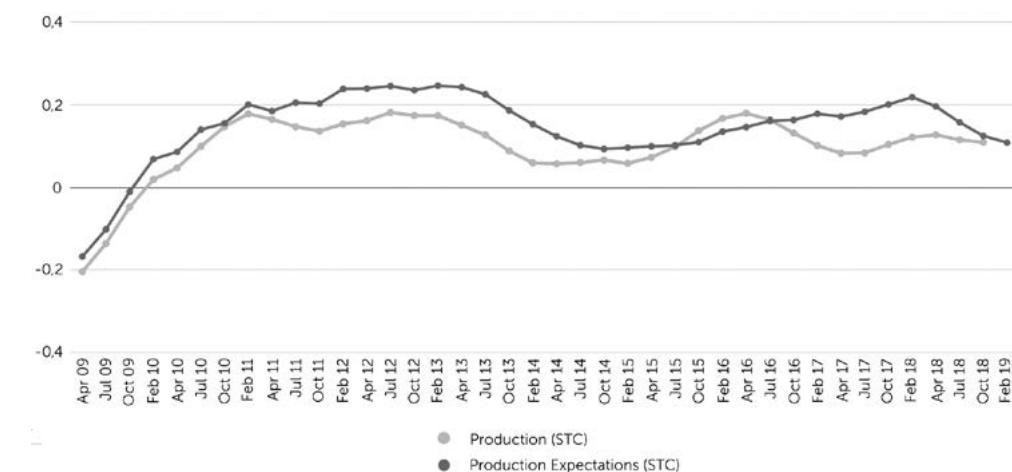
### **FINANCIAL AND ECONOMIC SITUATION AT THE ENTERPRISE: GETTING BETTER**

One of the positive trends of 2018 was improving the assessment of the financial and economic situation in the enterprise. In 2018, managers of enterprises were more satisfied with the results of their company than in the previous five years. The analyses of both raw data (shares of respondents) and seasonally adjusted indexes imply such an improvement.

As compared to July 2018, in October 2018, the share of respondents who positively assessed the economic and financial situation of the company increased to 20.6% from

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IN 2018, MANAGERS OF ENTERPRISES WERE MORE SATISFIED WITH THE RESULTS OF THEIR COMPANY THAN IN THE PREVIOUS FIVE YEARS

Figure 1: Trends in business activity: Estimates of past and expected changes in production [seasonally adjusted trend; horizon of expectations of 3 months]



Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

13.7%, while the share of those who negatively evaluated the financial and economic situation of the company, decreased from 24.74% in July to 14.6% in October 2018. If the balance (the difference between positive and negative estimates) is compared, an increase from -11% in July to + 5.9% for October 2018 may be observed. It should be noted that this indicator has attained a positive value for the first time in the last five years, which is unconditionally positive in 2018.

Similarly, the analysis of the seasonally adjusted *Index of Assessment of the Current Financial and Economic Situation at the Enterprise* also indicates positive changes in business activity in the industry sector<sup>9</sup>. Since February 2015, there has been a tendency to improve the assessment of the financial and economic situation of enterprises. Although, strictly speaking, this is a reduction in the rate of deterioration of

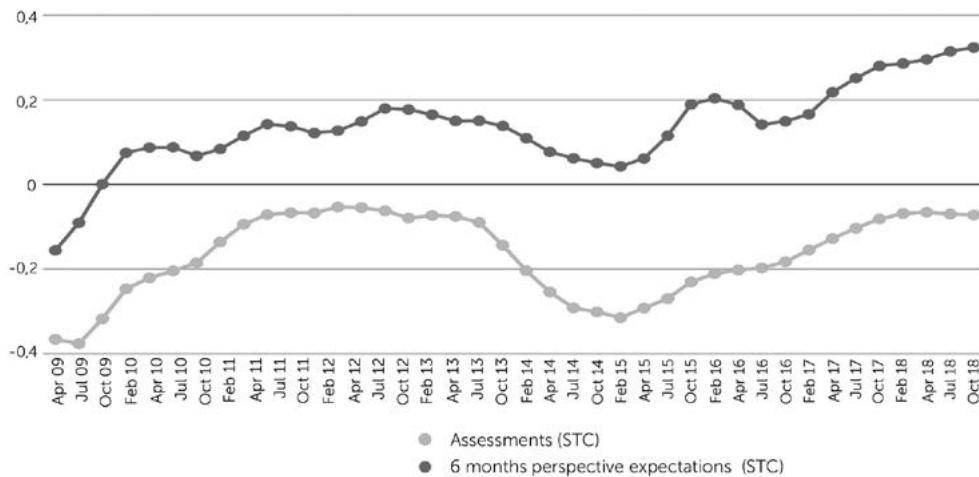
such an assessment, the trend is unconditionally positive [See Figure 2].

### **EXPECTED CHANGES IN BUSINESS ACTIVITY OF ENTERPRISES IN THE LONG TERM SIX MONTHS**

Unlike the trend of business activity built on three-month expectations that shows a slowdown after February 2018 [See Figure 1], the trend of business activity based on half-year expectations has shown to be improving since July 2016 [See Figure 2]. However, when comparing the non-seasonally adjusted data (the shares of "optimists" and "pessimists"), it may be observed that their expectations in the six-month perspective, as well as in the three-month perspective, become more cautious. Thus, the share of "optimists" declined from 40.6% to 31.1%, while the share of "pessimists" increased from 3.7% to 7.4% in October 2018 compared to July 2018. As a result, the value of the balance shown in the *Index of Expected Changes in the Economic Situation* decreased from 0.39 to 0.24. At the same time,

<sup>9</sup> IER (1998-2019) *Business Opinion: Industry*.

Figure 2: Trends in business activity: Assessments and expected changes of an economic situation at the enterprise [seasonally adjusted trend; horizon of expectations of 6 months]



Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

the share of those who expect neither an increase in business activity nor a decrease, spiked from 55.7% in July 2018 to 61.5% in October 2018. Thus, the tendency to increase business activity based on six-month expectations is also volatile and may change in time; seasonally adjusted data show an increase in optimism, while raw data show that although the share of "optimists" is pre-

dominantly larger than "pessimists", the difference between them is shrinking.

#### BUSINESS ACTIVITY IN TWO YEARS: PLANS DEPEND ON THE SIZE OF THE ENTERPRISE

As far as long-term expectations are concerned, optimistic forecasts dominate the pessimistic ones, although the difference between them sharply decreased in October 2018. For the first time since the launch of the *Business Tendency Survey*, we asked about business activity prospects in two years: in October 2017, and later in February, July, and October of 2018.

In October 2017, 37.3% of respondents planned an expansion of business activity in the perspective of two years, and only 6.8% predicted a decrease in their business activity. The balance sheet ratio was +30.5%. Next, throughout 2018, the value of this indicator had decreased and reached the lowest value of +5.6% in October 2018. This increase was mainly due to a significant

LONG-TERM  
BUSINESS  
EXPECTATIONS  
DEPEND  
ON THE SIZE  
OF AN ENTERPRISE

“

## THE RESULTS OF 2018 SHOW SOME IMPROVEMENT IN THE BUSINESS CLIMATE BASED ON ENTERPRISES ASSESSMENTS

increase in the share of those who predicted a decrease in their business activity in the next two years. Thus, 31.6% of all respondents planned to expand their business activity within two years, while 26% expected to reduce their business activity.

Long-term business expectations depend on the size of an enterprise. Expectations of large enterprises differ significantly from the expectations of small and medium enterprises [See Figure 3]. Among the large companies, only 3.8% reported that they planned to reduce activity for the next two years, whereas 60.4% of managers of large enterprises reported their plans to further expand their activities. On the other hand, almost a third of small and medium-sized enterprises expected to reduce their business activity in the next two years. This means that large companies feel more comfortable in the current business conditions. In contrast, SMEs are more likely to perceive business environment and economic conditions as not favorable, and as a consequence will not plan to expand their activities.

Summarizing the above analysis, we note that although the values of both absolute

and seasonally adjusted indicators remain added, this tendency is evidence of the dominance of positive assessments and forecasts over negative ones. In this light, the dynamics of the trends themselves indicates an instability of growth as long-term plans depend chiefly on the size of enterprises.

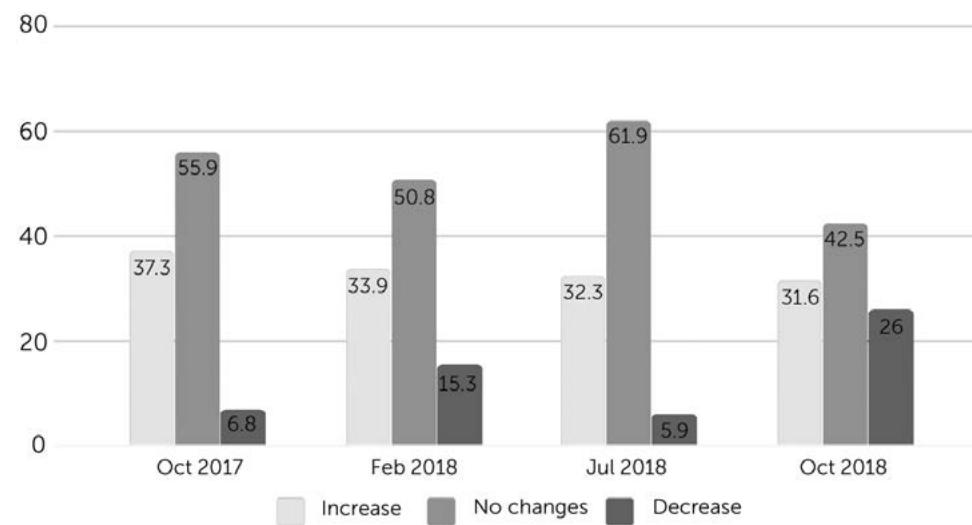
#### BUSINESS CLIMATE DETAILS: ASSESSMENT OF PREDICTABILITY AND CLARITY OF LEGISLATION HAS IMPROVED

Every May, IER investigates regulatory burdens across the three variables<sup>10</sup>: 1) the percentage of enterprises that indicate the interference of the state in operating activities; 2) the percentage of enterprises that consider economic legislation unclear and unpredictable; and 3) the percentage of managers' time spent on interaction with government officials. The variables have equal weights. The higher the value of the indicator, the worse for enterprises in regards to the business climate, which is measured by this indicator. In order to provide an overall assessment of the regulatory burdens in Ukraine we calculated the Annual Indicator of Regulatory Burdens (AIRB) as arithmetic means of these three variables.

The results of 2018 show some improvement in the business climate based on enterprises assessments. The value of AIRB has decreased from 34.4% in 2017, to 30.5% in 2018 [See Figure 4]. In 2018, the reduction of the values of indicator is characteristic for enterprises of all sizes. For small, medium, and large enterprises the indicator has decreased – compared with 2017, by 3.9, 4.2, and 3.7 percentage points, respectively.

<sup>10</sup> In this survey, we avoid looking at the changes in registration procedures and quantity of regular/irregular controls by regulatory bodies, since progress in this area is well recorded by other analysts. See, for example, IER (2017) *Annual Business Climate Assessment 2016/2017*.

Figure 3: Dynamics of long-term expectations of enterprises [% of respondents]

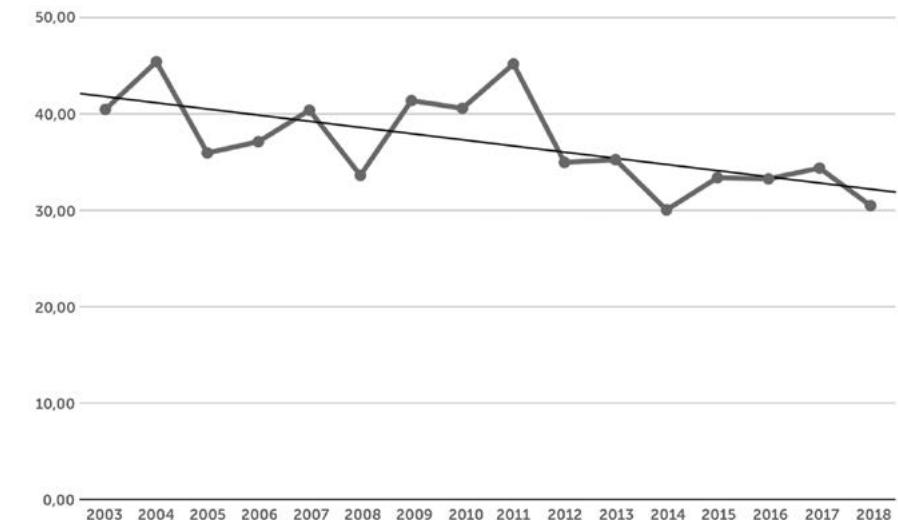
Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

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THE LARGER  
THE SIZE  
OF THE ENTERPRISE,  
THE MORE TIME  
MANAGERS SPEND  
ON INTERACTING  
WITH GOVERNMENT  
OFFICIALS  
ON THE INTER-  
PRETATION  
AND APPLICATION  
OF LAWS

A decrease in AIRB (which signifies an improvement of business climate) has occurred due to a significant drop in one of the variables, namely unpredictability and non-clarity of regulatory acts. The share of respondents who considered legislation to be contradictory and unpredictable decreased from 51.3% in 2017, to 31% in 2018. The share of respondents who considered the legislation to be contradictory and unpredictable among small enterprises decreased the most, while the smallest decrease was measured for large enterprises. Such a change is very important for the quality of the business climate, which means that it became easier for companies to plan their activities. It is particularly important that SE recorded the decrease of uncertainty. However, let us not forget that the data was obtained during the moratorium on inspections for small business, which had acted as a kind of “shield” for businesses, and which has since been abolished in 2019<sup>11</sup>.

<sup>11</sup> There is a moratorium on the conduct of inspections

Figure 4: The Annual Indicator of Regulatory Burdens (AIRB) [score 0=no burdens; 100=maximum of burdens]

Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

Therefore, in order to make far-reaching conclusions, it is necessary to examine the new data for 2019 and analyze their regulatory impact.

Moreover, the other two indicators of this index not only did not improve, but they even deteriorated. The level of state intervention in entrepreneurial activity is considered by respondents to be high. In 2016, this indicator reached a record high of 46%, then dropped to 38.5% in 2017, and in 2018, it rose again to 45%, thus almost returning to the 2016 level.

Time tax also increased in 2018, as managers spent 15.6% of their working time on interacting with government officials. The value of this indicator after an initial de-

crease in the years 2011-2015 (from 19.9% in 2011 to 11.4% in 2015), kept increasing for three years in a row – in 2016, the value was 12.5%, in 2017 it was 13.4%, and in 2018, it increased to 15.6% [See Figure 5]. The fluctuation of the indicator for the enterprises was more or less the same – it observed a decrease between 2011-2015 and then slightly increased during the period of 2016-2018. The lowest rate of growth was recorded for small companies; moreover, in 2017 and 2018, the values of “time tax” for this group were almost the same – 13.5 and 13.6 respectively.

The larger the size of the enterprise, the more time managers spend on interacting with government officials on the interpretation and application of laws.

of business by the controlling authorities (except for the State Fiscal Service of Ukraine and the State Financial Inspection of Ukraine) in 2015 and 2016. It was prolonged for 2017 and 2018, but the list of state bodies outside of moratorium has been expanded.

According to the surveyed managers, the increase of “time tax” may be explained by several reasons. The first would be the situation in Ukraine back in 2014, a tragic year

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## UKRAINIAN BUSINESS IS SOMEWHAT MORE PESSIMISTIC ABOUT POSSIBLE CHANGES IN THE FIRST HALF OF 2019, WHICH IS PROBABLY DUE TO THE FORTH-COMING ELECTIONS

in the history of modern-day Ukraine. The invasion of Russian troops, the annexation of Crimea, and the occupation of part of Ukraine led to revising the Ukrainian agenda in order to protect the sovereignty and territorial integrity of the country. In this period, state institutions were practically destroyed by President Viktor Yanukovych's kleptocratic regime. The state relocated its resources in response to external threats (including the war with Russia), while its domestic policy remained rather liberal – partly because of the lack of power from law enforcement. While the moratorium on inspections, discussed above, was launched in 2015, the de facto inspections were not conducted in 2014 due to the lack of control authorities had to do this. This may explain the decline of "time tax" in 2014 (12.5%) when compared to 2013 (13.4%) [See Figure 5]. The second reason for such a fluctuation of "time tax"

might have been explained by the implementation of a moratorium on inspections. In 2017 and 2018, the moratorium was prolonged, but the list of bodies that were not subject to it<sup>12</sup> was so significant that, according to many experts<sup>13</sup>, it virtually nullified its existence.

Thus, on the basis of the annual data, we can talk about certain changes for the best of only one (albeit very important) of the three indicators IER tracks.

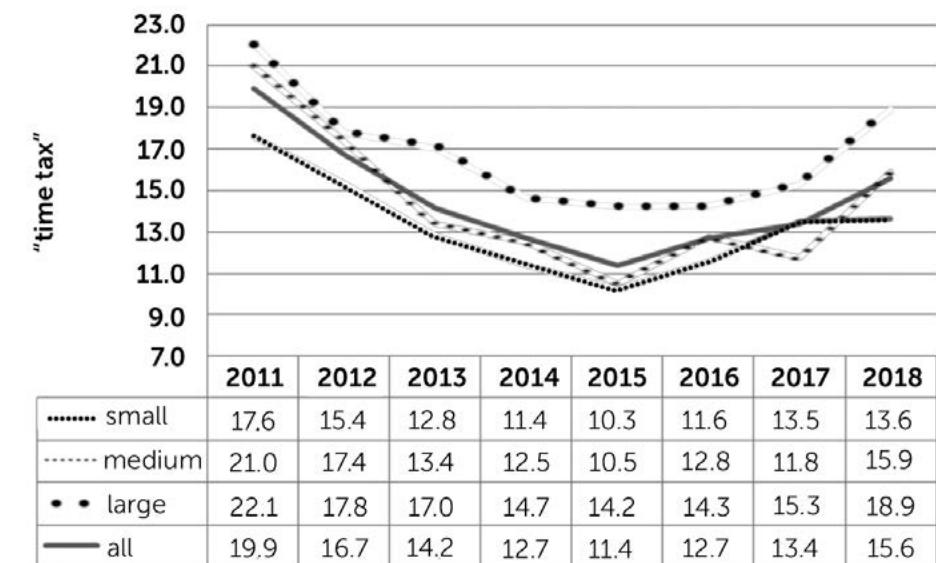
### BUSINESS CLIMATE: IMPROVING CURRENT ASSESSMENT AGAINST THE BACKGROUND OF LESS OPTIMISTIC EXPECTATIONS

In the background of mixed annual trends on regulatory burdens, an important trend for the year 2018 was the improvement of quarterly business climate assessments, against the backdrop of instability of economic growth and cautious expectations for the future. In 2018, for the first time in many years, IER recorded a gradual improvement in the assessments of the current state of the business climate. If we compare the *Index of the current state of the business*

<sup>12</sup> According to the Law on temporary measures of implementation of state oversight and control (No 1728, 03.11.2016), the list of the state bodies that had the right to conduct inspections despite of moratorium included fourteen bodies. These were: 1) the state regulatory body for energy and utilities; 2) National Commission on Securities and Stock Market; 3) State Procurement Service; 4) State Tax Administration; 5) State Audit Office of Ukraine and its territorial bodies; 6) State export control service; 7) State Inspectorate for Nuclear Regulation of Ukraine and its territorial bodies; 8) State Labor Organization and its territorial bodies; 9) State Aviation Service; 10) the State Architectural Inspection; 11) Ministry of ecology and natural resources; 12) National Council of Ukraine on Television and Radio Broadcasting; 13) National Bank; and 14) Antimonopoly Committee of Ukraine.

<sup>13</sup> See, for example, the interviews with Ksenia Liapina, Head of State Regulatory Service in Ukraine: <http://www.drs.gov.ua/press-room/moratorij-na-perevirky-u-2017-rotsi-praktykum-dlya-pidpryemstviv/> or [http://uz.ligazakon.ua/ua/magazine\\_article/EA009942](http://uz.ligazakon.ua/ua/magazine_article/EA009942)

Figure 5: "Time tax": Average time that enterprises' managers spend on communication with representatives of state authorities [arithmetic mean]



Source: IER (1998-2019) *Business Opinion: Industry*

environment<sup>14</sup> in October 2018 with the corresponding period of 2017, we see that the indicator significantly improved – it increased by 15 percentage points (from -0.17 to -0.02), while it still remains in the negative. This increase was due to the almost double reduction of the share of business managers who consider the environment unfavorable (from 31% in October 2017 to 16.2% in October 2018). Meanwhile, the rise of the share of managers that assess business climate as favorable also doubled (from 8% in October 2017 to 15.5% a year later).

In turn, expectations of changes in the business climate show a different trend. The beginning of 2018 in Ukraine was character-

ized by growing optimism about improving the business environment. In April 2018, the index of expected changes in the business

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## ON THE EVE OF THE ELECTION, BUSINESS BECOMES MORE CAUTIOUS AND CONSERVATIVE IN ITS PROJECTIONS AND ACTIONS

<sup>14</sup> Index of change of *Index of Expected Change* shows the balance between positive and negative answers of respondents; its values may vary between -1 (all answers are negative) and +1 (all answers are positive).

environment increased by 13 points compared with February 2018 and is now at the level of 0.22. The rise of values of *Index of Expected Changes in the Business Environment* occurred at the expense of an increase in the share of those who expected positive changes (from 19.7% to 25.8%), while at the same time reducing the share of those who anticipated a deterioration of the business environment (12% to 7.2%, respectively). Simultaneously, 52.6% of company executives reported that they did not expect changes in the business environment during the next half-year. In July 2018, the *index of expected changes in the business environment* remained virtually unchanged at 0.21. However, in October 2018, its value fell by 0.16 percentage points. This decrease in the said index was due to a simultaneous reduction of the share of "optimists" from 29.5% in July to 27.6% in October, and an increase in the share of "pessimists" from 8.6% to 11.8%, respectively.

Thus, against the backdrop of improving the assessments of the current state of the business environment, Ukrainian business is somewhat more pessimistic about its possible changes in the first half of 2019, which is probably due to the forthcoming elections.

#### UNCERTAINTY CAUSED BY ELECTIONS

What are the factors affecting business valuation and expectations? Various factors affecting the estimates and expectations may be taken into account in this regard. For starters, political instability and uncertainty about the future caused by elections are one of them. On the eve of the election, business becomes more cautious and conservative in its projections and actions.

The analysis of historical data [See Figure 7] of the IER *Business Tendency Survey* suggests that business conducted before the elections, during the so-called "wait-and-

**BUSINESS CONDUCTED BEFORE THE ELECTIONS, DURING THE SO-CALLED "WAIT-AND-SEE POSITION", TYPICALLY LEADS TO ASSESSMENTS AND PLANS FOR THE FUTURE TO BECOME MODERATE**

"see position", typically leads to assessments and plans for the future to become moderate. This moderation is caused by fears due to the uncertainty of what the future may bring after the elections. In numerical data, this "wait-and-see position" is reflected by an increase in the proportion of those who do not plan to either expand or reduce their activities, and expect neither deterioration nor improvement of the business environment.

This behavior distinguishes all business pre-election periods, and relevant literature<sup>15</sup> suggests that this is not unique to Ukraine.

<sup>15</sup> See, for example, Berger, H. and U. Woitek (1997) "Searching for Political Business Cycles in Germany", [in]: *Public Choice*, Vol. 91, pp. 179-197; or Canes-

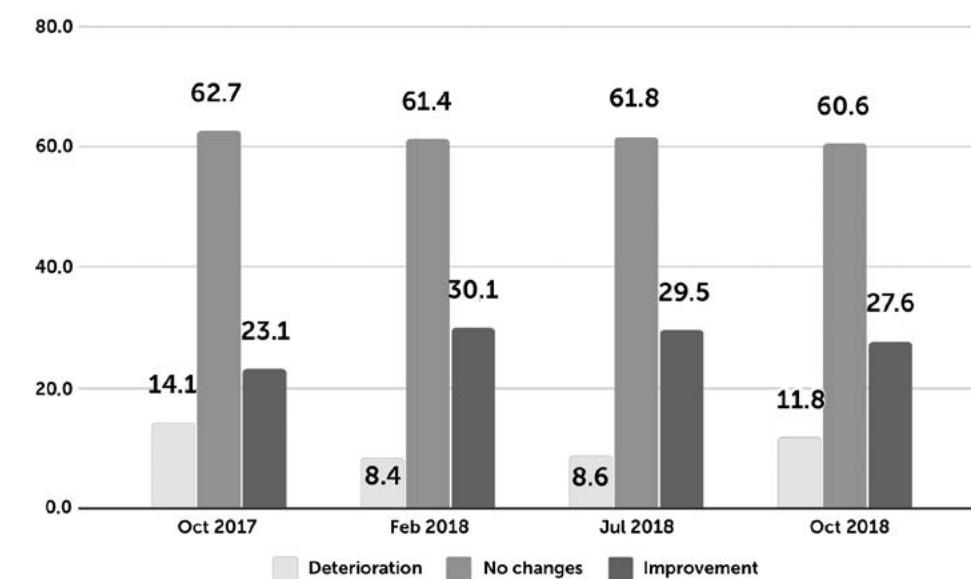
According to international experience<sup>16</sup>, the analysis of the results of research of business economic cycles shows that in the period before the elections, business expectations become more cautious with the post-factum measurements of the economic behavior of the business indicate it becomes more moderate. This is due to the growth of what economists call uncertainty. Even though this behavior is characteristic of all economies, in those with better regulation, more efficient institutions, and a more predictable economic policy, the impact of possible changes due to elections on the business environment is smaller. In Ukraine, where in-

Wrone, B. and J. Park (2014) "Elections, Uncertainty and Irreversible Investment", [in]: *British Journal of Political Science*, Vol. 44(1), pp. 83-106.

<sup>16</sup> Buthe, T. (2000) "The Business Confidence Effects of Political Uncertainty: Some Simple Calculations on Pre- and Post-Election Periods in Germany, 1976-1998", a paper prepared for the 25<sup>th</sup> CIRET conference in Paris.

**THE RUSSIAN MILITARY AGGRESSION IN UKRAINE SIGNIFICANTLY CONTRIBUTED TO THE REINFORCEMENT OF THE UNCERTAINTY FOR UKRAINIAN BUSINESS**

Figure 6: Expected changes in the business climate [% of respondents]



Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

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STRENGTHENING  
THE CAPACITY  
OF STATE  
INSTITUTIONS  
TO ENSURE  
THE RULE OF LAW  
AND SECURITY  
OF PROPERTY  
RIGHTS AGAINST  
THE BACKDROP  
OF NEGLECTING  
THE ROLE  
OF INFORMAL  
RELATIONS  
IN THE ECONOMY  
ARE THE MAIN  
PRECONDITIONS  
FOR REDUCING  
THE PRE-ELECTION  
UNCERTAINTY  
FOR BUSINESS  
IN THE FUTURE**

stitutions and rules are not so strong, where economic policy during the last decade was inconsistent, and where having personal relations with the authorities is still considered as an important factor in conducting business successfully<sup>17</sup>, the very fact of possible personal changes “at the top” contribute to the increase of uncertainty.

In the IER study, the uncertainty is measured by two simple indicators: 1) the share of respondents who could not predict the changes in the financial and economic situation in the enterprise in the half-year perspective, and 2) the share of respondents who do not know in what direction the business environment will change in six months.

According to the results of the IER *Business Tendency Survey*, throughout the Ukrainian economic history, uncertainty increases before and remains high for at least a quarter after a presidential election. A significant increase in uncertainty was also observed during the 2008-2009 economic crisis. Another instance of a growth in uncertainty was recorded at the end of 2010 and was caused by the economic policy of the Mykola Azarov government during which the so-called “tax Maidan” occurred as a reaction to the possible increase of tax pressure for small and medium businesses. Additionally, the events in the fall of 2013, and subsequent developments caused by the Russian military aggression in Ukraine significantly contributed to the reinforcement of the uncertainty for Ukrainian business [See Figure 7]. Only since mid-2016, the business environment has become more predictable – the survey identified a gradual reduction in the proportion of those who cannot decide on the business climate in six months.

<sup>17</sup> According to the IER survey, 46.0% of managers of enterprises consider informal relations with government officials as important or very important in ensuring success in business.

**“  
THE RATING  
OF EXPECTED  
REFORMS  
IN 2018 CHANGED  
SIGNIFICANTLY  
AS COMPARED  
WITH PREVIOUS  
YEARS**

This tendency lasted until July 2018. According to the results of the surveys conducted in July and October 2018, the share of respondents who could not determine either the economic situation in the enterprise, or the changes in the business climate in half a year, was increasing. Still, both rates are much lower than observed during the period of 2010-2017. In particular, the share of managers of enterprises that could not predict the next six months on the financial and economic situation in a company in October 2018 amounted to 15.3%, in July 2018 to 15.9%, an increase from 12.7% in April 2018. In comparison, in October 2015, 32.7% of respondents could not make a six-month forecast.

On the basis of the analysis of the previous cases of business uncertainty, it may safely be assumed that the roots of the current uncertainty also stem from the forthcoming elections and the likely changes that these could bring. Strengthening the capacity of state institutions to ensure the rule of law

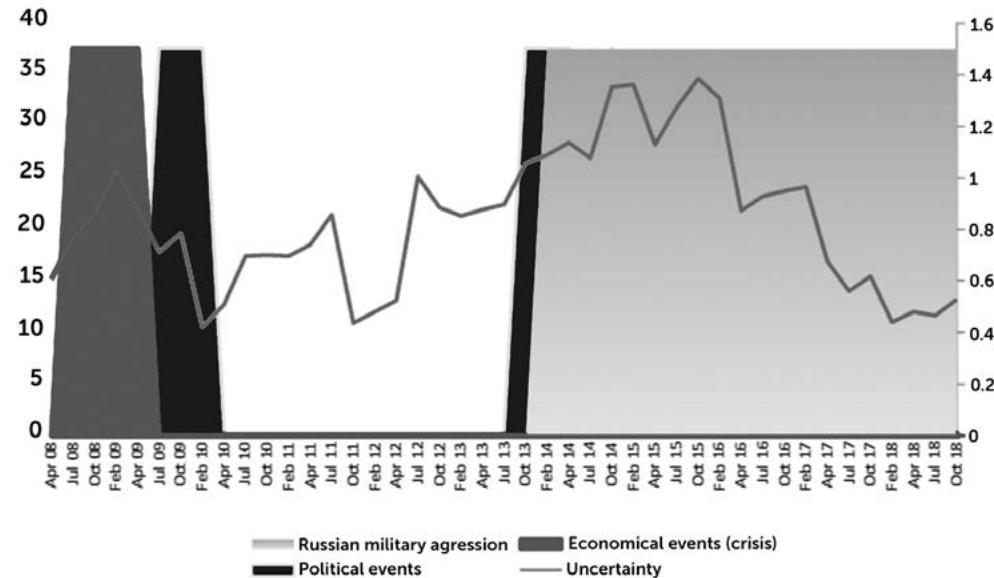
and security of property rights against the backdrop of neglecting the role of informal relations in the economy are the main preconditions for reducing the pre-election uncertainty for business in the future.

**IMPEDIMENTS TO THE GROWTH  
OF PRODUCTION**

What impediments did Ukrainian businesses face in 2018 and do the changing attitudes and performance barriers constitute important issues for understanding economic trends in 2018? Following the IER surveys conducted in October 2018, “low demand” took first place on the list of obstacles to the growth of production. This hurdle is ranked among the top ten impediments to production growth in the past ten years, sometimes swapping places with such problems like “a lack of liquidity”. It should be noted that the share of managers of enterprises for which low demand is an obstacle increased in October 2018 to 57.6% from 53.9% in July 2018.

The second place in the rating was occupied by “liquidity problems”. This problem has been listed as one of the top impediments throughout a long period of observation. At the same time, the share of respondents who pointed out the problem of liquidity as a barrier to growth in their enterprise decreased from 60.5% in July 2018 to 49.0% in October 2018. Such a change means that by the end of that year enterprises somewhat improved their financial conditions. The third obstacle is the “high competitive pressure”. Its importance for respondents in October 2018 remained almost unchanged when compared to July 2018 and amounted to 42.7%. From an economic point of view, the fact that enterprises have experienced a relatively high level of competition in the markets, which is rather good news because competition pushes business development.

Figure 7: Uncertainty level in Ukrainian business [the proportion of respondents unable to make predictions on the business climate change in six months]



Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

Furthermore, “unfavorable regulatory climate”<sup>18</sup> took the fourth place in the rating, with 36.1% of respondents identifying it as a major issue that may have a detrimental effect on the business environment. The value of this indicator has risen by 10.5 percentage points between July and October 2018, mainly due to an increase in the share of respondents who said that corruption is an impediment to growth – a number which was fluctuating [See Table 1]. There are two possible explanations of such a change: either something happens in the business environment frequently (quarterly) or it might

be a reaction of the business to media reports on corruption.

The fifth and sixth places in the rating for obstacles were occupied by “the shortage of skilled workers” (33.3%), and “a lack of raw materials” (31.3%) respectively. The problem with the shortage of skilled workers was one of the most divisive issues in 2018. Based on the IER survey results, it is not possible to check whether this indicates “brain drain” or is a result of a poor system of vocational education. Either way, it signals that the labor force issue will be of key importance for economic development in the near future in Ukraine. The reported greater significance of the “lack of raw materials” indicator likely stemmed from logistical difficulties faced by numerous enterprises due to a blockade of the Ukrainian Azov Sea by Russia.

<sup>18</sup> Unfavorable regulatory climate is a combined indicator that includes three simple indicators: 1) the share of respondents who consider high regulatory pressure an impediment to business growths; 2) the share of respondents who consider corruption an impediment to business growths, and; 3) the share of respondents who consider frequent changes in legislation an impediment to business growth.

The least significant impediment for enterprises in October 2018 were “power supply problems” (7.3%) and “affordability of loans” (5.9%), which means that businesses have no problem securing a loan. Meanwhile, 29.1% of respondents stated that high interest rates are the impediment to growth [See Figure 7]. The power supply problem is usually at the bottom of the list of impediments; nevertheless, in 2018, this indicator observed an increase, which was a direct result of hybrid Russian aggression in Ukraine.

#### EXPECTED REFORMS IN 2018: CHANGE OF PRIORITIES

The rating of expected reforms in 2018 changed significantly as compared with previous years [See Figure 8]. The measures that characterize the creation of favorable and equal conditions for all business entities have shifted to the bottom of the ranking, while measures aimed at supporting specific sectors or activities have risen to the top. In 2018, the top ten of the expected reforms included measures aimed at creating favorable conditions for doing business and – for the first time since the launch of the survey – measures aimed at state support. This expectation is a signal that businesses require not only favorable business conditions, but also some specific policies of support (possibly, in the form of protectionism). At the same time, it is worth remembering that state support or specific economic conditions for some specific group in Ukrainian economic history are very often associated with “wasted” private interest and negatively impact economic or sector development (for example, a “free economic zone” policy at the beginning of 2000 or a special tax regime for automobile companies, among others).

The first place in the rating was occupied by the need to further reduce the single social tax (identified by 43.1% of respondents), followed by the need for stability of

THE VERY  
POSSIBILITY OF ANY  
PERSONAL CHANGES  
“AT THE TOP”  
CONTRIBUTES  
TO ECONOMIC  
UNCERTAINTY

the legislative field (39.1% of respondents) – in particular, the expectation of a three-year moratorium on changes to legislative acts regulating economic activity. The third place was occupied by the need for simplification of tax and accounting (30.3% of respondents). From the 4<sup>th</sup> to the 6<sup>th</sup> places there were measures of support that respondents expect from the state, given either to an enterprise from a specific sector or for specific activities (innovative enterprises, energy saving measures, etc.). The 7<sup>th</sup> place was held by the need for a full-scale e-government (26.6% of respondents). Ensuring full VAT refund was 8<sup>th</sup> place, the transformation of the state tax administration from control into service agency ranked 9<sup>th</sup>, while the creation of an effective mechanism for implementing legislation occupied 10<sup>th</sup> place.

When comparing the changes in the rating of expected reforms between 2017 and 2018, several conclusions may be drawn. First of all, the share of enterprises expecting the introduction of e-governance has almost halved. The development of e-governance has been championed in the analyzed years and the data show that enterprises felt the first results. The second change regards

Table 1: The impediments to the growth of production [% of respondents]

	October 2018	February 2018	April 2018	July 2018	October 2018	October- July 2018
<b>1. Low demand</b>	62.8	64.9	59.8	53.9	57.6	<b>3.8</b>
<b>2. Liquidity problems</b>	50.0	53.4	51.5	60.5	49.0	<b>-11.5</b>
<b>3. High competitive pres- sure</b>	44.0	38.9	46.7	42.2	42.7	<b>0.5</b>
<b>4. Unfavorable regulatory climate (includes):</b>	36.9	32.1	42.3	25.6	36.1	<b>10.5</b>
a) high regulatory pressure	20.5	12.5	18.9	15.1	20.5	<b>5.4</b>
b) corruption	11.1	9.1	16.5	5.4	14.2	<b>8.8</b>
c) frequency of changes in economic legislation	17.8	17.2	14.8	7.8	10.8	<b>3.0</b>
<b>5. Insufficiently skilled workers</b>	12.4	15.2	19.2	23.6	33.3	<b>9.7</b>
<b>6. Insufficient raw materials</b>	21.1	23.6	25.8	25.6	31.3	<b>5.7</b>
<b>7. Excessive taxation</b>	28.5	32.8	33.7	33.3	29.5	<b>-3.8</b>
<b>8. High interest rates</b>	20.8	23.6	19.9	24.4	29.5	<b>5.1</b>
<b>9. Unfavorable political situation</b>	36.2	29.7	32.3	27.5	27.8	<b>0.3</b>
<b>10. Outdated technologies</b>	13.8	10.8	10.3	13.2	11.8	<b>-1.4</b>
<b>11. Lack of production capacity</b>	9.1	10.5	5.8	19.0	10.4	<b>-8.6</b>
<b>12. Power supply problems</b>	4.4	5.7	10.3	9.7	7.3	<b>-2.4</b>
<b>13. Availability of loans</b>	5.7	8.4	11.3	5.8	5.9	<b>0.1</b>

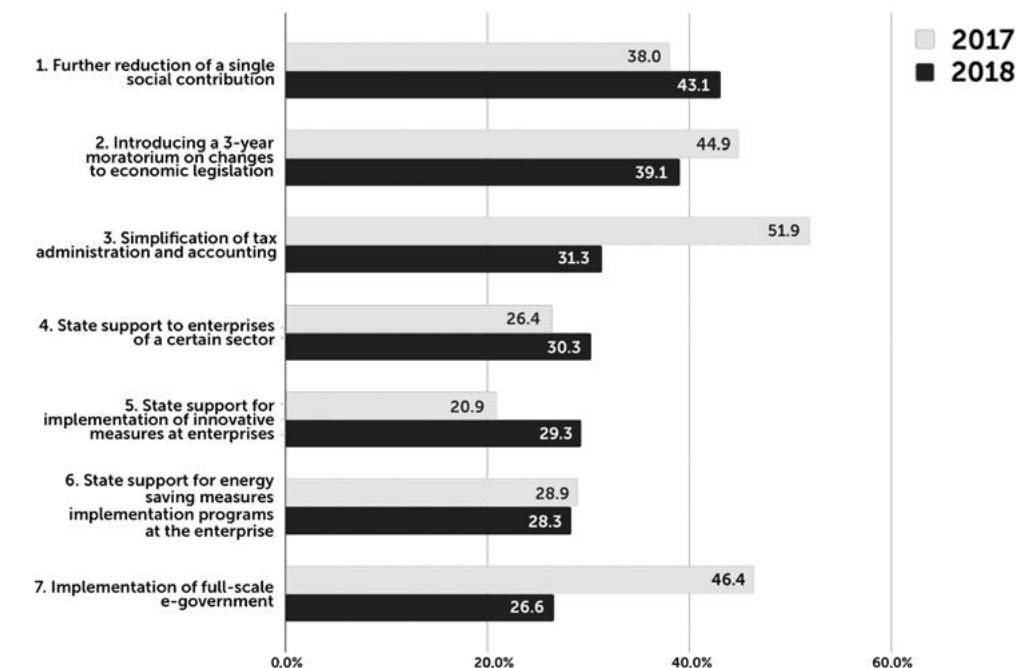
Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

a reform of tax administration. The share of those who are waiting for simplification of tax administration and accounting decreased by 20 percentage points. This drop means that the measures undertaken to improve the situation in the field were significant, although it still requires more efforts to improve the quality of tax administration in the country. The third important change in 2018 versus 2017 occurred in the last places in the rating, which were held by such measures as, for instance, the provision of a full VAT refund. This result indicates that by introducing the system of automatic VAT refund the problem with no refund of VAT that existed during Viktor Yanukovych's time has already been solved. Moreover, the introduction of a three-year moratorium on implementing the reform has taken

a higher place in the ranking (2<sup>nd</sup> compared to 3<sup>rd</sup> in 2017) – however, the proportion of respondents who identified this measure has decreased by 5 percentage points. This result is a clear message from business to policy makers – business needs a stable and predictable environment.

In summation, the abovementioned results show that the policy measures aimed at improving the business environment became less demanded by enterprises. This trend may indicate some progress in these areas – in particular in deregulation, the introduction of e-governance, and the imposition of VAT refunds. At the same time, enterprises expect the state's support. What caused this change? Perhaps businesses felt the results

Figure 8: Top 7 expected reforms in Ukraine [% of respondents]

Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

of relevant reforms at improving the business environment and creating equal rules of the game for all business entities and now want to get preferential treatment for themselves? Is it an indicator of rising populist tensions among businesses? So far, it is difficult to provide answers to these questions. However, given the fact that surveys of the population show the attractiveness of populist slogans, and the business sector reflects public opinion because it simply is a part of society, there is a reason for reflection: why have the expectations for receiving state support increased in 2018? Regardless of this fact, the measures aimed at improving the business environment should be actively implemented in future.

#### **LONG-TERM CONCLUSIONS**

Summarizing, in terms of business expectations, positive assessments and forecasts dominated over the negative ones in the year 2018. Nevertheless, it became clear that businesses typically remain cautious in their plans in the years of a possible political change (election years). Despite this phenomenon, in a two-year perspective, entrepreneurs remain quite optimistic towards their business activities. Still, the growth of production is unstable, and the rate of growth is not enough. The shortage of skilled staff can be one of the factors inhibiting economic activity in the future. Additionally, long-term business plans vary by the size of an enterprise, with large companies being commonly very optimistic, unlike small and medium-sized companies. Finally, business plans for the next six months (the 4<sup>th</sup> quarter of 2018 and the 1<sup>st</sup> quarter of 2019) are under the influence of expectations of the result of the presidential election. (The results of the parliamentary election will depend on the results of presidential election).

It must, therefore, be emphasized that in Ukraine, where institutions and rules are

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POLICY MEASURES AIMED AT IMPROVING THE BUSINESS ENVIRONMENT BECAME LESS DEMANDED BY ENTERPRISES

“under reconstruction”, economic policy is becoming predictable only now, and informal relations with representatives’ authorities are still important or even crucial for being successful in business, the very possibility of any personal changes “at the top” contributes to economic uncertainty. Thus, it is paramount to strengthen institutions, establish clear “rules of the game”, and stick to them.

Special attention needs to be paid to the findings regarding business expectations of stability of the legislative environment, discussed in this article. From 2015 to 2018, the share of enterprises that would have expected a moratorium on changes in the legislative for economic activity increased sharply from 17.6% in 2015 (12<sup>th</sup> position in the rating of the expected reforms) to 39.1% in 2018 (2<sup>nd</sup> position). Noteworthy, the support for this measure peaked in 2017 (44.9%), while ranking 2<sup>nd</sup> place in 2018, which should serve as a strong signal to policy makers, politicians, and reformers.

Against the backdrop of a further need to complete the reforms and implement legislation in line with Ukraine’s EU Associa-

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IN UKRAINE, WHERE INSTITUTIONS AND RULES ARE “UNDER RECONSTRUCTION”, ECONOMIC POLICY IS BECOMING PREDICTABLE ONLY NOW, AND INFORMAL RELATIONS WITH REPRESENTATIVES’ AUTHORITIES ARE CRUCIAL FOR BEING SUCCESSFUL IN BUSINESS, THE VERY POSSIBILITY OF ANY PERSONAL CHANGES “AT THE TOP” CONTRIBUTES TO ECONOMIC UNCERTAINTY

tion Agreement, such results indicate the complexity of the tasks ahead – it is, indeed, necessary to conduct reforms, but at the same time crucial to maintain stable conditions for business. This means that the planned changes must be predictable and done in a timely and orderly fashion. Taking into account the situation with the implementation of reforms (such as the reforms of tax administration, of customs authorities, court reforms, etc.), there is only one mandatory recommendation – the reforms must be sped up. And Verkhovna Rada must play the key role in the process of introducing the vital change for Ukrainian society.

As a window of opportunity for conducting successful reforms quickly closes, no time should be wasted. Whichever presidential candidate or a party wins the 2019 elections; they must continue to keep the focus on cultivating a friendly environment for business. •



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OKSANA KUZIAKIV

Executive Director of the Institute for Economic Research and Policy Consulting (IER)

# Two Steps Forward, One Backward



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RADOVAN  
ĎURANA

**O**ver the last decades, the post-socialist bloc countries have seen significant economic growth. The transformation to the market economy gradually yields its fruits, the unemployment rate in each of these countries, now also members of the European Union (EU), is lower than the average unemployment rate of the Eurozone.

Economic growth is strong, but the convergence of these countries to the developed West does not proceed as fast as the general public would like. The causes are multiple and this issue of *4liberty Review* focuses on one of them in particular – namely, regulation.

In the foreword to this issue, Dr. Detmar Doering of Friedrich Naumann Foundation for Freedom writes: "The fact that people whose lives are not excessively regulated by the state, and who are able to determine their legitimate goals for themselves, are more creative and productive and live in more productive and creative societies, can still be fairly well proven empirically". A statement worth remembering.

We must agree that removing superfluous regulation has the potential to release tied financial and human capital, leaving space for entrepreneurs to be creative and thus to enhance society's well-being. Cutting red tape has, therefore, become one of the priorities not only at the EU level but also individually in the CEE countries. Governments are setting up working groups, preparing packages of measures. However, the results are contradictory.

Improving the business environment is usually not a matter for businessmen, but politicians and bureaucrats. These are usually the people who are not doing business themselves, and many times they had never

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been business owners or employers. They look at the business environment through the glass of their offices and are thus often incapable of grasping the full extent of this topic. In the best-case scenario, they follow various indexes and rankings, trying to make up for their lack of experience or expertise. Their goal and strategy are to move the country upwards in the rankings. In the worst-case scenario, however, the governmental strategy is based solely on a random accumulation of different measures that bring isolated improvements, whereas the overall picture of the business environment does not change.

Relying too much on international rankings is inherently flawed. Each index is just a piece of a complicated puzzle, which has been simplified for the sake of its quantification to enable drawing international comparisons. Every attempt to transform legal regulations into a point scale hides the weight of individual regulations. This is, however, not to dismiss the indices and rankings. Their developers work hard



to tune them to be as precise as possible. Alas, they will always have their limitations. Still, not having any rankings at all would be far worse, as bureaucrats would have nothing to shore up.

An example from Serbia demonstrates how shifting the ranking does not guarantee a real improvement in the business environment. The regional differences in the work of the authorities or the difference between the letter of the law and the actual enforcement of the regulation are the factors that are very difficult to be captured by rankings.

Another sign of the "cutting red-tape movement" is the inability to stop the influx of new regulations. Lithuania is a success story of a country that has lately been improving its position in international rankings – it is already close to the Top 10 in the *Doing Business* rankings. Nevertheless, there is a lively discussion about the regulation of opening hours in retail stores. In Poland, a similar measure was adopted recently to limit Sunday sales. The politicians had put it under the label of helping small merchants and introduced this regulation with the support of a petition organized by the trade unions. The article by Marcin Zieliński of Civil Development Forum (FOR) on favoring small entrepreneurs in Poland describes how politicians promote popular regulations without properly analyzing their impact. Unintended consequences of these regulations often lead to different outcomes than the politicians desire.

Similarly, the efforts of Czech regulators to improve the business environment are constrained by new regulations. The digitalization of the public sector helps to speed up some administrative processes, but at the level of a small manufacturing company, the number of operations is not decreasing. Quite the opposite – as the

*Bureaucratic Index of the Czech Republic* shows, the burden is even greater.

Improving the business environment and deregulation often ends up in the form of a resonating PR catchphrase, a commendable goal in a government manifesto, or a promise given at the meeting with employers' representatives. A Slovak example shows that even a courageous commitment – the creation of anti-bureaucratic packages or the presence of institutional preconditions for deregulation – may not be enough. The country does not improve in the rankings, on the contrary, it worsens. Despite the indisputable benefits of deregulation of the business environment, this goal has not become an across-the-board political priority. For each more serious positive action, another new regulation can be attributed. Politicians and bureaucrats

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generally do not want to give up control over the business environment. But why?

On the one hand, the possibility of the control means power. This is a dangerous area where the risk of state-capture by interest groups is really acute and corruption follows. Unfinished liberalization on the Bulgarian electricity market shows how politicians do not like to change the *status quo* that helps the elected at the expense of the masses.

On the other hand, it is often an uninformed public who grievously demands strict regulation without understanding its negative impacts. And politicians like to offer these regulations if an increase in popularity is likely to follow.

Meanwhile, consumer protection has become a modern dogma, thus resulting in the creation of new regulations. A complex network of restrictions and obligations takes over the responsibility of the consumers for their decisions. Their safety is the ultimate priority regardless of the cost.

Noteworthy, the promotion of a welfare state is closely linked to regulation. Therefore, today, real deregulation of the business environment seems an unattainable utopia. In fact, we can only talk about streamlining the administrative burden of these regulations. For a while, the creative potential has been restored in the cyberspace, but the consumer protection umbrella is already being opened in this sector as well. This phenomenon, however, should not discourage politicians, experts, and entrepreneurs from the continual effort to improve the business environment.

Needless to say, unlike Western Europe it is much more challenging to deal with regulation efficiently for post-socialist countries. Reducing the amount of required

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## POLITICIANS AND BUREAUCRATS GENERALLY DO NOT WANT TO GIVE UP CONTROL OVER THE BUSINESS ENVIRONMENT

paperwork or shortening the process for the listing of a new company, is an easy task. The real challenge is to improve the business environment by improving law enforcement, the stability of the legal environment, and the reduction of corruption. Only then can scoring a position in the Top 20 of Doing Business be seen as truly meaningful. •



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RADOVAN  
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### MEMBERS OF 4LIBERTY.EU NETWORK

**Free Market Foundation** (Hungary) is a think tank dedicated to promoting classical liberal values and ideas. The organization's projects focus on advocating a free market economy and fighting racism. The Foundation's activities involve education, activism, and academic research alike, thus reaching out to different people.

**Liberální Institut** (Prague, Czech Republic) is a non-governmental, non-partisan, non-profit think tank for the development, dissemination, and application of classical liberal ideas and programs based on the principles of classical liberalism. It focuses on three types of activities: education, research, and publication.

**The Lithuanian Free Market Institute** (Vilnius, Lithuania) is a private, non-profit organization established in 1990 to promote the ideas of individual freedom and responsibility, free markets, and limited government. The LFM's team conducts research on key economic issues, develops conceptual reform packages, drafts and evaluates legislative proposals, and aids government institutions by advising how to better implement the principles of free markets in Lithuania.

**The F. A. Hayek Foundation** (Bratislava, Slovakia) is an independent and non-political, non-profit organization, founded in 1991, by a group of market-oriented Slovak economists. The core mission of the F. A. Hayek Foundation is to establish a tradition of market-oriented thinking in Slovakia – an approach that had not existed before the 1990s in our region.

**IME** (Sofia, Bulgaria) is the first and oldest independent economic policy think tank in Bulgaria. Its mission is to elaborate and advocate market-based solutions to challenges faced by Bulgarians and the region face in reforms. This mission has been pursued since early 1993 when the institute was formally registered a non-profit legal entity.

**The Academy of Liberalism** (Tallinn, Estonia) was established in the late 1990s. Its aim is to promote a liberal world view to oppose the emergence of socialist ideas in society.

**INESS** (Bratislava, Slovakia), the Institute of Economic and Social Studies, began its activities in January 2006. As an independent think tank, INESS monitors the functioning and financing of the public sector, evaluates the effects of legislative changes on the economy and society, and comments on current economic and social issues.

**Projekt: Polska** (Warsaw, Poland) comprises people who dream of a modern, open, and liberal Poland. It is those to whom a democratic, effective, and citizen-friendly government is a key goal, and who help accomplish this goal while enjoying themselves, forming new friendships, and furthering their own interests.

**Liberales Institut** (Potsdam, Germany) is the think tank of the Friedrich Naumann Foundation for Freedom dedicated to political issues such as how liberalism can respond to challenges of the contemporary world and how liberal ideas can contribute to shaping the future.

**Fundacja Liberté!** (Łódź, Poland) is a think tank created in Łódź in 2007. Its mission is to promote an open society, liberal economic ideas, and liberal culture, and to organize a social movement around these ideas. Among the foundation's most recognizable projects are: Liberté!, Freedom Games, 6. District. The foundation is coordinating the 4liberty.eu project on behalf of Friedrich Naumann Foundation.

**Republikon Institute** (Budapest, Hungary) is a liberal think tank organization based in Budapest that focuses on analyzing Hungarian and international politics, formulating policy recommendations, and initiating projects that contribute to a more open, democratic, and free society.

**Civil Development Forum (FOR)** (Warsaw, Poland) was founded in March 2007 in Warsaw by Professor Leszek Balcerowicz as a non-profit organization. Its aim is to participate in public debate on economic issues, present reliable ideas, and promote active behavior. FOR's research activity focuses on four areas: less fiscalism and more employment, more market competition, stronger rule of law, and the impact of EU regulations on the economic growth in Poland. FOR presents its findings in the forms of reports, policy briefs, and educational papers. Other projects and activities of FOR include, among others, Public Debt Clock, social campaigns, public debates, lectures, and spring and autumn economic schools.

**Visio Institut** (Ljubljana, Slovenia) is an independent public policy think tank in Slovenia. Aiming for an open, free, fair, and developed Slovenia, the Visio Institut is publishing an array of publications, while Visio scholars regularly appear in media and at public events.

### COOPERATING PARTNERS FROM EASTERN PARTNERSHIP COUNTRIES

**The Institute for Economic Research and Policy Consulting** (Kiev, Ukraine) is a well-known Ukrainian independent think tank, focusing on economic research and policy consulting. IER was founded in October 1999 by top-ranking Ukrainian politicians and scientists, and a German advisory group on economic reforms in Ukraine, which has been a part of Germany's TRANSFORM program. Its mission is to provide an alternative position on key problems of social and economic development of Ukraine.

**Svetilnik** (Ljubljana, Slovenia) is a non-profit, non-governmental, and non-political association. Its mission is to enlighten Slovenia with ideas of freedom. The goal of the association is a society where individuals are free to pursue their own interests and are responsible for their actions.

**New Economic School – Georgia** (Tbilisi, Georgia) is a free market think tank, non-profit organization, and NGO. Its main mission is to educate young people in free market ideas. It organizes seminars, workshops, and conferences for education and exchanges of ideas. NESG was founded by Georgian individuals to fill the knowledge gap about the market economy in the country and the lack of good teachers and economics textbooks.

**MIHAJLO GAJIĆ****IS DOING BUSINESS REPORT A GOOD TOOL FOR DESCRIBING BUSINESS REGULATION IN ALL COUNTRIES? (A SERBIAN PERSPECTIVE)****PAGE 010**

One of the reasons why the Doing Business report should be taken with caution in all countries it covers is due to the existence of regional disparities. The DB is calculated on the basis of data coming from the biggest city in the country (usually the nation's capital) and only in the cases of the most populous countries (such as China, Russia, India, the United States etc.) data from the second biggest city in the country is also used. This brings out the question whether the situation in the nation's capital or its most populous city is a good representation for the situation in the country as a whole.

**MICHAEL FANTA****GOVERNMENT STRATEGY TO REDUCE ADMINISTRATIVE BURDEN: CASE OF THE CZECH REPUBLIC****PAGE 048**

The fact that administrative barriers are unpleasant, especially for entrepreneurs, and negatively influence overall competitiveness of the whole economy, has been realized by the Czech government about fourteen years ago and they decided to act. However, as it turns out, oftentimes, the intention of the government (although with noble purpose) does not match the desired effect.

**PAVEL PETERKA****HOW MUCH RED TAPE IS TOO MUCH RED TAPE****PAGE 060**

Although the Czech Republic is not doing the worst when compared to its neighbors, it is frightening that in a relatively small company, one person has to devote approximately five weeks just to finish the paperwork required by the state. Now, at a time of economic growth, we can get our hands on it. But worse times will come, and companies will need every resource to stay on the market.

**MARCIN ZIELIŃSKI****SMALL IS NOT ALWAYS BEAUTIFUL, ESPECIALLY WHEN AIDED BY (POLISH) GOVERNMENT****PAGE 070**

Despite its declaration to promote economic growth and development of Polish companies of all sizes, the current Law and Justice government introduced numerous bad regulations (a freeze on trade in agricultural land, restrictions imposed on new pharmacies, and a ban on Sunday retail trading) that were intended to promote small companies and not their expansion.

**GINTARĖ DERŽANAUSKIENĖ AND ANETA VAINĖ****RETAIL OPENING HOURS: REGULATION THAT FAILS****PAGE 084**

Since 2012, nine European countries have taken measures to liberalize the regulation of retail opening hours: Denmark, France, Finland, Italy, the Netherlands, Portugal, Spain, and Malta. Meanwhile, Hungary and Poland introduced restricting regulations in 2015 and 2018 respectively.

**KALOYAN STAYKOV****POWER MARKET LIBERALIZATION IN BULGARIA: A DECADE OLD PROBLEM****PAGE 110**

The process of power market liberalization in Bulgaria is a textbook example of deregulation on paper, and no matter how much the market structure has changed in the past decade it is still characterized by a high degree of concentration and lack of competition.