

HOW GOOD ARE WE AT ESTIMATING BARRIERS TO BUSINESS? A CLOSE LOOK AT THE UKRAINIAN BUSINESS ENVIRONMENT¹

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High regulatory costs and a high incidence of corruption are commonly associated with Ukraine, but how high is high? To be effective, policies aimed at removing the barriers to business should be based on accurate estimates of the magnitude of these barriers. In our research we focus on one specific issue: the costs related to inspections of businesses by the regulatory authorities. This particular set of regulations is representative of the general issue, and furthermore these inspections contribute significantly to the overall business costs in Ukraine. To investigate these inspection costs in detail, we conducted case studies and in-depth interviews with entrepreneurs in three large Ukrainian cities (Kiev, Kharkov, and Donetsk) during 2004 and 2005. The comparative analysis of these costs is of special interest because our findings contrast with the estimates using alternative methodologies that currently inform policy discussions in Ukraine. This analysis is also of interest because of the change in regime in Ukraine at the end of 2004 and the associated expectations of dramatic improvements in the business environment.

Introduction

Since starting the transition to a market economy in the late 1980s, Ukraine has been building a system of institutions to support entrepreneurial activities. By now, there has been significant progress in this area, and Ukrainian business has been quickly developing. At the same time, the Ukrainian business environment cannot be considered as friendly and supportive for business because of rather hostile regulation by the central and local authorities. Significant regulatory barriers are related to the following procedures: getting permits for business operation, licensing, taxation, customs procedures, and inspections by the regulatory authorities [1-5]. All these procedures are characterized by ambiguous legislation, high discretionary power of regulatory officials, ineffectiveness and inefficiency of the legal means for protection of entrepreneurs' rights, and extensive corruption which significantly lowers business profitability. It should be noted that corruption in the Ukrainian society is not limited to business regulation activities. It is pervasive and even customary in Ukraine [6], which complicates its elimination in all spheres, including business.

To develop policies that remove inappropriate barriers to business development, we need accurate estimates of the current size of these barriers. Though it is commonly known that

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corruption related to business regulation in Ukraine is extensive [1-4], appropriate policies to fight corruption depend on its incidence. For example, if bribes are paid in 10 % of cases related to a certain regulatory procedure (getting a permit or inspection by a regulatory agency), the policy may involve the strengthening of enforcement without changing the rules. If bribes are paid in 80 % of cases, the inferences and policy implications may be quite different. The large percentage may indicate that something is wrong with the requirements themselves, that they are unrealistic to meet, and it does not make sense to insist on enforcing these rules because it will dramatically affect the business profitability and reduce incentives for entrepreneurial activities in the society. It matters whether a business cannot survive without making unofficial payments to the regulatory authorities, or whether unofficial payments are optional and made by only a fraction of entrepreneurs, say, who are violating laws and rules.

An 80 % corruption incidence indicates that bribery has become a systemic rather than sporadic phenomenon, and bribe giving and bribe taking are the equilibrium strategies. Thus accurate measurement of the incidence of corruption, which is related to the magnitude of barriers, is very important for choosing the right policy.

Once the policy aimed at removing or lowering the barriers to business development is chosen, it is important to monitor the results of this policy implementation. Usually reforms are introduced by a trial-and-error method. In this connection we need to monitor closely both the changes in formal institutions and the outcomes they lead to, first of all in terms of the costs of doing business. If we are mismeasuring how big the barriers are initially, then it's difficult to measure the changes. Thus, for developing a regulatory policy and monitoring the outcomes of its implementation we need to develop a measurement technique to a credible estimate of the costs of doing business. The discussion of our measurement methodology and the results obtained using this methodology will be at the center of this paper.

The total costs of doing business represent a composite of the costs of compliance with separate regulatory procedures, such as business legalization, inspections, clearing customs, etc. In our earlier study reported at the ISNIE 2004 conference [7], we considered the business legalization procedures and estimated the related costs. In the present study, we focus on the post-legalization costs of doing business, specifically the costs related to inspections of businesses by different regulatory agencies. These are a significant part of the total costs of doing business in Ukraine.

1. Inspections as a major regulatory burden for Ukrainian businesses

Ukrainian businesses frequently undergo inspections by various regulatory agencies. Among them are the tax authorities, police, fire department, sanitary and epidemiological service, consumer rights protection department, and others [3].

The fundamental purpose of inspections is to detect, punish, and prevent violations of law, thus protecting the society from negative impact of entrepreneurial activities. The effectiveness of inspections depends on a number of factors. The first is how reasonable are the regulatory demands to be met by business. If the requirements are excessive, this will lead to the waste of resources both by businesses (on meeting the requirements), and by the regulatory authorities (on checking whether these requirements are met). The effectiveness of inspections is also connected with the principal-agent problem in the regulatory sphere and is determined by the ability of the regulatory authority to enforce law through its agents. Corruption in the process of inspections reduces their disciplining effect on entrepreneurs and leads to an income redistribution between entrepreneurs and regulatory officials in the absence of any benefits for the society.

Common problems related to inspections of businesses in Ukraine are the frequency of inspections; conflicting, unclear and/or excessive demands made on the part of inspectors; and non-transparent procedures. Furthermore, inspections in Ukraine are characterized by a high incidence of corruption [1-3]. All these problems are closely related to deficiencies in the legislation that governs inspection. The legal basis for inspections in Ukraine is quite complex.

The inspection process is based on the authorization of ministries and central regulatory agencies to enforce compliance with the legal acts they issue. The inspection process is regulated by separate legislative acts which define the functions and existence of the central regulatory agencies and, stipulate their right to conduct inspections of enterprises, without providing further definition of the limits or scope of such inspections. There is no unified legislation to consolidate the process and stipulate standard inspection procedures².

Below we briefly describe the most common inspections faced by Ukrainian businesses and the problems related to them.

Inspection by the tax authorities is an inspection which cannot be avoided by any business. In Ukraine, the interaction with the tax authorities has always been costly, for many reasons.

The high levels of some taxes give rise to tax evasion as businesses seek to become or remain profitable. Tax evasion has become common among Ukrainian businesses. However, since tax evasion leads to insufficient revenue for the state and local budgets, the tax authorities make additional efforts. Thus the functions of Ukrainian tax inspectors become fiscal rather than controlling. That is, tax inspectors come to extort missing payments for the budget rather than to control the tax discipline and compliance with tax legislation. This determines the biased behavior of tax inspectors, who are given quotas – the amount of money they must raise during inspections in the form of official fines.

The costliness of interacting with the tax administration is also caused by imperfections in tax-related legislation – contradictory requirements, ambiguity, frequent changes, etc. These imperfections lead to a high discretionary power of tax inspectors and to vulnerability of entrepreneurs during inspections, which increase the corruption and bribery associated with inspection activities.

For small businesses, the best way of reducing the costs of interaction with the tax authorities is switching to the simplified tax system³.

In 2005, after the Orange Revolution, there were made some attempts to alleviate the tax inspection burden on entrepreneurs by limiting the rights of the tax authorities to conduct unscheduled inspections and by stipulating the maximum duration of inspections⁴. The changes in legislation were considered by entrepreneurs as progressive, protecting them from the arbitrary rule of the tax authorities, and showing respect to tax payers. However, these positive changes did not last long, and soon the legislation was revised again⁵. The reason for such revision was a drop

² The necessity of such legislation is commonly recognized and the draft of the corresponding law is prepared and discussed in the Parliamentary committees.

³ The simplified method of tax filing, accounting and reporting (unified tax) introduced in Ukraine in 1998 is available to firms which employ less than 50 people and have an annual turnover of less than UAH 1 million (US\$200,000). This system allows qualified firms to pay a majority of taxes as one tax with one report. Private entrepreneurs (physical persons) also qualify for the simplified system as long as they employ no more than 10 employees and have annual sales of less than UAH 500,000 (US \$100,000).

⁴ On January 12, 2005, the Supreme Rada adopted the Law № 2322-IV with a cumbersome name “On the introduction of changes into some legislative acts of Ukraine (concerning the strengthening of legal protection of citizens and implementation of mechanisms of realization of constitutional rights of citizens to entrepreneurial activities, personal inviolability, security, respect for personal dignity, legal assistance and protection)”. On the basis of this law, changes limiting the rights of controlling agencies were made in particular in the Law “On the State Tax Service of Ukraine”. According to these changes, any unscheduled tax inspections could be conducted only on the basis of the corresponding court decision. Before, for conducting such inspections it was sufficient to receive approval of the head of the local tax authority. According to the law it is the court that would decide whether the grounds for such inspection are sufficient or not. The representatives of the potential object of such inspection had the right to participate in the court procedure and to submit the appeal if they disagree with the court decision. The law also banned the participation of the tax police in scheduled and unscheduled inspections unless they were conducted in the framework of criminal investigation

⁵ The changes to the Law “On the State budget 2005” (№ 2505-IV of March 25, 2005) stipulated the new revision of the Law “On the State Tax Service”, practically restoring status quo. In the revised version of the law “On the State Tax Service” it was stated that unscheduled inspections could be conducted on the basis of the decision of the head of the tax authority instead of the court decision. Besides, the maximum duration of inspections was increased – in the new revision of the Law the duration was counted in working days instead of calendar days.

in the main performance indicators of local tax offices, related to collection of fines and extracting tax debts.

Among the most frequent inspections are those by the fire safety departments and the sanitary and epidemiological service. These are officially aimed at protecting the local community from hazards generated by business. These inspections fulfil their task only to some extent. Though associated with extensive corruption, they certainly have a disciplining effect on businesses making them meet at least the basic requirements of fire and sanitary safety. However, the official requirements include several which are hard or very costly to meet, while at the same time they are not crucial for the safety of the business employees and local community. Such requirements become an instrument by which fire and sanitary inspectors can extort bribes from businesses. On the one hand, the inspectors have the right to demand that such requirements be met; on the other hand, they do not take much risk if they close their eyes to the evasion in return for a bribe.

During several recent years inspections by the consumer right protection department have become rather frequent. These inspections are industry specific. They represent one of the major burdens for Ukrainian retailers.

The police (the Ministry of Internal Affairs) should also be named among frequent inspectors of Ukrainian businesses, although in accordance with the Ukrainian legislation the rights of the police to conduct inspections are very limited and related mostly to criminal cases when the police intervention is necessary.

To sum up, the costliness to businesses of inspections by the regulatory authorities is connected with imperfections in the legislation governing legislation, which endow regulatory officials with high discretionary power, gives poor possibilities for enforcement of law, and provides no effective means to protect the rights of entrepreneurs.

2. Research goals

As we have seen above, inspections in Ukraine bring with them many problems for businesses. How large are the difficulties – the barriers – that they create?

The most comprehensive and systematic study of the Ukrainian business environment is conducted by the International Finance Corporation (IFC) in its annual surveys of the Ukrainian small and medium enterprises [1-3]. The goal of these surveys is to identify key regulatory barriers impeding business development in Ukraine and to develop recommendations for improving the business climate. These surveys cover all major regulatory issues and provide a very good insight into the main problems faced by Ukrainian businesses. The assessments include examination of the legal framework for business activities, study of the entrepreneurs' perceptions of the business environment, estimates of the frequency and length of regulatory procedures undergone by entrepreneurs, identification of the problems related to separate regulatory procedures, and many other issues. At the same time the costs of doing business are not estimated directly.

In contrast to these surveys, our own research looks very closely at one regulatory procedure. We focus on inspections, study them in detail, and measure the associated costs of this regulatory activity for entrepreneurs. Specifically, we measure the costs associated with inspections by the regulatory authorities during the years 2004 and 2005. This time period is of special interest because the ruling regime changed at the end of 2004. The Orange regime, which came to power after the 2004 presidential elections and was widely supported by Ukrainian entrepreneurs, declared its intentions to radically improve the Ukrainian regulatory environment and proclaimed war on corruption. Did any changes in the business environment take place as a result? If yes, how did they affect the costs of doing business, in particular the costs of inspections?

We collect data on several objective and quantitative characteristics related to inspections, such as the number and variety of inspections, the magnitude of the inspection costs in monetary

terms, and the types of inspection costs. We study the composition of inspection costs and their sources, looking at official payments and unofficial ones. In addition, we look at qualitative aspects, like patterns of behavior of regulatory officials and entrepreneurs during inspections, and entrepreneurs' stated reasons for choosing certain strategies in dealing with the regulatory authorities.

3. Research methodology

To study the dynamics of these inspection costs, we conducted two series of in-depth interviews with a panel of owners of small and medium businesses in different industries. We used a specially developed questionnaire in all cases. However, the in-depth interviews frequently went beyond the questionnaire and achieved the depth of case studies.

We chose entrepreneurs who were operating in one of three large Ukrainian cities: Kiev, Kharkov, and Donetsk. Surveying entrepreneurs working in different cities and industries allowed us to obtain a greater spectrum of responses and to examine some industry- and region-specific differences.

Our sampling procedure requires special discussion. Studying the costs related to business inspections of businesses in Ukraine is nearly equivalent to studying corruption. This poses additional problems for researchers. Corruption is a sensitive issue often very difficult to study. Potential respondents are frequently unwilling to discuss their behavior concerning corruption because i) corruption is illegal and can be punished by law, ii) respondents are afraid of doing harm to and spoiling relations with those whom they paid bribes, and iii) they feel uncomfortable to admit they have engaged in unethical behavior

Thus, getting respondents to cooperate in studies involving corruption is challenging. Respondents need guarantees of confidentiality, and simple references to an interviewer's ethical code rarely suffice. Under these circumstances, personal trust in the interviewer matters a lot. Respondents must be certain that the information they divulge will remain strictly confidential. This condition is hard to fulfill if the interviewer is an unknown person, as in large-scale surveys with random sampling. Increasing the sample size there may not yield additional accuracy if there is a systematic bias against disclosure. Respondents who do not trust the interviewer will tend to keep silent about their corruption practices, and the costs related to unofficial payments will continue to be underestimated.

Although our study has the disadvantage of small sample size, and the respondents were not chosen as a random sample from a larger population, our respondents did have considerable confidence about confidentiality and were thus more likely to provide accurate data on sensitive issues such as corruption.

We approached our respondents through informal networks of friends, acquaintances, relatives, and business partners.⁶ We maintained absolute confidentiality and anonymity of our respondents, using only pseudonyms in the completed questionnaires. Our personal reputations and the reputation of those who recommended us were guarantors that we would maintain confidentiality. So, we personally had something to lose in case of break of confidentiality, as our reputation and personal relations with entrepreneurs or those who recommended us to the respondents were at stake. In a way, we exchanged hostages with our respondents.

Certainly this way of sampling is not universal for studying sensitive issues. In some cases, sharing information with a personally known interviewer can also lead to distortions in responses. This is particularly the case when the respondent is ashamed to disclose the information to the interviewer. In our study, this effect is unlikely, given the peculiarities of the Ukrainian environment and the customary character of corruption in practically all spheres of life. A different matter is that serious cases of corruption in business will not be reported even to the

⁶ Earlier we used the similar way of sampling (approaching respondents through informal networks) in the study of the costs related to small garment business legalization [7].

closest friends or most trusted interviewers.. For matters involving large unofficial payments to the city administration for land plot allocation, or bribing a politician to getting preferences for one's business, most entrepreneurs will keep silent to everyone. (This is especially relevant for large businesses.) However, our study focuses on inspections, where unofficial payments are as a rule much smaller and represent a very common practice.

The main deficiency of our design is the large reliance on the researchers' personal connections within the business community⁷.

We investigate some issues of sampling bias by comparing the business practices of those who were willing to be interviewed with firms in general business data. Did we overselect among businesses with corruption experiences, and underselect among those who worked successfully without making unofficial payments? We believe not. All those who refused to participate in this study indicated explicitly that they were afraid of discussing the issue of corruption during inspections. This is strong evidence that they too had corruption experiences.

Another approach to non-probability sampling is focus groups. This approach has also been used in IFC studies of the Ukrainian business environment. These involve informal discussions with groups of entrepreneurs concerning the major problems of business operation. . The advantages of such groups are synergetic effects, mutual influence, and interaction between respondents stimulating discussion. However, they usually produce only qualitative descriptions of the respondents' experience and their attitudes. In contrast, our respondents provide not only qualitative information but also quantitative characteristics. As each of our respondents was interviewed alone, their opinions were not influenced by others present. And their answers were given confidentially to one person only, not shared before an entire group.

Summarizing the approaches:

The focus group approach provides some insight into the problems of the business environment quickly and at low cost.

Surveying a small sample of entrepreneurs approached through informal networks provides a more detailed study of the actual practices of entrepreneurs. The narratives of entrepreneurs' experiences provide insights into how this market works. Furthermore, the survey is likely to provide better information on particularly sensitive issues like corruption

The large probability sample using standard surveying techniques is the best for quantitative studies of relatively neutral issues of business regulation. Measuring change over time requires that the behaviors and respondents' willingness to report them do not vary in opposite directions over time. Concerning the important issue of measuring change, using large random samples of respondents whose cooperativeness is questionable, it is possible to trace it if the degree of cooperativeness and attitudes to corruption remain the same over years. That is a particularly big problem if the actual practices differ dramatically from those entrepreneurs are willing to report. Are the reported changes reflective of actual changes or changes in the willingness to report? An improvement in the actual corruption environment could show up perversely as a decline if respondents become more forthcoming about reporting corruption in an improved environment.

Our sample description is given in Appendix 1. Fifty-six firms are included in the survey. We would have preferred a larger sample, but this survey does provide valuable numbers to compare with other estimates. It also provides an extended narrative on how the process works and for what reasons.

⁷ The costs per observation are also substantial. Locating potential respondents, traveling to each city to elicit cooperation, and undertaking the interviews required approximately 615 hours of time from the principal investigators.

4. The main findings

4.1. The types and frequency of inspections

67 % of the businesses surveyed underwent inspections by different government agencies in 2004 and 74 % in 2005.

The average number of inspections both in 2004 and in 2005 estimated for our sample is presented in Fig. 1.

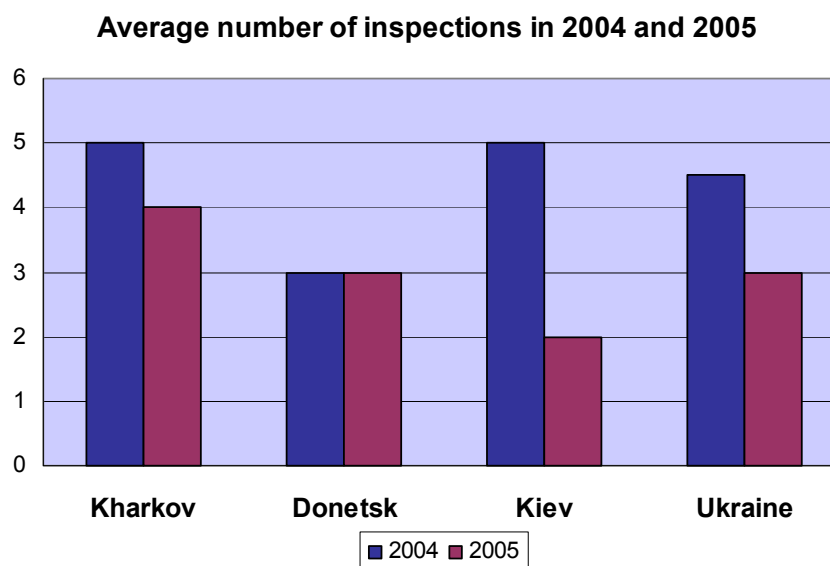


Figure 1⁸

As is seen from the figure, in 2005 the average number of inspections decreased in Kharkov and Kiev, while in Donetsk this number remained unchanged. It is necessary to trace the future dynamics of inspections to understand whether it is a long- or short-term trend. The lower number of inspections in 2005 may have resulted from the uncertainty as to the policy of the new regime immediately after the “Orange revolution”, changes in the legislation mentioned in section 1, which made the regulatory agencies restrain from inspections. Some respondents noted that there had been a period from January 2005 to May 2005, when the inspection burden was practically removed. To all appearances, the regulatory authorities did not know what to do and how to behave under the new regime. Despite the small size of the sample, the dynamics of the total number of inspections is definitely meaningful and reflects the actual situation with inspections in Ukraine in 2004 and 2005.

As far as Donetsk is concerned, the relatively small number of inspections in this city in 2004 is consistent with the findings of the IFC 2005 annual survey⁹ of the Ukrainian business environment, which show that the business environment in Donetsk in 2004 was the best in Ukraine according to the evaluations by local entrepreneurs.

It should be also noted that the average number of inspections in 2004 estimated in our survey was smaller than the number found in the IFC 2005 survey (5 and 9 respectively). This discrepancy may be connected with the fact that our study covered only 3 Ukrainian cities which are characterized by relatively more favorable local business conditions according to the IFC 2005 survey findings [3].

An important characteristic of inspections is their legitimacy. In Ukraine inspections represent a powerful mechanism of income redistribution to inspectors and to the regulatory agencies, which stimulates regulatory officials to use this mechanism as often as possible even beyond the limits of law. In this connection we asked the respondents to evaluate the legitimacy of the inspections conducted at their firms. Some respondents were not sure whether the

⁸ In all figures, by Ukraine we mean the data for the entire sample, i.e. for Kharkov, Donetsk, and Kiev altogether.

⁹ The survey was conducted in 2005 but it describes the state of the Ukrainian business environment in 2004.

inspection was legitimate or not. The inspection governing legislation is complex, and some respondents are unaware of their rights and the rights of the regulatory agencies to conduct inspections. They do not have enough time to go into details and follow constantly changing legislation governing inspections by different regulatory authorities. So, we had to do probing by asking respondents whether official acts on the results of inspections were drawn, whether the inspectors had a document giving them the right to inspect that particular firm, whether inspectors filled out the inspection log etc. In Figs 2 and 3, the percentages of legitimate and illegitimate inspections are presented.

Percentages of legitimate and illegitimate inspections in 2004

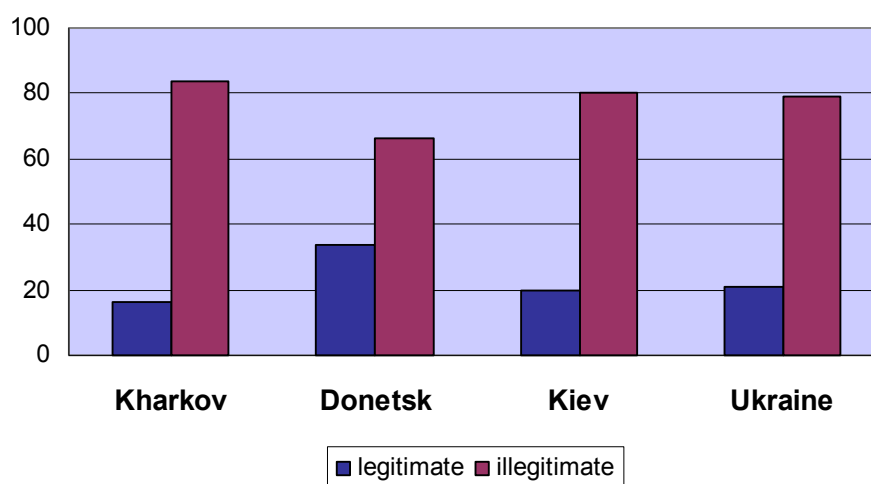


Figure 2

Percentages of legitimate and illegitimate inspections in 2005

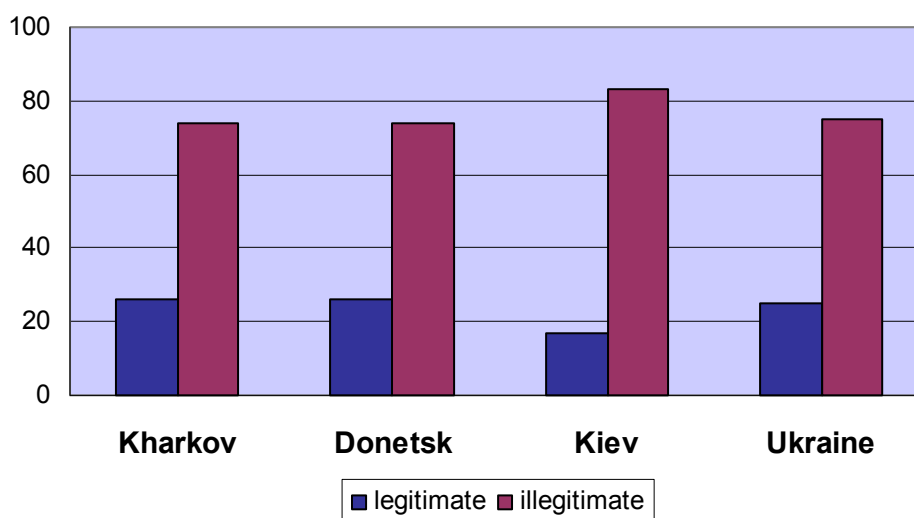


Figure 3

As is seen, over 75% of inspections were illegitimate both in 2004 and in 2005. In 2004, Donetsk was in better position from the point of view of the legitimacy of inspections. In 2005, there was no positive dynamics as far as the legitimacy of inspections is concerned, though the total number of inspections dropped.

In Figs. 4 and 5, the distributions of inspections by regulatory agencies are shown for the years 2004 and 2005. We show the total number of inspections by a certain regulatory agency for the whole sample (N = 56). The most frequent “visitors” in 2004 were tax administration, police,

tax police, and fire safety department. In 2005, the fire safety inspections occupied the leading position. The frequency of inspections by the tax administration, police and tax police decreased, which was to all appearances connected with the changes in the inspection governing legislation in the beginning of 2005 (see section 1), which limited the possibility for conducting unscheduled inspections by the tax authorities, and especially the tax police, without the court decision. Though this limitation lasted only till the end of March, the tax authorities and tax police became more cautious in interfering with business activities of firms in 2005. The fire safety inspections were not affected by the law which may account for the absence of any significant change in the number of fire safety inspections.

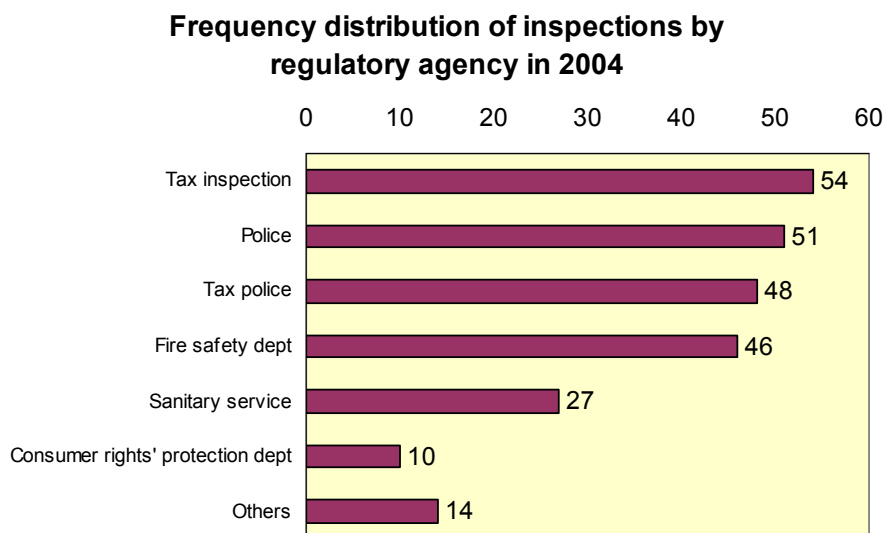


Figure 4

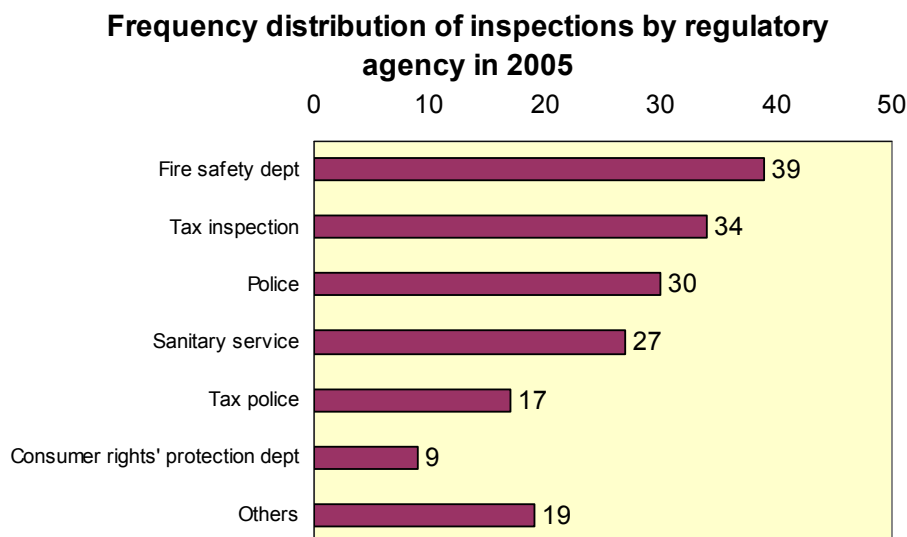


Figure 5

Let us compare our results with those of the IFC 2005 survey. As is seen from Figure 6, exhibiting the IFC 2005 survey data [3], the results agree to some extent. The tax administration, fire safety department and sanitary and epidemiological service are found among the most active inspecting authorities both in our and in the IFC survey. At the same time we did not register such an intensive inspecting activity of the Pension and Social Insurance Funds as was reported by the IFC, at least as far as on-site inspections are concerned. Our respondents regularly dealt and submitted accounts to the above mentioned Funds but were not inspected by them on-site. At the same time we found the police (the Ministry of Internal Affairs) to be more active inspectors than it was shown in the results of the IFC survey – according to our data approximately 30 % of the

respondents were inspected by the police in 2004, whereas according to the IFC survey data – only 10 %. One explanation is unwillingness of respondents to report their dealing with the police, taking into consideration usually illegitimate nature of the police inspections and explicit extortions of money during these so-called inspections.

The IFC 2005 survey data on the inspection activity of different regulatory agencies [3]

The Tax Administration, Fire Department, Pension Fund, and Sanitary and Epidemiological Service showed the most inspection activity in 2004

% of respondents inspected by the given authority in 2004

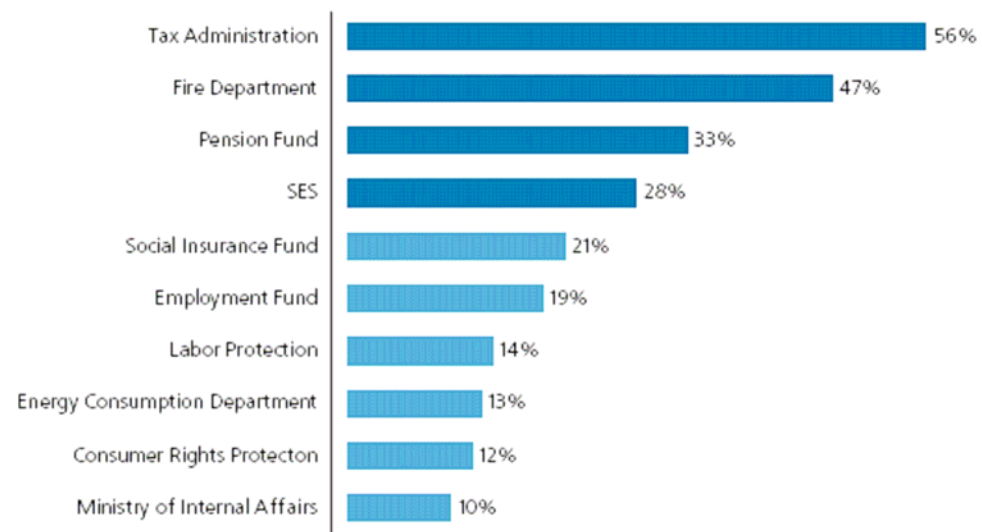


Figure 6

Some inspections are industry specific and their frequency depends on the sample structure by industry. For example, the department for consumer rights protection is a nightmare for retailers. So, the more retailers are in the sample, the higher the number of inspections by the consumer right protection department.

Inspections by the environmental protection department concern first of all businesses which are potentially harmful for the environment (in our sample it was a firm selling fuel). Such businesses are subject to regular inspections by the environmental protection department.

The number of inspections by the fire safety department and by the sanitary and epidemiological service depends upon whether the firm is the owner of its premises or it rents the premises. As a rule, if a firm rents the premises, it does not have to deal with the above mentioned regulatory agencies. It is the owner who deals with them. That's why the more firms from the sample own their premises, the larger the number of inspections by the fire safety department and the sanitary and epidemiological service will be reported.

It is very useful to compare the results of the large probability sample survey and the in-depth study with a small non-probability sample of respondents who are willing to share the details of their dealing with the regulatory authorities. The discrepancy in the results will help to identify potential sources of error, to refine questionnaires and to improve the survey administration.

4.2. The costs of inspections

One of the chief goals of our research was to estimate the costs incurred by businesses during inspections. Initially we tried to estimate both explicit monetary costs and opportunity cost of time spent on dealing with inspectors. However, the respondents often either found it difficult to recall exact amount of time spent on inspections, or considered this time insignificant, or had difficulties in expressing the spent time in monetary terms. That is why we confined our estimate to monetary sums and cost of gifts and services related to inspections.

We divide the inspection costs into three groups. The first is official payments – fines and other penalties. They are connected with income redistribution between the entrepreneur and the state (local) budget.

The second group of the inspection costs is so-called “voluntary contributions”. The beneficiary is usually the regulatory agency involved in the inspection not a particular official. In principle voluntary contributions can be considered as official payments. We isolate them in a separate group because unlike fines they are theoretically optional. For example, an inspector can ask an entrepreneur to subscribe to a newspaper or journal issued by the regulatory agency he/she represents or a fire inspector can ask an entrepreneur to render assistance to the local fire safety department by buying for them a fire extinguisher. Although no one is mistaken by the word “voluntary” even when contributions are asked for in the most polite way, however sometimes request for such contribution can take form of blatant extortion. Entrepreneurs usually consider it wise to make voluntary contributions when asked for to win benevolence and cooperation of the regulatory agency in question in the future.

The third type of inspection costs is unofficial payments. We deliberately avoid the word bribes here and tried to avoid this word during the interviews. Like corruption can be defined and understood broadly, especially by those who do not study it professionally, bribe is also understood differently by different respondents. In some cases there is no doubt either on our or respondents’ part that the unofficial payment they made was a bribe. For example when the police come with a view to check whether the software on the firm’s computers is licensed (in the vast majority of cases such inspections are illegitimate) and threatens the firm owner or manager to seal the computers and take them for the expertise, the owner/manager pays a bribe. However, our respondents often protested when we tried to call “a bribe” their different “gratitude payments”. For example, after a tax inspection is over, most entrepreneurs make a gratitude payment to tax inspectors (in our survey the size of such payments ranged from 17 USD to 400 USD). The entrepreneurs give the following explanations for making such payments: “we are satisfied with the sum of fine imposed on our firm”, “they (inspectors) have such low salaries, so I supported them out of sympathy”, “I just want to keep good relations with them”, etc. It is a part of culture in many countries to tip a waiter, taxi driver, hairdresser, etc, sometimes in the hopes for the future good treatment, sometimes out of tradition. Some of gratitude payments in business are very similar to tip, especially when they are small, given to insignificant clerks and without much hope to see them again.

There is also such a thing as postponed services. For example, in exchange for indulgent treatment of a firm during inspections some regulatory official may reserve “the right” to ask the firm about a favor. For example in our survey we had a respondent who was asked by his patron from the tax administration to give a lift from time to time, or to help with transporting some home appliances from a store. Another respondent owning a wood-processing shop reported that the police demanded him to repair and to make some pieces of furniture in return for indulgent treatment on their part.

Another illustrative example related to the treatment of unofficial payments by entrepreneurs. An owner of local mass media claims that he is not inspected at all due to the good relations with the local regulatory authorities. However, in return he places different announcements of the local administration, tax authorities, and police in his mass media free of

charge. At the same time he insists that it is not associated for him with any losses because he does not have too many paid announcements to compete with the free ones for space and time¹⁰.

In general, many entrepreneurs show tolerance towards corruption and even understanding when officials “behave modestly” and do not demand too much and too often.

The latter example with the mass media owner poses another problem: what should be included into the costs of inspections. It is a very important problem of methodology of measuring the costs of inspections. The thing is that payments made during inspections represent only the tip of the iceberg because some official and unofficial payments are made to prevent inspections or to minimize the costs of inspections. At the request of a regulatory agency or city administration an entrepreneur can make different voluntary contributions which are not directly related to inspections. But if the entrepreneur refuses to make the requested contributions he or she may become the first candidate for inspections, because inspections are often used as an instrument of putting pressure on business. An entrepreneur can also pay remuneration to an influential person or regulatory official for protecting his/her business from harassment by the regulatory authorities, for rendering advice or consultations, for acting as intermediary in settling conflicts related to inspection, etc. In some cases such payments are made on a regular basis. It is called “to put someone on the payroll”. For example, an entrepreneur can “put a fire inspector on the payroll”, i.e. to pay him monthly a small sum in exchange for not being harassed by inspections. When a powerful person who can influence the behavior of the regulatory authorities is “put on the payroll”, the sums paid can be rather large. It should be noted that respondents are very reluctant to tell about such payments to influential people, so one cannot count on precise estimates of these costs.

If for successful business operation and first of all for alleviating the burden of inspections it is necessary to establish and maintain good relations with the regulatory authorities, at least part of the costs of building and maintaining such relations can be also treated as inspection costs, although it significantly complicates the estimates of such costs. For example, a firm may report no inspections in a particular year. Does it mean that the inspection costs are equal to zero? Perhaps not, if the firm has the fire inspector on the payroll and financially supports a regulatory agency which can potentially conduct inspections at the firm. The following case illustrates this idea.

In 2003, a firm-wholesaler had multiple inspections by the fire safety department, the sanitary service, the tax police. In 2004, the firm owner decided to change the pattern of the interaction with these regulatory authorities, and paid a regular “salary” to the fire inspector (from 20 to 40 USD a month), to the sanitary inspector (from 20 to 40 USD a month) and the tax police (400 USD a month). As a result in 2004 the firm had no inspections by these agencies at all. Thus it is seen that small number or absence of inspections at a firm may reflect the fact that the firm owner managed to intimidate the hostile regulatory environment by making official and unofficial payments to right people and agencies. Such behavior can be treated as internalization of transactions with the regulatory authorities by organizing these transactions within the firm [8].

Thus when studying the costs of inspections, special attention should be paid to those respondents who did not have inspections, with a view to finding out whether some other payments have been made to the regulatory authorities or influential patrons to prevent inspections at the respondents’ firms. So, the definition of the inspection costs is still to be refined.

In our research we isolated the costs directly related to inspections, i.e. the costs incurred during inspections, and the costs related to establishing good relations with the regulatory agencies which may affect the frequency and costliness of inspections. In this paper we show only the direct costs of inspections but argue that direct costs underestimate the total costs of inspections.

¹⁰ We estimated that annually his favors to the local administration, police, tax authorities and fire safety department in the form of free announcements cost around 1000 USD.

Let us show it using an example of calculating the costs of a tax inspection incurred by a firm in 2004.

The firm in question is a limited liability company with the annual revenue 900,000 UAH / 180,000 USD. The company owners and management believe that it is cheaper to have good relations with the tax authorities and to make official and unofficial payments from time to time without trying to fight for their rights. The firm maintains long-lasting relations with one of the local tax inspectors. They give the inspector little gifts (flowers, chocolates, etc.) for the birthday and for some other holidays. The total sum of all those gifts does not exceed 100 UAH / 20 USD a year.

To make the time and the consequences of tax inspections fully predictable, the chief accountant of the firm invites this tax inspector herself when it is convenient for the firm. In 2004, she contacted the inspector and asked her to come with an inspection. The inspector arranged all necessary formalities for the inspection. The inspection was properly registered in the firm's log of inspections. The inspector did not have either to check any documents or to control the tax discipline. She knew that the chief accountant was very competent and fully trusted her. After some bargaining the inspector and the chief accountant agreed on the sum of the official fine (1,300 UAH / 255 USD)¹¹. The chief accountant decided herself what "violation" they would be fined for and made corresponding "mistakes" in the accounts. Then together with the tax inspector they prepared all necessary documents: reports, conclusions and inspection acts. After official part of the inspection was over, the tax inspector was given 400 USD for "strengthening the friendship".

Thus, we estimate the tax inspection costs incurred by the firm in 2004 cost at $(255+400) = 655$ USD. Note that we did not include the sum of gifts made during the year because these costs are not incurred during the inspection, although intuitively it is clear they are related to the inspection. Thus we show that direct expenses during inspections are an underestimate of the total inspection costs.

The approach used by the firm in question allows its owners and chief accountant to have things under control, to plan expenses in advance, and not to be afraid of being caught off guard by a biased unfamiliar inspector.

Fig. 7 shows how much the inspections cost the entrepreneurs from our sample in the years 2004 and 2005.

The costs of inspections in 2004 and 2005 (USD)

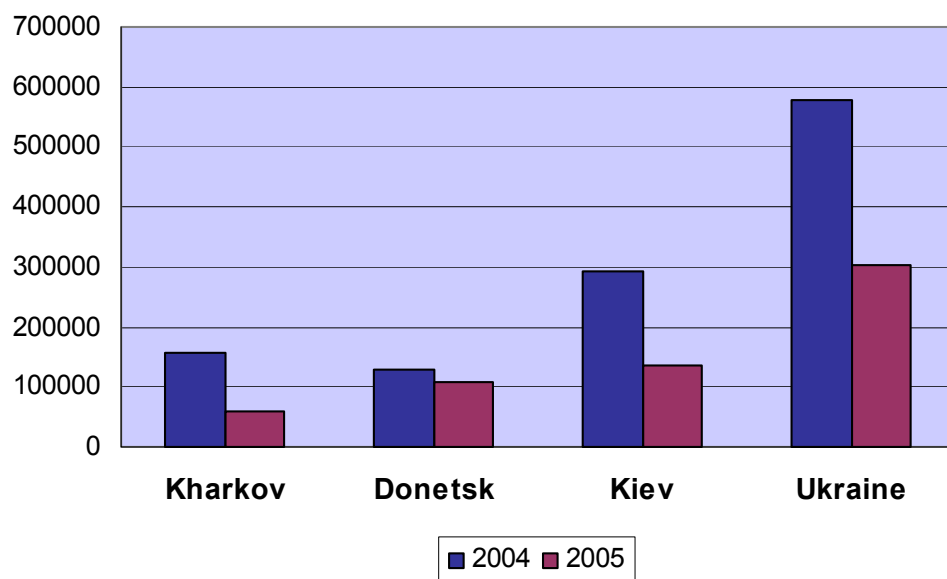


Figure 7

¹¹ The inspectors do not leave firms without a fine because they have quotas of fines – the plan they must fulfil.

It can be seen that despite the larger sample size and the larger number of inspections (Fig.1) the total costs of inspections are smaller in Kharkov both in 2004 and 2005. For all cities the decrease in the costs of inspections in 2005 is observed.

The diagram in Fig. 8 allows us to compare the total costs of inspections across cities. It presents the share of the inspection costs in the annual sales of the inspected firms. To calculate this share, we divided the total costs of inspections by the total sales of the firms that were inspected in the corresponding year and multiplied the result by 100 %. Figure 8 also clearly shows the positive dynamics in the inspections costs in 2005.

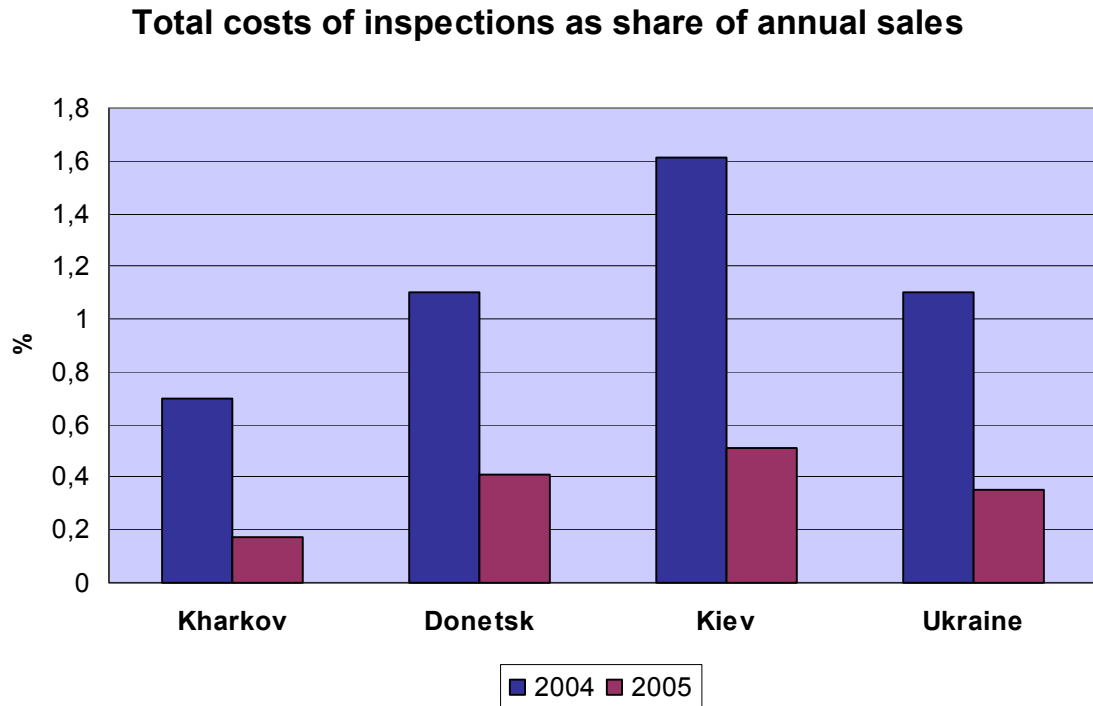


Figure 8

In Figs. 9 and 10 the distribution of the costs of inspections among different agencies is presented. The most costly are inspections by the tax police, police and tax inspection, both in 2004 and 2005. However, the magnitude of the costs related to inspections by these agencies decreased in 2005 (due to the decrease in the number of these inspections), and there occurred a certain redistribution of the costs among these agencies. In particular, in 2004 the largest contribution to the overall costs of inspections was contribution by the tax police. In 2005, it was the tax administration that accounted for the largest contribution to the total costs of inspections.

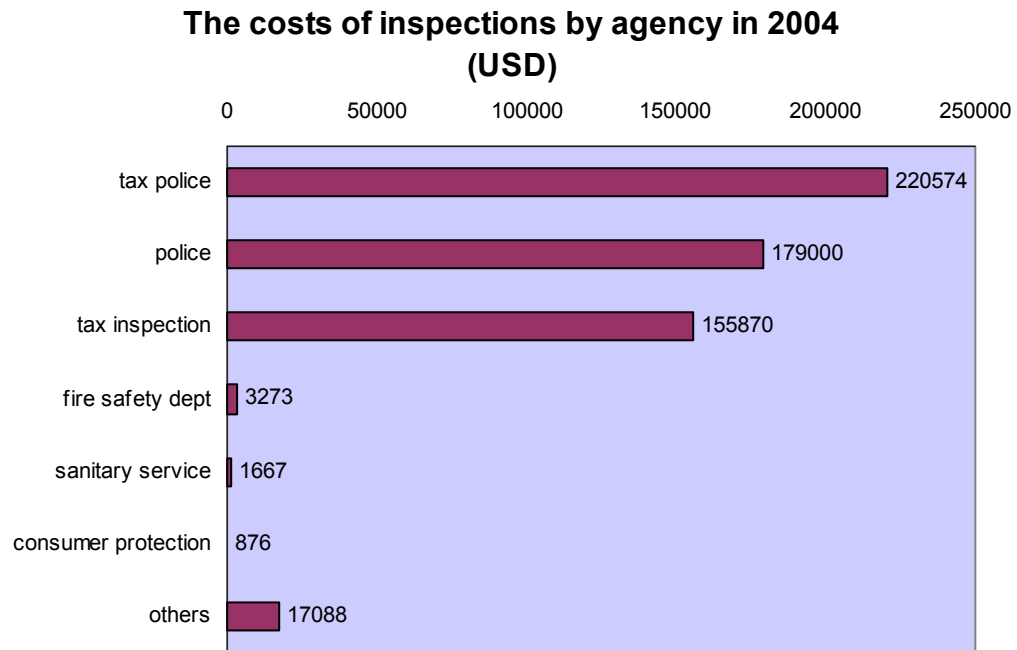


Figure 9

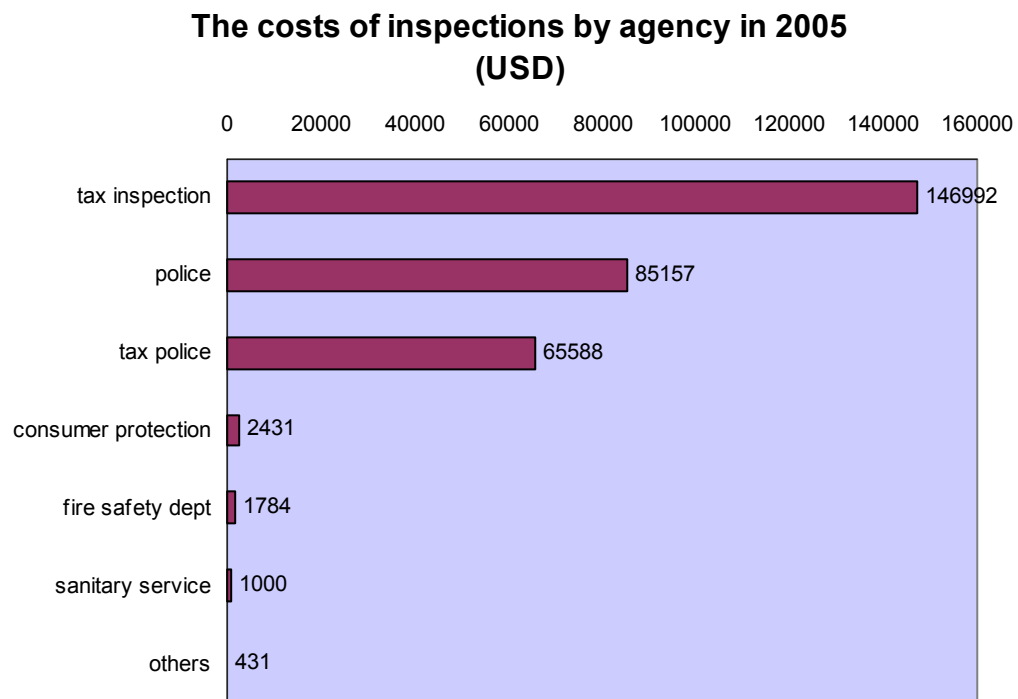


Figure 10

We also estimated the relative shares of official and unofficial payments and voluntary contributions in the total costs of inspections (Figure 11).

The structure of the inspection costs in 2004 and 2005

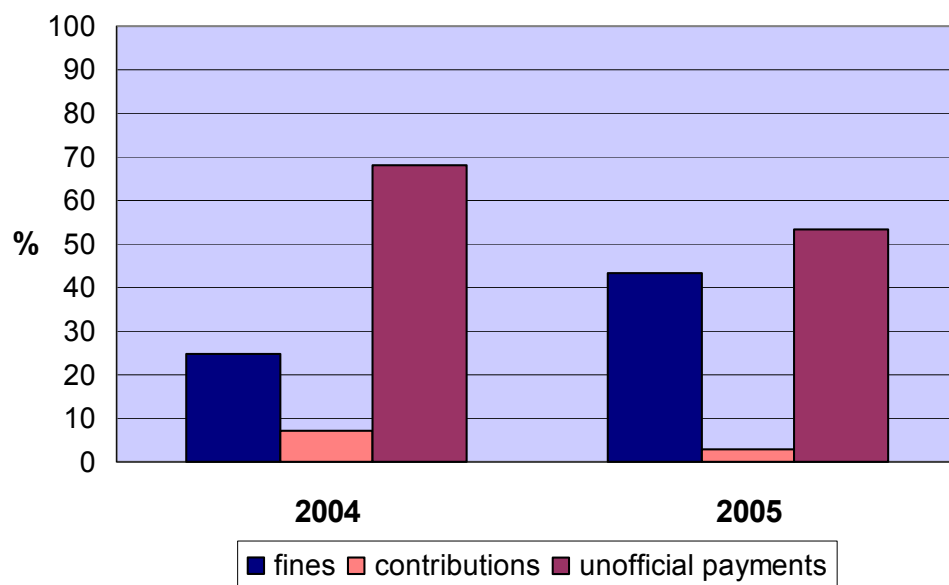


Figure 11

As is seen, unofficial payments constituted the largest part of inspection-related costs both in 2004 and in 2005. In 2005, the share of unofficial payments in the total costs of inspections somewhat dropped.

Figures 12 and 13 show the shares of official and unofficial payments to the regulatory agencies, whose inspections are the costliest for businesses, i.e. to the tax police, police and tax inspection, for the years 2004 and 2005 respectively.

The shares of official and unofficial payments in the costs of inspections in 2004 (%)

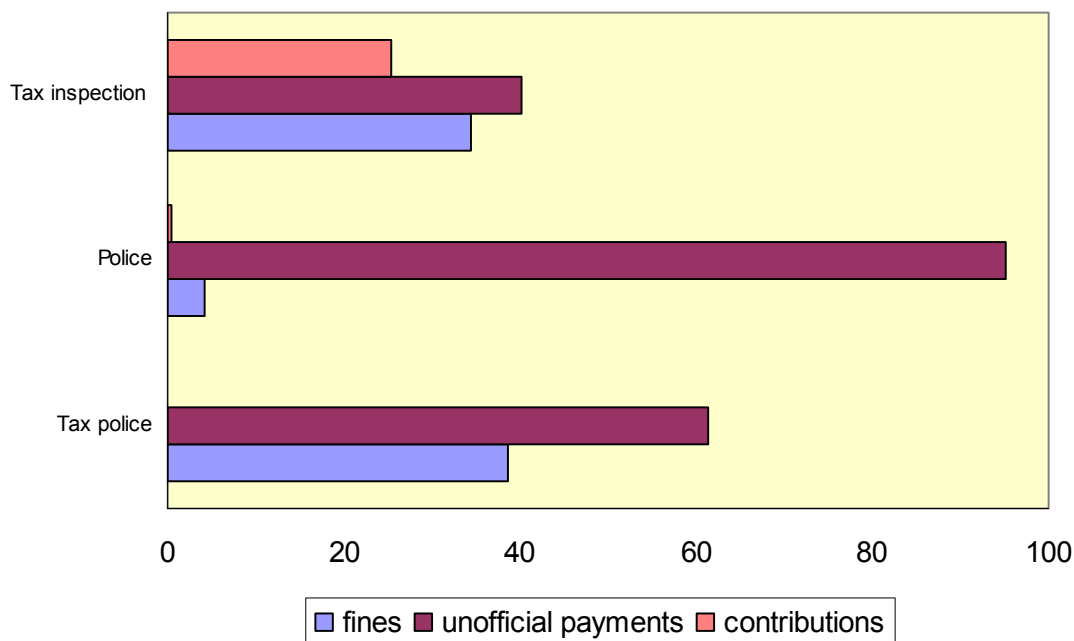


Figure 12

The shares of official and unofficial payments in the costs of inspections in 2005 (%)

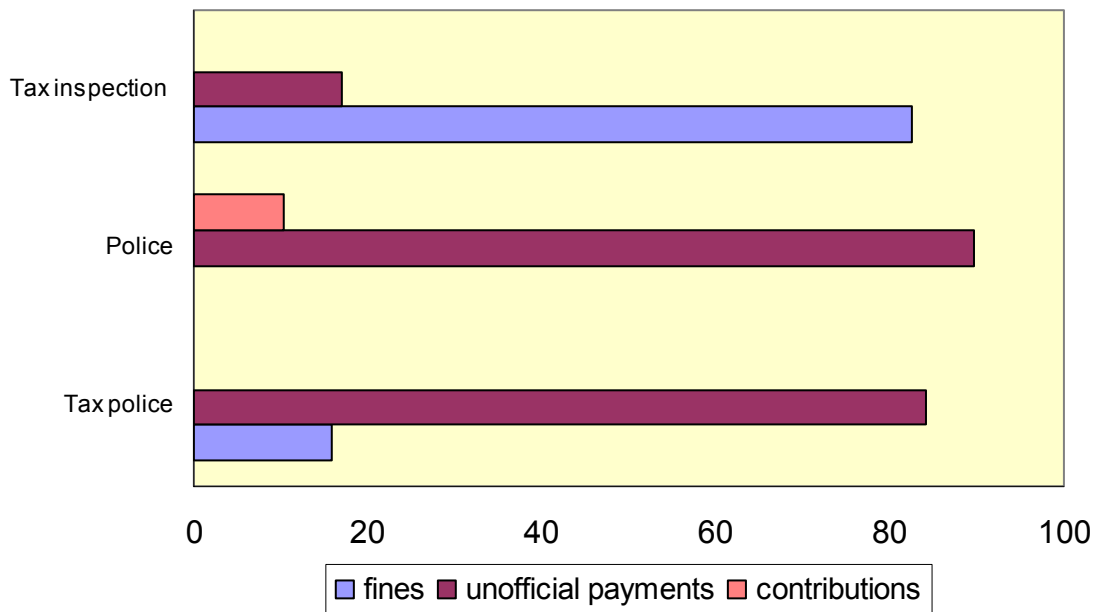


Figure 13

One of the primary goals of inspections by the tax authorities and tax police is to extract missing payments to the state budget. However, in 2004, the share of fines (official payments to the budget) imposed by these two agencies constituted 37 % in the total costs of inspections, whereas the share of unofficial payments was as large as 53 %. The rest (10 %) were voluntary contributions intended to support these particular agencies. In 2005, the corresponding shares were the following: official fines – 63 %, unofficial payments – 37,8 %, contributions – 0,2 %. Thus, in 2005 the share of official payments became significantly higher, i.e. redistribution to the state increased compare to redistribution to inspectors. However, it is the tax authorities that account for this change in direction of redistribution because the contribution of the tax police in terms official payments was much smaller.

It can also be seen that inspections by the police make the least contribution to the state or local budget in the form of fines. The redistribution resulting from such inspections is almost exclusively to the benefit of inspecting officials. The large amounts of unofficial payments testify for the ineffectiveness of inspections taking into account their initial purpose.

One of the most important results of our study is the measurement of the corruption incidence during inspections, which clearly demonstrates that the sampling procedure significantly affects such measurement. According to our study, the incidence of unofficial payments during inspections for our sample in 2004 was as high as 86 % (i.e. 86 % of inspected firms had to make unofficial payments)¹², while in the results of the annual 2005 survey of the Ukrainian small and medium enterprises conducted by the International Finance Corporation it was reported that only “one-fifth of respondents whose businesses were inspected admitted making unofficial payments to inspectors” [3]. So, our number is at least three times as high as that reported by the IFC. We explain the gap by the difference in the degree of sincerity of the respondents in our study and in the IFC survey. We dealt with cooperative respondents approached through the informal networks, and we believe 86% is an underestimate in that all the non-respondents declined to be interviewed for “confidentiality” reasons, whereas the IFC dealt with a large probability sample whose cooperativeness in the study of the sensitive issues could be questioned a priori.

¹² In 2005, the corruption incidence during inspections was 72 %.

A similar situation was observed in the INDEM Foundation studies of corruption in Russia [9]. When asked directly about giving a bribe to a government official, 22 % businessmen answered that they had never done that, and more than one third of them answered that they did not understand what the interviewer was talking about. However through a number of indirect questions researchers estimated the corruption incidence at 84 %. This result was viewed as rather reliable and, by no means, an overestimate.

To support our hypothesis regarding the advantages of the non-probability sampling used in this work for studying corruption issues, at the end of each interview we asked our respondents whether they would share the same information with an unknown interviewer. The answer was negative in 100 % of cases. The most common reasoning was the following: i) "How do I know who that person is and what he/she will do with such information? The information is strictly confidential and not to be disclosed to strangers. I share it with you because I know you and trust you", ii) "I am not interested in participating in such surveys. If it were not you, I would not agree to answer questions", iii) "With an unknown interviewer I would discuss general issues and complain about the business climate without giving any specific information about my business".

4.3. The patterns of behavior and strategies used during inspections

To better understand what causes high incidence of corruption in the process of inspections, it is necessary to study the strategies of behavior of both parties during inspections and motivation behind these strategies.

As one of our respondents put it, the behavior of different regulatory authorities is similar:

Step 1. To find some insignificant, non-principal violation of laws, rules, instructions, etc.

Step 2. To exaggerate the importance of that violation, presenting it as a serious crime.

Step 3. To propose to pay a ridiculously large fine.

The strategy used most frequently during inspections both by the regulatory officials and entrepreneurs is bargaining. Bargaining concerns the sums of official payments, which are at inspectors' discretion, sums of voluntary contributions and unofficial payments. The bargaining strategy better works for entrepreneurs in dealing with the fire safety department, sanitary and epidemiological service, and tax authorities. In case of dealing with the tax police and police, entrepreneurs sometimes seek assistance of an influential person who can put pressure on the inspectors. Their counterparts from these two agencies usually use the threatening strategy.

Conversely, the strategy of seeking assistance of an influential person is used very seldom during inspections by the fire safety department, sanitary and epidemiological service and tax inspection.

When pressure exercised by the regulatory authorities becomes unbearable, entrepreneur may change the strategy. One of our respondents, an owner of a chain of stores selling home appliances (the annual sales are 3.5 mln UAH / 690,000 USD), had to change his strategy in dealing with the consumer right protection department. However, before we discuss the change in his strategy, let us briefly describe the specificity of inspections conducted by that department.

According to the observations of our respondents who dealt with the consumer right protection department and taking into consideration a high incidence of unofficial payments during inspections by this department (in 2005 unofficial payments were made in 100 % of cases), the consumer right protection is not the highest priority for inspectors who use their position for improving personal well-being. On the other hand, perhaps indirectly these inspections have a disciplining effect on retailers, at least to some extent, because the retailers try to minimize possible violations and thus to minimize the sum of unofficial payments. The inspectors from the consumer right protection department use standard pretexts for inspections: usually they come either to investigate someone's complaint or to make so-called controlling purchase. Then, it is a matter of skills to find fault with the seller. Typical violations are the following: the certificate is not translated into Ukrainian; a price tag is absent (one of the respondents said that often they purposefully drop the tag on the floor or steal it), etc. Certainly the attitudes of respondents to

inspectors are often biased, however this simple example about the price tag shows the potential vulnerability of entrepreneurs in such inspections.

Now we are coming back to the case of the home appliances seller, who believes that meeting all possible legal requirements is difficult if not impossible and may significantly affect his business profitability. That is why he looks for some compromise between the degree of meeting the requirements and the amount of unofficial payments to inspectors. So, the seller of home appliances paid the inspectors from the consumer right protection department approximately 3,000 UAH / 600 USD a year in 2004 and 2005, and they left him alone. However, in 2006, they tried to impose on his firm a fine of 36,000 UAH / 7,000 USD. To avoid the fine, he paid 2,000 USD unofficially. Then he turned to some influential people, and they promised to protect him from the “obtrusive attention” of the department for the protection of consumers’ rights.

It is interesting to note that such strategies as resistance and defending one’s rights, appealing to court, turning to public prosecutor’s office or to the internal security of the regulatory agency are practically not used at all, though as was shown in section 4.1, most of inspections by the regulatory authorities are illegitimate. Even being aware of illegitimacy of the inspection, business owners or managers often prefer to settle the problem peacefully (making some unofficial payment) instead of conflicting with the regulatory officials. A short-term victory may have unpleasant long- (and not so long-) term consequences. A Ukrainian entrepreneur can always be found guilty because of imperfect legislation, unfeasibility of many requirements and high discretionary power of regulatory officials.

For example, one of the respondents, who was inspected by the police, decided to defend her rights in court. The litigation lasted for 45 days, and in accordance with the court decision she had to pay a fine as large as equivalent of US\$ 3000. Today she says that she would never make this mistake again. If she had not tried to defend her rights in court, it would have cost her US\$ 300 – the amount of unofficial payment demanded by the inspectors.

Another respondent reported the following experience. His firm had a minor conflict with an employee of the Pension Fund. To revenge, the employee contacted the public prosecutor’s office and informed them about 2-month wage arrears at the firm (the firm was newly created, and the wage arrears were explicable). So, the firm was inspected by representatives of the public prosecutor’s office together with the police. By the moment when the inspection came, the firm had already liquidated all wage arrears. However, the inspectors started to look for other possible violations and threatened to impose a large fine on the firm for using the non-licensed software. The firm made unofficial payment of 500 USD to solve this problem. Thus, the minor conflict with the employee of the Pension Fund cost the firm 500 USD. It should be mentioned that after leaving the firm in question, the inspectors stopped by at another firm (next door) and extorted unofficial payments from it too, also for using the non-licensed software, though they had no official right to inspect that firm.

Perhaps such negative experiences account for the timidity of a large number of entrepreneurs and their accepting the rules of the game dictated by the regulatory authorities. The major problem here is that entrepreneurs view inspectors not as single officials whose actions can be challenged and who themselves can be punished for law violations. Entrepreneurs often consider inspectors as a part of the system which can hardly be fought. At least fighting this system may come too costly. The most principal and self-confident entrepreneurs try to actively resist, for example by suing the regulatory authorities, most frequently tax administrations, and winning in court. But the vast majority does not want to divert resources from business activities and seeks for cost-minimizing ways.

One of such ways is maintaining good relations with the regulatory agencies and making connection among the officials. Many respondents stressed that to do business successfully, a firm must create a friendly environment by establishing informal relations with the regulatory authorities. One of the respondents said that usually after inspections they exchange telephone numbers with inspectors so that the firm could contact them for consultation or for assistance if

the firm gets some problem with their agency. At the same time avoiding conflicts with the regulatory authorities, the firm must always bargain when making unofficial payments, otherwise it runs the risk to become a cash cow for greedy officials.

4.4. The factors affecting the frequency and costs of inspections

Although inspections represent a barrier for practically all Ukrainian businesses, the burden associated with inspections can be different for different businesses. As was already mentioned, some inspections are industry specific. For example, cafes and restaurants are inspected by the sanitary and epidemiological service much more frequently than other types of businesses. Wood-processing shops must be ready to have more frequent and more rigorous inspections by the fire safety department. Inspections by the consumer right protection department are a serious burden for retailers.

Inspections by the tax authority are common for all businesses, however, some of firms attract more attention of this agency. As the most common ways of tax evasion in Ukraine are hiding profits and showing very low salaries on the payroll (and paying the most of the salary unofficially “in the envelope”), the firms showing in tax accounts negative profits and salaries lower than the minimum specified by law become the objects for inspections by the tax authorities more frequently as potential tax evaders.

Special attention is also paid to firms-exporters. The major goal of inspecting such firms is to check whether they are really entitled to the demanded reimbursement of value added tax (VAT). There are quite a few firms in Ukraine that cheat with the VAT reimbursement. As a result VAT is returned to them unduly, in the absence of corresponding export activities.

The system of taxation chosen by a business also affects the costs of tax inspections. Firms and private entrepreneurs-physical persons¹³ which use the simplified system of taxation (see section 1) have much lower costs related to the inspections by the tax authorities. The activity of firms or entrepreneurs using the simplified system of taxation turns out non-transparent for the tax authorities. Due to very simple procedures of filing taxes it is more difficult for tax inspectors to find some fault with such firms or entrepreneurs and find a pretext for official fines. Besides the revenues of such firms are small, so tax inspectors cannot count on large payments whether official or unofficial. It should be noted that many owners of firms in Ukraine resort to the following practice: they register one or more private entrepreneurs-physical persons using the simplified system of taxation as satellites to their main firm. They divide operations between the main firm and satellites in such a way which would allow them to minimize taxes. For example, the simplest, the most transparent and the least profitable operations can be realized through the main firm using the general system of taxation, while less transparent and the most profitable activities are realized through the private entrepreneurs.

In our study we tried to reveal additional factors that may facilitate the inspection procedures for the firms. For the beginning we asked the respondents about the relative complexity (easiness) of inspections for their firms compare to other firms of the same size and from the same industry. Figure 14 shows the distribution of answers to this question.

¹³ There are two alternative forms of the business registration in Ukraine - registration as a private entrepreneur (physical person) and registration as a legal entity. The latter in turn can be realized in different organizational forms: a private firm based on single proprietorship, limited liability company, full liability company, additional liability company, differentiated liability company, open and closed joint stock companies and so on.

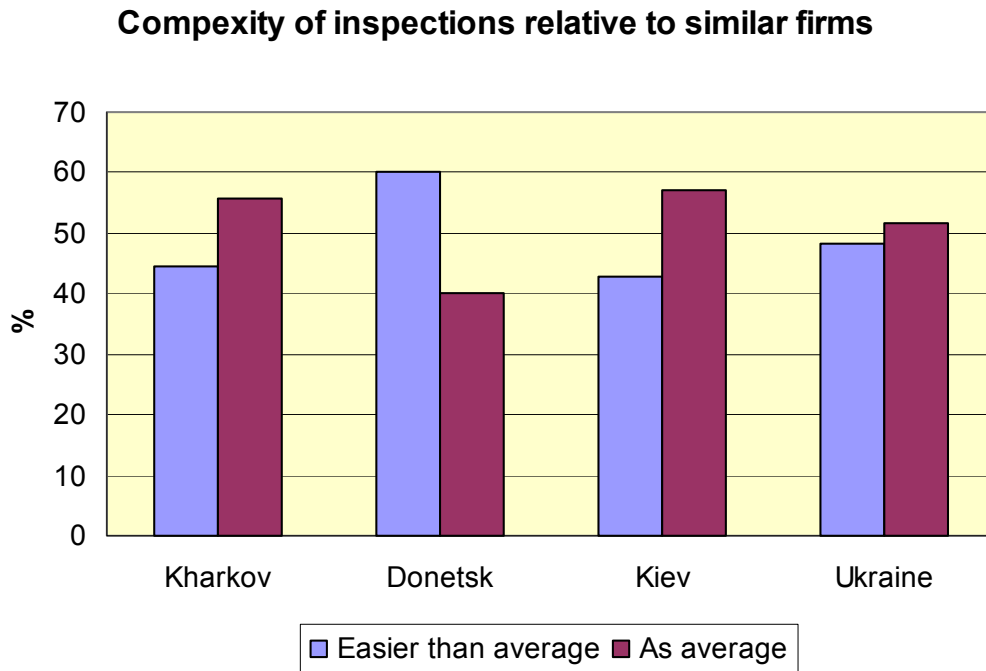


Figure 14

No one answered that their experience with inspections was more difficult than on average. The ratio of those who believed that their experience was easier than average to those who evaluated their experience as average is approximately 50:50. Among the factors that help very much in the process of inspections, 86 % of the total number of respondents mentioned strong ties in the city (75%, 93 % and 91 % in Kharkov, Donetsk and Kiev respectively); 55 % - connections in political circles (35 %, 73 %, and 66 % in Kharkov, Donetsk and Kiev respectively). In fact strong ties in the city and connections in political circles may just protect businesses from inspections. However such protection may be not free of charge. 57 % of the respondents named past experience related to inspections as a factor that helps during inspections (40 %, 60 %, 83 % in Kharkov, Donetsk and Kiev respectively). Many respondents emphasized that they learned the rules of the game from their past experience and had already established connections with some regulatory officials.

91 % of the total number of respondents said that the membership in business associations does not help in any way. This result is consistent with the data of the IFC 2005 survey according to which 80% of business proprietors surveyed did not feel that business associations were capable of defending their rights [3]. The same attitude to business associations was revealed in the studies of corruption in Russia conducted by the INDEM Foundation [10].

One of our respondents additionally mentioned that businesses that keep low profile - no office or office without any conspicuous entrance, plate with the name of the firm, etc. - attract much less attention of the regulatory authorities, especially of the police, than those which cannot hide because of their specificity (restaurants, stores, etc.) or want to look solid both outside and inside.

The inspection costs may be lower in some special cases, for example for businesses located in metro stations. They are not inspected by the police, fire inspector, sanitary inspectors, etc. because metro has its own infrastructure whose representatives do not pester businessmen with inspections and do not extort money. However, the unofficial entrance fee for the possibility to locate one's business in metro can be rather large.

Conclusions

Measuring the magnitude of barriers to business development accurately in terms of the costs of doing business is very important for developing effective regulatory policies and

monitoring the results of their implementation. However, these costs are difficult to measure accurately when businesses are heavily involved in corruption activities but fear to admit this involvement or to disclose the size of their unofficial payments.

In Ukraine, the costs of business inspections by the regulatory authorities constitute a significant share of the overall costs of doing business there. Because those inspections are associated with extensive corruption, we need to find ways to measure inspection costs which yield reasonable accuracy.

We study a small sample of business respondents located through informal networks. They report a much higher incidence of corruption during inspections than does a large probability sample of business respondents surveyed by the IFC. Our survey also permits us to study the behavior of both parties involved in inspections in greater detail.

We also examine issues concerning the definition of inspection costs. We argue that if one counts only the direct payments during the inspection, this will yield an underestimate of the real inspections costs. We argue for including payments made at other times, either to prevent inspections or to lower their frequency and costs. However, the definition is still to be refined.

We also suggest that making unofficial payments on a regular basis to potential inspectors or to those who can influence the regulatory authorities' behavior, with a view to preventing inspections, can be considered as behavior to minimize the costs of transacting with regulatory authorities by organizing corresponding transactions within the firm.

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THE SAMPLE DESCRIPTION

Table 1 – The sample structure by city

City	Number of businesses surveyed	Percentage of businesses surveyed, %
Kharkov	27	48
Donetzk	15	27
Kiev	14	25
N=56		

Table 2 – The sample structure by gender

Gender	Number of respondents	Percentage of respondents, %
M	35	62
F	21	38
N=56		

Table 3 – The sample structure by age

Age	Number of respondents	Percentage of respondents, %
Below 28	8	14
28 – 34	15	27
35 – 39	11	20
40 – 44	9	16
45 – 50	7	12
Above 50	6	11
N=56		

Table 4 – The sample structure by the level of education

Education level	Number of respondents	Percentage of respondents, %
Secondary	7	13
Higher	47	84
PhD	2	4
N=56		

Table 5 – The sample structure by industry

ISIC Rev.3.1 (International Standard Industrial Classification of All Economic Activities)

#	Industry	Code	Number of businesses
1	Processing and preserving of fruit and vegetables	D1513	1
2	Manufacture of vegetable and animal oils and fats	D1514	1
3	Manufacture of bakery products	D1541	1
4	Distilling, rectifying and blending of spirits; ethyl alcohol production from fermented materials	D1551	1
5	Manufacture of wearing apparel, except fur apparel	D1810	3
6	Service activities related to printing	D2222	1
7	Treatment and coating of metals; general mechanical engineering on a fee or contract basis	D2892	1

8	Manufacture of pumps, compressors, taps and valves	D2912	1
9	Manufacture of lifting and handling equipment	D2915	1
10	Manufacture of instruments and appliances for measuring, checking, testing, navigating and other purposes, except industrial process control equipment	D3312	4
11	Building of complete constructions or parts thereof; civil engineering	F4520	2
12	Building installation	F4530	1
13	Maintenance and repair of motor vehicles	G5020	1
14	Wholesale of food, beverages and tobacco	G5122	1
15	Wholesale of other household goods	G5139	6
16	Wholesale of solid, liquid and gaseous fuels and related products	G5141	1
17	Wholesale of metals and metal ores	G5142	1
18	Wholesale of construction materials, hardware, plumbing and heating equipment and supplies	G5143	1
19	Wholesale of computers, computer peripheral equipment and software	G5151	1
20	Other wholesale	G5190	2
21	Retail sale in non-specialized stores with food, beverages or tobacco predominating	G5211	2
22	Retail sale of textiles, clothing, footwear and leather goods	G5232	2
23	Retail sale of household appliances, articles and equipment	G5233	2
24	Retail sale of hardware, paints and glass	G5234	1
25	Other retail sale in specialized stores	G5239	7
26	Restaurant	H5520	2
27	Activities of travel agencies and tour operators; tourist assistance activities n.e.c.	I6304	1
28	Activities auxiliary to financial intermediation n.e.c.	J6719	1
29	Software publishing	K7221	1
30	Accounting, bookkeeping and auditing activities; tax consultancy	K7412	1
31	Business and management consultancy activities	K7414	1
32	Motion picture and video production and distribution	O9211	2
33	Hairdressing and other beauty treatment	O9302	1

Table 6 – The sample structure by business organization form

Business organization form	Number of businesses surveyed	Percentage of businesses surveyed, %
Private entrepreneur – physical person (single tax)	10	18
Limited liability company	2	4
Limited liability company with satellites - private entrepreneurs-physical persons	35	62
Private firm	2	4
Joint stock company	4	7
Unlimited liability company	3	5
N=56		

Table 7 – The sample structure by the number of employees

Number of employees	Number of businesses surveyed	Percentage of businesses surveyed, %
Below 10	22	40
10 – 20	18	32
21 – 40	9	16
Above 40	7	13
N=56		

Table8 – The sample structure by the volume of annual sales (average volume for 2003 – 2005)

Sales volume, USD	Number of businesses surveyed	Percentage of businesses surveyed, %
Below 200,000	22	39
From 200,000 to 600,000	13	23
From 600,000 to 1,200,000	4	7
From 1,200,000 to 2,000,000	7	13
From 2,000,000 to 6,000,000	4	7
Above 6,000,000	6	11
N=56		