

Background paper prepared for the World Development Report 2005

## **Case Study: Inspectorate Reform in Latvia 1999-2003**

Jacqueline Coolidge  
Lars Grava  
Sanda Putnina

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### **Abstract**

This background paper reviews the reform of the state inspections system in Latvia from 1999 through 2003. The aim of the case study is to illuminate the political and institutional reform elements and the intricate day-to-day management of such public sector reform endeavors, and highlight the mechanisms and management tools that are transferable and could be applied to similar reform efforts elsewhere.

The views expressed are those of the authors and do not necessarily reflect official views of the World Bank.

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**Abbreviations**

ARCS	Administrative and Regulatory Costs Survey
BPAR	Bureau of Public Administration Reform
CM	Cabinet of Ministers
FIAS	Foreign Investment Advisory Service
FICIL	Foreign Investors' Council in Latvia
GoL	Government of Latvia
LDA	Latvian Development Agency
PSAL	Programmatic Structural Adjustment Loan

## **Case Study: Inspectorate Reform in Latvia, 1999 – 2003**

### **Executive Summary**

Latvia began a comprehensive reform of government inspectorates in 1999, in the context of a broader program for removal of administrative barriers to investment. In 1998, both the World Bank's corruption survey, and the study of administrative barriers to investment carried out by the Foreign Investment Advisory Service found that government inspections caused substantial problems for businesses, including disruption of their business activities, risk of possibly severe sanctions, and corruption.

Most government inspectorates tended to operate with a "control mentality," focusing on enforcing government regulations (however arbitrary), discovering infractions, and assessing fines or other sanctions (e.g., freezing bank accounts, seizing equipment, or even forcing a business to suspend production).

In 1999, the Government of Latvia entered into a formal process of dialog with representatives of the business community, and agreed on reform of the various inspectorates (*inter alia*) as a high-priority item that were included in an Action Plan adopted by the Council of Ministers in May 1999.

Subsequently, in negotiations between the Government of Latvia and the World Bank for a new Structural Adjustment Loan, the former proposed that some items from the Action Plan, including reform of the inspectorates, be included as conditionality. The World Bank agreed, which served to reinforce the importance of this set of reforms, and also led to increased resources (both domestic and international) being devoted to the effort.

The reform program included:

- A new "instruction" on the rights and responsibilities of government inspectors vis-à-vis inspectees (particular private sector businesses);
- Increased information available to businesses about the inspection process in general and about each specific inspection in particular;
- A requirement for written inspection reports after all inspections;
- Formation of an Inspection Coordination Council
- Training for inspectors in how to develop a "client orientation" to their work;
- Development of performance indicators in several key inspectorates

Most of the above reforms were implemented in 2000 and 2001. At the end of 2001, a business survey of administrative and regulatory costs found that most businesses no longer considered government inspections to be a serious obstacle. A series of "templates" filled out by each of the main inspectorates showed that several of them were able to supply detailed data for purposes of monitoring performance in terms of the mandates of the respective institutions (e.g., reductions in work-place accidents, illnesses and fires) and of efficiency (e.g., ratio of inspectors to inspectees). They also

have data about the number sanctions imposed, number of appeals, outcomes of appeals, etc. **[More data from Dec. 2003 survey to be added]**

At least two of the most progressive inspectorates can now document that they are achieving improved outcomes (e.g., fewer workplace accidents) with the same resources.

The success of the national-level inspections reform program can also be contrasted to the lack of such a program for municipal level inspections (primarily municipal police inspections). Survey data from the 2001 business survey showed that municipal police inspections were still a significant source of complaints from businesses, including harassment and extortion of bribes. The municipal police in Riga have now pledged to implement a reform program modelled on the national program.

Thus we can conclude that the inspectorate reform program has been largely successful so far, in terms of maintaining and improving the Government's goals of safeguarding public health, safety and the environment while reducing the associated costs and risks imposed on businesses.

These reforms are noteworthy because most transition and developing countries have found it very difficult to implement a coordinated reform program of this nature across a range of different agencies. In the case of Latvia, they appear to have benefited from the following circumstances and measures:

- A consensus across most political parties to accelerate reforms in order to join the European Union;
- Elections bringing in a new government immediately after the World Bank and FIAS reports, which was not embarrassed by the reports, was interested in solving the problems identified, and was led by the Prime Minister as "Champion" of the reform effort;
- A strong, well-organized, and constructive private sector ready to contribute to the effort of designing the reforms and cooperating with their implementation and monitoring; and
- A strong and active layer of "technocrats" in government who maintained continuity as governments changed, provided critical intellectual input from within government, and willingly handled all the details of the reform process.

Over a five-year period, it is clear that the key inspectorates affecting businesses have evolved towards a "compliance orientation", focussing on helping their "clients" to understand government requirements and to live up to them. The reforms are continuing, with regular monitoring to assess performance and to revise the Action Plan regularly to keep it on track and effective in delivering needed improvements.

## **Case Study: Inspectorate Reform in Latvia, 1999 – 2003**

This background paper reviews the reform of the state inspections system in Latvia from 1999 through 2003. The aim of the case study is to illuminate the political and institutional reform elements and the intricate day-to-day management of such public sector reform endeavors, and highlight the mechanisms and management tools that are transferable and could be applied to similar reform efforts elsewhere.

### **A. Reform Context**

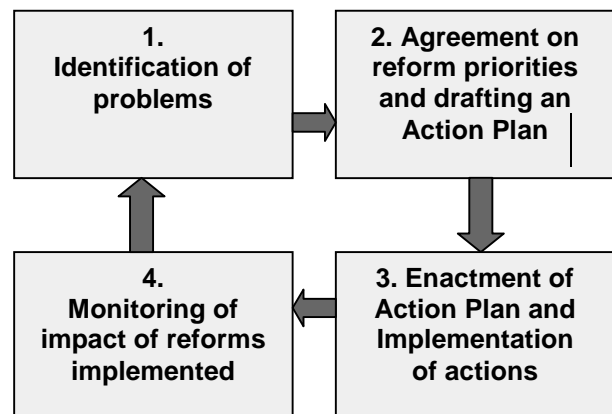
This section first outlines the background of the inspectorate reform and then proceeds to discuss the pre-reform situation and how the inspectorate reform efforts originated.

#### **I. Broad Government Program for Improvement of Business Environment**

The reform of state inspections system took place in the context of broader government-wide efforts to improve the investment climate by identifying and reducing administrative barriers to investment.

Latvia has implemented an effective and sustainable mechanism to identify and reduce administrative barriers to investment through the process of structured dialogue among stakeholders that follows a “cycle of reform” consisting of:

- 1) systemic identification of problems;
- 2) structured dialogue between government and business community to agree on priorities for reform and draft an Action Plan;
- 3) adoption of the Action Plan and implementation of necessary reforms by policy-makers;
- 4) ongoing monitoring of the business environment and assessment of the impact of reforms.



The targeted reforms of the business environment that started in 1999 have produced tangible changes and have also been noted by the business community and a number of international organizations for their innovative nature and effectiveness<sup>1</sup>. The most

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<sup>1</sup> The European Commission’s Annual Reports on Latvia’s Progress Towards Accession since 1999 and onwards have consistently praised the “serious efforts of Latvia to improve the business climate”. The European Commission’s Directorate General of Enterprise awarded these reform activities “CC BEST” status, meaning that the policy of Latvia in this area is an example for other EU candidate countries for improving their competitiveness. And the World Bank – and in particular its FIAS

significant results since 1999 have been achieved in improving government inspections, as well as enterprise registration, tax administration, customs and border-crossing, construction, real estate and expatriate residency.

The key element and operational expression of the cycle of reform in general and these reforms specifically is a legal instrument: the Government-adopted Action Plan for Improving the Business Environment. The Action Plan is an inter-ministerial planning document established first in 1999 and updated regularly, which summarizes:

- (a) the problems expressed by businesses,
- (b) the specific tasks to be undertaken in order to solve the problems, agreed to in structured dialogue between public and private sector technical experts,
- (c) the institutions responsible and
- (d) implementation deadlines.

The Action Plan includes amendments to legal acts, revision and simplification of procedures, improvement of coordination between different institutions, preparation and publication of information as well as training of state officials. The Plan is a "living document," as it is regularly updated to include new items and removes those that have been implemented. By May 1, 2003, 79 of 89 tasks included in the Action Plan since 1999 have been successfully implemented, which represents a very high (approximately 90 percent) success rate of these reforms.

Inspectorate reform grew out and benefited from the system for development and monitoring of the implementation of the Action Plan for Improving the Business Environment. The inspectorate reform efforts that evolved through this process of dialogue with the business community were later institutionalized as a separate "Inspectorate Improvement Program" by the Government.

The constellation of stakeholders included political leaders, technocrats, various state institutions, non-governmental organizations like business associations, and international institutions, in particular the World Bank. The core constant underlying, coordinating and sustaining these efforts was the technocratic level staff at the Latvian Development Agency<sup>2</sup> (LDA) and the Bureau of Public Administration Reform<sup>3</sup> (BPAR). Both institutions enlisted domestic resources like government experts and business professionals and regularly tapped into other sources, such as the political leadership or the World Bank as necessary. The sections below will discuss in more detail the role of each of these stakeholders.

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program – to a significant extent have based the development of its tools for reduction of administrative barriers on the experience gained and pilot projects undertaken in Latvia.

<sup>2</sup> The Latvian Development Agency is an independent legal entity wholly owned by the Government of Latvia. It is functionally subordinate to the Ministry of Economy.

<sup>3</sup> The Bureau for Public Administration Reform was established in 1997. In January 2000 it was formally merged into the Secretariat for the Special Tasks Minister for Public Administration and Municipal Reform Issues. From May 2000 the name of the institution was the Secretariat for the Special Tasks Minister for State Reform. The functions of the Bureau for Public Administration Reform were fully integrated into the Secretariats for two successive Special Tasks Ministers. For the sake of clarity, this case study will refer to the Bureau for Public Administration Reform throughout, although as indicated here, at various points in time the precise name of the institution was different.

It should also be noted that the coalition governments had fairly short life spans, to the extent that since 1993 there have been 11 governments. The time period reviewed in this study – 1998 to 2003 – was no exception. The role of the civil servants and the technocrats inevitably increases in such a system, since they are the ones that ensure continuity and smooth functioning of the system at a time of change in government. However, it should also be noted that up until 2002 there was no real change in the overall political leadership, as more or less the same parties (sharing similar, if not identical, platforms) formed successive coalition governments and ministers rotated from one sectoral ministry to another. This, as discussed later, proved to be an important factor in ensuring political support for the inspectorate reform process.

## **II. Pre-reform Situation**

The desire to integrate into the economic and security structures of Western Europe after regaining independence in 1991 had created a consensus for reform in Latvia<sup>4</sup>. Early on, economic policy was based on the tenets of a liberal market economy with a focus on creating the necessary institutional structures and maintaining a consistent macroeconomic policy. Some progress had already been achieved by 1998 when Latvia joined the World Trade Organization.

The main foreign and economic policy goal of the country remained accession to the EU, and when the EU Vienna Council in December 1998 officially decided not to start accession negotiations with Latvia at that time, the Latvian political elite and civil service were embarrassed into more decisive action. The overall program for accession to the European Union adopted by the government led to an acceleration of reforms in a number of areas, but most importantly clearly defined the strategic directions, the implementation of which was not disputed. In addition to the already existing consensus of a liberal economic policy, a new consensus was developed for accelerated harmonization of legislation with that of the EU and the need for a broad set of public administration reforms. The key implementers of these strategic goals were to be government technocrats.

As regards the investment climate, just as in many post-communist transition countries, the situation in Latvia in 1998 was characterized by recurring problems in conducting business. These problems were related to burdensome and unmotivated visits by government inspectors delays in transferring property rights, unclear immigration procedures for foreign citizens, unnecessarily large numbers of permits for construction approval, etc. All these area-specific problems had in common, to a greater or lesser extent, such cross-cutting issues as inconsistent implementation and interpretation of laws and regulations, a general lack of reliable recourse by enterprises, little or no exchange of information among government institutions or between the public and private sectors. The reforms that had been undertaken up until then and at a very fast pace were largely structural and macro-level, geared towards setting up the overall framework and legislative base. There was never much time to think through and plan for the implementation of the new laws, and this was left by

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<sup>4</sup> To better understand the context of the reforms and the relative strength of various stakeholders, a brief account of the political and administrative system in Latvia is useful. Latvia is a unitary state, parliamentary democracy with a proportional electoral system. The Prime Minister presides over a coalition government, typically formed by 3-5 parties with a majority in the parliament.

the wayside. So by the end of 1998 the main complaint of businesses was that although the legislation was in place and in generally good quality, it was the implementation and application of the legislation that caused problems for doing day-to-day business. Also, the culture of the public administration, including the inspecting institutions, in many cases still revolved around the ideas of policing and use of administrative authority to enforce the rules, with little or no concept of the enterprise as “the client”, who should be encouraged and helped to comply with requirements.

An understanding of the need to focus on the inspectorates in particular grew out of the study on Administrative Barriers to Doing Business in Latvia prepared by FIAS for the LDA at the end of 1998 and finalized in 1999. Based on face-to-face interviews with foreign and domestic businesses operating in Latvia, FIAS found that “inspections were one of the most often-mentioned complaints of Latvia when describing the administrative environment for investment.” Also the 1998 World Bank study<sup>5</sup> on corruption in Latvia released in December drew attention to the relationships between businesses and inspectors in general.

Specifically, the activities of the inspectorates were characterized by the following:

- *Frequent, uncoordinated and inconsistent checks.* There were complaints that there was little coordination or exchange of information among inspectorates either at the same level (the central government inspectorates, for example) or different levels (central government inspectorates and regional inspectorates implementing the same legislation). There was reported to be very little consistency from inspector to inspector – even inspections from the same inspector were reported to have different results at different times.
- *Intimidating behavior by inspectors.* Businesses expressed complaints about the aggressive and unpleasant attitudes of inspectors during on-site visits.
- *Nontransparent inspection procedures.* There was little understanding by enterprises of what were the rights and obligations of both the inspector and the enterprise itself. Often, the mandate of the inspectorate and the objectives of the visit were not clear. Few of the inspectorates required their inspectors to complete reports that would be available to the business – particularly when the findings were positive.
- *Ineffective appeal procedures.* There were complaints that there were few realistic mechanisms for recourse. The typical mechanism – appealing to the head of the inspectorate – was often unattractive to investors because of potential problems in the future with the inspector whose decision had been called into question. The alternative mechanism, the courts, was perceived to be lengthy and expensive.

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<sup>5</sup> “Corruption in Latvia: Survey Evidence” 1998, World Bank.

- *Burdensome rules.* Investors complained that fines could be given for unimportant reasons – copies made on wrong color paper, incorrect grammar, etc. Inspectors were reported to have wide latitude of what could be assessed as an infraction and what the fines should be. Although the fines tended to be small, more problematic for businesses was the nuisance factor, and the opportunity cost of a company manager spending time with a Government inspector.
- *Administrative corruption.* Because the inspectors had wide latitude and low levels of accountability, investors claimed that on-site inspections were often opportunities to solicit bribes. The 1998 World Bank Corruption Report<sup>6</sup> presented a statistical basis for these qualitative and anecdotal assertions. In response to a question to enterprises that “had contact” (which excludes those that were not visited by an inspectorate, for example), the graph records the percent of the relevant enterprises that reported that “unofficial payments” were required. For the key inspectorates, the results are as follows:
  - Sanitary inspections: about 12%
  - Fire inspections: about 12%
  - Inspection by tax authorities or audits: about 8%

The study summarized the problem as follows: enterprises “suggest that there is excessive discretion, a factor known to be a *cause* of corruption.”<sup>7</sup>

To illustrate the status and attitudes of the pre-reform inspectorates, some politicians, technocrats and even inspectors have used (often colorful) phrases like these:

- “No one disturbed the inspectorates in their grazing” (politician)
- “They were each a kingdom unto themselves” (technocrat)
- “Each was a servant to a different master” (inspector)
- “Each inspectorate had been left marinating in its own juices” (inspector)

The consequences of these problems were a disruption of business and frequent incidents of harassment and corruption. As documented by the World Bank’s recent report on *Doing Business 2004*, higher regulation is associated with lower productivity and higher unemployment:

Heavier regulation is generally associated with greater inefficiency of public institutions and more corruption, but not with better quality of private or public goods. The countries that regulate the most--the poor countries—have the least enforcement capacity and the fewest checks and balances to ensure that regulatory discretion is not used to abuse businesses and extract bribes.<sup>8</sup>

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<sup>6</sup> “Corruption in Latvia: Survey Evidence” 1998, World Bank.

<sup>7</sup> “Corruption in Latvia: Survey Evidence” 1998, World Bank, p. 9.

<sup>8</sup> World Bank, *Doing Business in 2004*, pg. 87.

This also led to a relatively unfavorable reputation for the investment climate in Latvia compared to some Central and Eastern European countries. For example, Latvia was rated at “3” by the Heritage Foundation in the mid/late 1990s (where 5 is worst and 1 is best); and 2.7 on Transparency International’s corruption perception index (where 0 is “very corrupt” and 10 is “highly clean”) and a “D” rating by the EIU’s Country Risk Ratings (see also Section IV.C, below for more recent, scores).<sup>9</sup> As will be shown below, most of these figures have demonstrated a significant improvement over time.

### **III. Reform Genesis**

In 1998, the impact of administrative and regulatory procedures on the business environment in Latvia was not consistently monitored by any government entity. At this time, the primary mandate of the Latvian Development Agency was investment promotion, export promotion and marketing. One of the activities of the Investment Department (which oversaw investment promotion) was advising individual foreign investors on doing business in Latvia. The Investment Department also handled complaints on a case-by-case basis of treatment by government authorities regarding the day-to-day difficulties of conducting business in Latvia, e.g., unclear immigration procedures for foreign citizens, delays in transferring property rights, burdensome and unmotivated visits of government inspectors, an unnecessarily large number of permits for construction approval, etc.

Since the complaints were often similar and began to fit a pattern, particularly regarding administrative barriers, the Director of the LDA Investment Department decided that a more comprehensive approach to identification and reform was necessary.

As a result, the Ministry of Finance and the LDA commissioned a Report on Administrative Barriers to Investment in Latvia<sup>10</sup>, prepared by the Foreign Investment Advisory Service (FIAS) of the World Bank. The Report analyzed and critically evaluated many problems related to employment, immigration, taxation, customs, purchase of real estate, construction, inspections, and other issues of importance to entrepreneurs and it became a critical catalyst in documenting the procedures and problems and suggesting solutions.

The main initiative – and the subsequent longer term effort at removing the administrative barriers to investment (including inspectorate reform) – came from middle-ranking and relatively junior government technocrats at the LDA. However, the broader context that allowed such an initiative to take root included the following:

- *EU accession.* As noted above, by 1998 the consensus of almost all participants in the political process (including mainstream Russian-based interest groups) was EU accession. Along with this objective came a number of underlying assumptions about improving the investment

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<sup>9</sup> [To be added...]

<sup>10</sup> Research undertaken in 1998 and 1999, published and distributed in 1999.

climate, fixing legislation and eradicating corruption that would serve as virtually indisputable arguments for administrative reform.

- *Change in government.* After Parliamentary elections in October 1998, a new government took office in January 1999. The new government did not feel embarrassed by the criticisms raised in the FIAS Report. It was willing to both listen to investors as well as address the shortcomings and deficiencies of the previous government. Therefore, the timing of the election cycle proved to be a crucial factor for initiating the reform efforts. However, frequent subsequent changes in government meant that for the reform efforts to continue, they needed to be supported (and preserved) at the technocratic level.
- *Increasing role for technical staff within government.* While there were frequent changes in the Latvian government, the civil service remained relatively stable (there was a relatively high non-political level – ministry state secretaries were for the most part the highest levels of career civil servants, and only ministers and their parliamentary secretaries were political). This meant that the reform process developed a technocrat-driven, bottom-up approach, almost regardless of the political changes taking place above.
- *Complaints from businesses.* While all of the above impetuses were government-based, there was one significant additional pressure – complaints from businesses that were channeled through the business associations and the LDA. As will be described in more detail, the input of businesses developed into a crucial control mechanism to keep constant pressure on the government, and the business community (in particular, certain business associations such as the Foreign Investors' Council of Latvia (FICIL)) also became a very active constituency to which the government was obliged to report. This relationship was in fact designed into the reform process through the Cycle of Reform and the Action Plan.

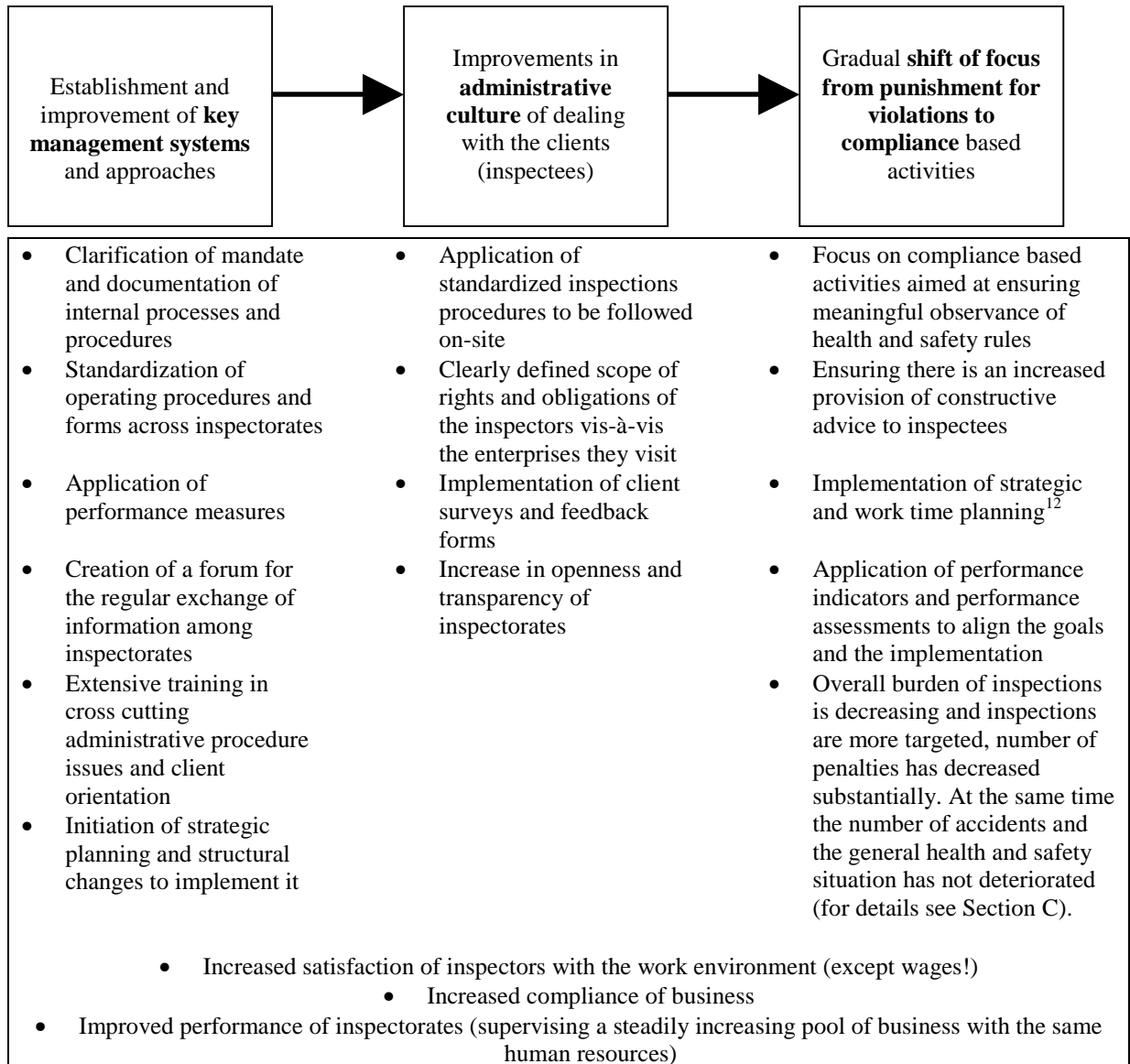
#### **IV. Key Reform Changes<sup>11</sup>**

The reform has resulted in significant changes to the way the inspectorates operate internally and in relation to the organizations and enterprises they are controlling. Although at the outset of reform, the focus was on altering the external operations like the conduct of inspections, application of penalties, etc, these adjustments could only be achieved by introducing significant changes to the internal management of these inspectorates.

The following key improvements in the inspections system have taken place as a result of the reform efforts:

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<sup>11</sup> This section provides a brief overview of key reform changes. More detailed discussion on the impact of reforms is presented in Section C.



## **B. Managing the Reform Process**

This section presents a detailed overview and analysis of the design and implementation process of Inspectorate reform and highlights critical aspects of the strategic and day-to-day management of such reforms.

The essence of the reform process in Latvia since 1999 has been a structured dialogue between the stakeholders. In most of the reform efforts, this meant dialogue between public officials and the private sector experts on issue-specific topics. However, another crucial aspect of “structured dialogue” is discussion among government representatives from different institutions. Such a lack of dialogue among the inspectorates was a key deficiency and, as this background paper will argue, its introduction was the necessary step to begin to resolve the problems of the inspectorates.

<sup>12</sup> For example State Labor Inspectorate assigns ~30% of inspectors’ time for advisory activities.

The key to commencing reform was overcoming the perceived lack of commonalities among the inspectorates (after all, they implement different substantive laws on sanitary standards, work safety, fire safety etc.) and instead creating awareness that certain aspects, in particular procedural behavior on-site and the rights and obligations of inspector vis-à-vis inspectee (the business), were common to all inspectorates.

The reform efforts described in this background paper were not the first efforts at improvement. There had been some cooperation among the inspectorates, including combined visits, for example, by the Labor Inspectorate, the Environmental Inspectorate and the Fire and Rescue Service. There had also been some reform programs, but mostly in the context of the line ministries (not with other inspectorates).

The following theses are presented here but will be further developed in the course of describing the inspections reform process in Latvia:

- It was a “**business-driven initiative**”. The entire administrative reform program could not have taken place without the pressure to reform from businesses. This pressure was channeled through the effective business associations such as FICIL that established working partnerships with the GoL in general and the LDA in particular.
- The World Bank’s **PSAL conditionality** regarding inspectorate reform – which were included at the suggestion of the GoL itself - were an important external pressure that helped get the BPAR actively engaged in guiding the process of reform. Once on board, the existence of PSAL conditionality helped the BPAR convince the inspectorates and other institutions of the importance of this effort.
- It was the combination of **home-grown ideas and external advice** that produced the mix of reform proposals that ultimately satisfied all stakeholders, were successfully implemented and produced positive results. The flexibility to assess various alternatives, the ability to leverage resources and adapt the inputs of various stakeholders were essential in the process of formulating reform measures and ensuring their implementation. It was necessary to maintain communication channels and hold discussions with various stakeholders at various points in time – other ministries, the inspectorates themselves, and businesses.
- An **external coordinator/moderator and neutral ground** were critical in the initial phases of bringing the inspectorates together to discuss how the problems identified could best be addressed. In addition, special consideration was needed to overcome the initial resistance when the informal meetings of the heads of inspectorates started. This was addressed by enlisting the support of one or two heads of inspectorates who helped to “break the ice” and by conducting initial meetings on the neutral topic of implementation of internal audit systems in the government institutions.
- There were times when a **formal and “legalistic” approach was necessary** to open the door for subsequent reform steps, since such an

approach was better understood and accepted by civil servants. By means of formal legal documents the first critical steps toward institutionalizing the evaluation and reform process were achieved.

- A necessary (but not sufficient) aspect of the inspectorate reform process was the **resolution of problems within and among the inspectorates** themselves. Once a mechanism for this had been established, then the problems with businesses could begin to be addressed.
- To introduce change, it was necessary to **start out first with simple management techniques** – internal operating guidelines, a requirement to always document the on-site inspection procedure regardless of the outcome, design of informational materials and their distribution. Over time, demand grew for more input and assistance in applying increasingly complex management systems as tools for improving the performance of the inspectorates. The inspectorates now have developed strategic plans, have started introducing performance management systems and a few are in the process of implementing Quality Management Systems based on ISO 9000 series standards.

## **I. Reform Formulation**

### *1. Overview*

There were several waves of reform formulation, followed by implementation, assessment, and another round of reform formulation. Oftentimes the formulation and implementation proceeded hand in hand. This process of evolution allowed the reform proposals to reach fruition and be raised at the right time, when the recipients and implementers had become receptive to specific proposals. Like most real-life examples of successfully implemented reforms, this one does not follow a linear pattern, and trying to describe and analyze it in such a fashion would do injustice to the lessons that can be learned. Nevertheless, we present the reform formulation process with some chronology to reflect the multifaceted nature of such a process, inevitably reducing the full flavor of sharp turns and dead ends encountered.

The formulation of the Inspectorate Improvement Program started as one component of the effort to Reduce Administrative Barriers to Investment (which later was renamed the Business Environment Improvement Effort, but the focus continued to be on administrative barriers). The foreign chambers of commerce and business associations like the Foreign Investors' Council in Latvia (established in the summer of 1999) also played a role in the initial stages in formulating the problems and suggesting solutions.

Certain aspects of inspections reform were included in the Government's Action Plan to Reduce Administrative Barriers in 1999, based on the FIAS Report. However, when an opportunity arose to strengthen these efforts and find them an appropriate institutional champion, the inspectorate improvement tasks were incorporated in the World Bank's PSAL.

In anticipation of the adoption of the PSAL in fall of 1999, and following it, the BPAR started active work on implementation of the tasks related to inspections reform. Later on, in September of 2000, the Cabinet of Ministers adopted a separate Inspectorate Improvement Program, which was drafted by the BPAR in cooperation with the Inspectorate Coordination Council and with some input from the Bank, the LDA and business community.

Now that the BPAR had taken the lead on this issue, the LDA assumed the role of overall monitoring and could slightly decrease its involvement in the day-to-day management of the Inspectorate reform. The LDA continued to pursue other objectives and problems defined in the overall Action Plan for Improvement of the Business Environment while carrying on dialogue with the business community and conducting systematic assessments of the business environment to enable it to monitor progress with the inspectorate reform program and intervene when necessary.

The BPAR and the Inspectorate Coordination Council continued to be in charge of the implementation of the Inspectorate Improvement Program until after the Parliamentary elections in autumn 2002. Following these elections the position of the Special Tasks Minister for State Reforms was not renewed and the BPAR was merged into the State Chancellery. By then majority of the measures envisioned in the Inspectorate Improvement Program had been implemented and accomplished.

The following text is a more detailed review of the critical points and events in the development of the Inspectorate Improvement Program.

## *2. Initial Formulation of Reforms (January 1999 – July 1999)*

To initiate an open discussion about the problems identified in the World Bank's Corruption Report and the FIAS Report on Administrative Barriers to Investment, the LDA invited business representatives and government officials to a presentation of the findings in January 1999. Soon after, the Prime Minister established a Steering Committee to come up with solutions to the issues identified. The Steering Committee, using both the recommendations from FIAS and the World Bank and suggestions from the subcommittees on specific questions, developed the first Action Plan to Improve the Business Environment in Latvia, containing more than 30 specific activities and designating the institutions responsible for implementing each activity.

### Steering Committee

The Steering Committee was composed of senior civil servants from all key ministries and state institutions affecting the investment climate and served as an umbrella institution whose status of direct reporting to the Prime Minister provided it with a mandate to invite other state institutions to participate as deemed necessary. It also included representatives of the private sector such as FICL (which included the foreign chambers of commerce), the Latvian Chamber of Commerce and Industry and other business associations.

The tasks of the Steering Committee were not sector-specific, but covered a broad spectrum of issues in the business environment. Therefore, to carry out the evaluation

of the problems and recommendations expressed in the FIAS Report and elaborate an Action Plan, four technical subcommittees were created:

- (1) for inspections problems,
- (2) for expatriate residency and work permit issues,
- (3) for registration, tax and customs matters, and
- (4) for land acquisition and construction issues.

Upon creation of the Steering Committee, the Prime Minister also designated the Business Environment Improvement Unit at the LDA to serve as the Secretariat of the Steering Committee, be in charge of the daily work and later monitor the reform process.

The work on the Action Plan proceeded in the four technical subcommittees, each of which was headed by a member of the Business Environment Improvement Unit at the LDA. The timeframe was extremely tight for the ambitious goals and the draft Action Plan for Removal of Administrative Barriers to Investment needed to be submitted to the Government by May 1999.

The subcommittee on inspections included a number of heads of State Inspectorates, key civil servants from some of the relevant line ministries, representatives from the BPAR and designated members of the business associations and chambers of commerce, including both foreign and local businesses. These were the groups that were involved in the formulation of the reform proposals.

At the political level it was the Prime Minister who championed the effort at that point in time (spring of 1999). The political leadership shifted to the Minister of Economy after a change in Government in July 1999 and remained there with successive Ministers of Economy. The crucial support of the Prime Minister at the initial phase was explicitly demonstrated in various ways, including opening the conference in January 1999, when the FIAS report was presented and findings discussed, issuing a decree on establishing the Steering Committee and launching the work of the Committee by participating in its initial meeting. However, the inception of the idea, the strategic direction, formulation of alternatives and day-to-day management of the overall reform effort came from the technical level at the LDA and later from BPAR for the inspections reform activities. This ownership of reform by the technical level, along with continuous pressure by business associations, explains why the efforts related to the Improvement of the Business Environment, including Inspectorate Reform, could sustain 4 or 5 changes in the Government between 1999 and through 2002.

The public and private sector members of the inspections subcommittee debated and discussed in great length the problems raised in the FIAS Report. Heated discussions emerged between the heads of inspectorates and businesses (especially those representing the FICIL), between the heads of inspectorates and other ministries and other inspectorates as well. The meetings were prepared, chaired, facilitated and followed up by the representatives of the LDA. These discussions resulted in proposals for improving the work of the inspectors and became one of the four main sections of the Action Plan, adopted by the Government in May 1999 (see [Annex X](#)).

## Action Plan

The measures included in the Action Plan for Removal of Administrative Barriers relating to inspectorate reform were the following:

- To address the problem of inconsistent treatment of inspected enterprises by the inspectors and to ensure that an administrative statement is always issued on-site in writing, BPAR must by 1 September 1999 develop and submit to the Cabinet of Ministers a draft instruction obliging the controlling institution to issue administrative statements in writing on-site or, in case of absence of an administrative statement to prepare, issue and place in the archives a description of each inspection, including the name, address of the inspected entity; the object of the inspection; the results of the inspection; detected breaches (with reference to relevant legislation) and indicating actions taken by the inspector.
- To address the problem of the lack of information to the public and businesses on inspectorates and their functions, all the inspections are required to develop their own internal regulations for operations, develop informational materials (on rights, appeals, legal requirements, etc.) and submit those to the BPAR by July 1, 1999. The BPAR was expected to assemble the information materials and the LDA to place them in the public domain.

### *3. Initial Implementation Experience and Refining of Reform Proposals (August 1999 – December 1999)*

During the process of gathering and analyzing the reports on the Implementation of the Action Plan in August of 1999, the LDA became aware that there was a need for more guidance for the inspectorates in preparing the internal operating regulations and information materials and the need for a more systemic approach to this task. The inspectorates turned out not willing or able to fulfill these tasks on their own. Their reports, which attempted to explain why the internal operating regulations had not yet been drafted, at best noted the need for more guidance and more typically indicated that all the pertinent information was already available in the laws and regulations.

At the same time, due to a change in government in July and the effect of the summer doldrums, much of the inertia for the reform was lost and the efforts threatened to fall apart. With the departure of the Prime Minister who supported these efforts, the LDA now had to search for new political champions to bolster the whole program for improvement of the business environment. The logical first attempt was appealing to the newly appointed Minister of Economy. It turned out that the interests and agendas of the two parties at this point coincided and complemented each other very well. The reform effort was thus sustained at this stage by the energetic drive of the new Minister of Economy.

The Minister of Economy had a specific agenda, initially unrelated to the efforts to reduce administrative barriers: his motivation to champion the overall business environment improvement effort arose from his disapproval of the almost single-minded focus of the Ministry of Economy on the activities of the Privatization

Agency. He thought that a new effort was necessary to redefine the role of the Ministry of Economy if it truly was to be the policy institution guiding economic development with a long-term strategy (since privatization, almost by definition, would have a mandate of limited duration). This new effort would turn out to be the program for removal of administrative barriers to investment.

The interventions and activities of the Minister of Economy in 1999 therefore served as the political catalyst for revitalizing the reform efforts. This was the second time that the efforts to remove administrative barriers were actively championed by a political leader. His tenure also marked the first successful attempts at institutionalizing the work on the Action Plan for Improvement of the Business Environment. Further on the political leadership played a lesser role in guiding the process and the reform efforts soon became mostly technocrat-driven (with ongoing monitoring and pressure by the business community and overall backing by the successive Ministers of Economy).

Due to this new drive, the LDA secretariat was mandated by the Minister of Economy to organize meetings with the relevant institutions included in the Action Plan and their supervising ministers. The team from the Ministry of Economy included the Minister, representatives from the LDA, and representatives from business associations. The purpose was to hammer out the specifics of reform, agree on a new timetable for the unimplemented measures in the revised Action Plan that was then submitted to the Cabinet of Ministers (CM) for adoption. As the Minister of Economy later explained, the reason that his fellow ministers allowed him to intervene in the activities of their subordinate institutions was that administrative barriers, including problems with inspectorates, were not their political priorities: "Politicians don't care about these problems." They were aware of the problems, but they were not painful for them politically, so there was no compelling reason to stop the Minister's (and LDA's) efforts.

In the context of inspectorate reform, such a meeting was held between the Minister of Economy and State Reform Minister on September 22, 1999. The aim was to refine the measures included in the Action Plan given the feedback from the inspectorates on the difficulties they were facing with implementing the assigned tasks. An agreement was reached on the following items and is reflected in the report to the CM on the implementation of the Action Plan, approved by the CM in October, 1999:

- BPAR must prepare a draft CM Instruction On Preparation Of Internal Operating Regulations In Inspectorates and submit it to the CM by November 30 (The instruction was adopted by the CM on January 18, 2000.).
- BPAR must prepare a report on the appeals mechanisms in inspectorates by November 23.
- BPAR must prepare a report on the functions of inspectorates including analysis of overlapping functions by November 23.

The first of the agreed tasks meant that the BPAR must itself learn the problems related to development of the internal operating regulations and assume a much more active role in guiding the inspectorates. The latter two tasks compelled the BPAR to

delve into the details of regulation of inspection activities in Latvia and analyze the work of these institutions in a comprehensive and systemic manner. Altogether, these measures resulted in a process of institutional learning that helped to create the much needed analytical capacity at the center of government and turned out to be critical in further design of the reform.

Simultaneously, while the World Bank and the Government of Latvia were negotiating the PSAL conditionalities in the spring of 1999 the LDA (acting through its parent ministry, the Ministry of Economy) determined that one means to ensure implementation of the recommendations from the FIAS Report and the Action Plan would be inclusion of the measures in the PSAL conditionalities, particularly the issues relating to reform of the inspections system and construction procedures. This would both provide pressure to meet the conditionality in full and by the agreed deadlines, as well as additional resources (PHRD grant) to assist with implementation. This initiative was supported by FIAS and by the World Bank staff working on the project at the time, but it is critical to note that the initiative for including this topic in the conditionality came from the GoL, not the Bank; thus the GoL had a strong feeling of “ownership” of these reforms.

The Policy Reform Program, signed by the Government as part of the PSAL 2 that was concluded with the World Bank in 2000, mandated the BPAR to work on the inspection issues. The PSAL and the related reform program as agreed with the World Bank was adopted by the Government in February 2000<sup>13</sup> and contained a description of problems and suggested measures originally included in the Action Plan for Removal of Administrative Barriers.

In December 1999 FIAS, LDA and BPAR organized a seminar for the inspectorates on the process of inspectorate reform, with a specific focus on the draft Instruction On Preparation Of Internal Operating Regulations In Inspectorates. Representatives of FICIL, the American Chamber of Commerce in Latvia and other business associations were asked to speak about their members’ experiences with inspectors. Although some members of the inspectorates had been present in the technical working groups under the Steering Committee, this was the first time that the heads of all the identified inspectorates (total of 28) had been called together, and at times the discussions became extremely tense since there was a critical mass to voice resistance to the proposed reforms. The difficulties lay in the fact that there may have been insufficient preparation to allow the inspectorates to understand that in terms of procedures carried out on-site at business premises, the inspectorates did in fact have a great deal in common, especially in terms of the burdens and risks they collectively imposed on businesses.

Despite the difficulties, a positive result was achieved. For the first time, the inspectorates had been brought together as a group. They were challenged *en masse* with the problems raised by the business community and understood that many of the complaints from businesses are the same, regardless of which specific inspectorate is at issue. During the discussions there was a gradual understanding and acceptance by the participating inspectors of the concept that regardless of the technical specifics of their field of regulation, the administrative procedures they employ on-site should be

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<sup>13</sup> Cabinet of Ministers protocol of 17.02.2000, no. 8 23.§

similar, and that they could all improve their effectiveness by helping their clients comply with requirements rather than focusing on discovering and punishing “infractions”.

The seminar also gave the opportunity for inspectors to express their specific concerns about the draft Instruction, which was a novelty in Latvia after independence. In fact, many of those involved within the GoL believed that such reforms were most efficiently imposed from the top-down, and that discussion would just be a waste of time. In fact, there was quite a bit of “venting” during most of the seminar. But as participants realized that their concerns were being taken seriously, they became more constructive, suggesting modifications to the reform program rather than dismissing it outright. In response to this, some of those who had been skeptical of the participatory approach to the design of reforms began to change their stance, and the concept gradually gained wider acceptance.

The Instruction was adopted by the Cabinet on January 18, 2000. The Instruction required each inspectorate to adopt internal operating regulations based on standardized requirements, including:

- The mandate for the inspectorate’s activities.
- Standardized operating procedures within the inspectorate.
- Defined scope of rights and obligations of the inspectors vis-à-vis the enterprises they visit.
- Standardized inspections procedures to be followed on-site.

The *Instruction On Preparation Of Internal Operating Regulations In Inspectorates* was never meant to be an end in itself. Instead, the goal had been to standardize on-site inspections procedures. One means to do this was to establish standard guidelines for the operating regulations of each of the inspectorates. But in order to create such standard regulations, the circumstances in Latvia at that time may have necessitated imposition from above. Although this was undeniably a formal and legalistic approach, it is difficult to imagine the Latvian inspectorates – at that particular stage of their development and in light of their lack of awareness of good governance principles – voluntarily complying with such an initiative, particularly based on their pre-reform attitudes (discussed above). A welcome by-product, whether planned or inadvertent, was that they were compelled to cooperate to learn from each other their experiences in implementing the Instruction.

#### 4. *Development of a Comprehensive Inspectorate Improvement Program (January 2000 – September 2000)*

In January of 2000 informal meetings began among the heads of the inspectorates. These meetings were moderated by the BPAR and the LDA. During this process it became clear to all stakeholders that the goal of improving the work of the inspectorates required a multi-pronged approach, including legislative change, training in procedures and client-orientation, experimentation through pilot projects, cooperation among the inspectorates and the government.

At this point the targeted assistance of FIAS and the WB proved to be of tremendous value. An external management consultant was hired to participate in the December 1999 seminar with the task of preparing proposals for a work program on improvement of the inspectorates. With inputs from LDA, BPAR, FIAS, WB, and a few heads of inspectorates, the proposals were finalized for the Inspectorate Improvement Program (February 2000), including:

- A training program for inspectors and heads of inspectorates, including enlisting the support of the School of Public Administration
- designing and setting up an institutional structure for coordination of activities and implementation of the program: the Inspectorate Coordination Council
- development of common inspecting procedures
- development of systems for assessing performance of inspectorates
- development of client orientation through training
- design and implementation of client information policy
- implementation of internal operating regulations of inspectorates (in the beginning in two inspectorates)

Through ongoing regular informal meetings among the heads of the inspectorates to discuss these proposals, support was generated for the establishment of the Inspectorate Coordination Council and implementation of the Inspectorate Improvement Program. This resulted in the formal establishment of the Inspectorate Coordination Council by a decree of the State Reform Minister on April 14, 2000<sup>14</sup>. The members of the Council included heads of 8 key inspectorates, representatives of the BPAR and LDA. The Chairman of the Council was elected by the members and would be rotated after every 6 months. During the first formal meeting of the Inspectorate Coordination Council on April 18, the State Inspectorate Improvement Program was adopted. The first Chairman of the Council was the Head of the State Labor Inspectorate, who had been a champion of this stage of the reform effort, and who had already initiated several successful reforms to improve efficiency within his own agency. He was behind mobilizing the support of a critical number of inspectorates for participation in such a program and through his example demonstrated to his peers that there was real value in participating in the pilot programs, engaging in innovative training, etc.

The implementation of the agreed Inspectorate Improvement Program was already underway when it was formally adopted by the CM on September 15, 2000. This typifies how the whole effort developed – bottom-up in terms of the interaction between the technical and political levels of government.

## **II. Reform Implementation. Implementation of the Inspectorate Improvement Program (April 2000 – June 2002)**

The Inspectorate Coordination Council monitored the implementation of the Program in 22 inspectorates. The Council was responsible for drafting an action plan for the

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<sup>14</sup> A new decree on the Council was issued on October 17, 2001 by another Minister for State Reform.

implementation of the Program involving all the interested parties and responsible institutions. The key components of the program were the following:

- Implementation of the CM Instruction *On Preparation Of Internal Operating Regulations In Inspectorates*
- Training for the Heads of Inspectorates and Inspectors
- Provision of Information to Clients
- Creation of a System of Performance Indicators and Internal Control in the Inspections
- Coordination of the Work of Inspectorates

The following text is largely based on the Program, with additional comments and observations to relate it directly to the focus of this Case Study.

1. *Implementation of the CM Instruction On the Preparation Of Internal Operating Regulations In Inspections (adopted on January 18, 2000)*

As envisaged in the original Action Plan for Improvement of the Business Environment, on the basis of this Instruction the inspectorates developed and implemented Internal Operating Regulations, which govern inspectors' activities related to the physical persons or legal entities to be inspected. The following inspectorates prepared their Internal Operating Regulations:

- |   |  |
|---|--|
| 1) State Quality Control Service for Crop Production;                           | 10) State Railway Technical Inspectorate;                            |
| 2) Plant Protection Service, Seed Control Department;                           | 11) State Electrical Transmission and Communication Inspectorate;    |
| 3) State Pedigree Breeding Inspectorate;  | 12) State Pharmaceutical Inspectorate;                               |
| 4) Lottery and Gambling Monitoring Inspectorate;                                | 13) State Education Inspectorate;                                    |
| 5) Quality Control Inspection for Medical Care and Working Ability Examination; | 14) State Culture Monument Protection Inspectorate;                  |
| 6) Consumer Rights Protection Center;   | 15) State Metrology Inspectorate;                                    |
| 7) Sanitary Border Inspectorate;  | 16) State Inspectorate for Monitoring of Precious Metals' Standards; |
| 8) State Construction Inspectorate;   | 17) State Sanitary Inspectorate;                                     |
| 9) State Labor Inspectorate;  | 18) State Technical Monitoring Inspectorate;                         |
|   | 19) State Fire and Rescue Service;                                   |
|   | 20) State Veterinary Service;  |
|   | 21) State Environmental Inspectorate.                                |

These regulations were crucial in establishing a unified inspection procedure and as a source of information for those inspected on the scope of inspectors' rights, duties and responsibilities, as well as on-site inspections procedures. This in turn facilitated a common understanding between inspectors and businesses about the official inspection procedure. The regulations state that one of the duties of the officer during the inspection is to inform the inspected person about the procedure for appeal of the decision, or the decision imposing an administrative penalty should contain information about the appeals procedure available. Implementation of these

regulations fostered accountability on the part of the inspectors and improved the transparency of their actions, as well as standardized the inspection procedure itself.

## 2. *Training for the Heads of Inspectorates and Inspectors*

Since inspectorates are legally part of the civil service, the School of Public Administration could be involved in their training. However, what was unique in the case of the Inspectorate Improvement Program was that the School agreed to tailor some of the training courses for inspectors specifically and arrange inspectorate-only courses. The School also accommodated the interests of the inspectorates to conduct training in their own premises.

Altogether 492 participants attended the seminars organized within the framework of the Training Program for the Heads of Inspectorates and Inspectors.

Training of inspectors was carried out in the following areas – on how to establish an internal audit system, assess risks, prepare informational materials for the clients and create an information system. Eight inspectorates organized seminars specifically on *Client-oriented communication* delivered by the School of Public Administration as part of the civil servants' training program.

Two inspectorates – the State Labor Inspectorate and the State Fire and Rescue Service hosted a pilot training course on *Strategic planning* conducted by a Swedish management consultant financed by the WB through a PHRD grant. This training was very well received by these two inspectorates, who carried on with the ideas and actually developed their strategic plans for 4-5 years, which now form the basis for their performance management systems. *Strategic planning* helped to analyze the role and place of the inspectorate in the public administration, to identify the needs and problems of the clients and to plan activities so as to ensure the most efficient implementation of the legislation. Following the success of the pilot training and using the local trainer trained during the work with the above two inspectorates, seminars on Strategic Planning took place in seven other inspectorates - State Construction Inspectorate, Quality Control Inspection for Medical Care and Working Ability Examination, Consumer Rights Protection Center, State Inspectorate for Monitoring of Precious Metals' Standards, State Sanitary Inspectorate, State Technical Monitoring Inspectorate, Sanitary Border Inspectorate.

## 3. *Provision of Information to Clients*

The initial skepticism evident in 1999 was overcome and later most of the inspectorates paid serious attention to client information and education. At the beginning of 2001, 16 inspectorates prepared *Client Information Strategies for 2001*. The *Client Information Strategies* envisage provision of information to the immediate clients (physical persons and legal entities working in the sector monitored by the inspectorate), as well as the general public on the following issues:

- activities of the inspectorate, main objectives, services provided, rights and duties;

- requirements established in the legislation and recent changes;
- rights and duties of the clients.

For public information campaigns, the inspectorates mainly used mass media and press conferences. To inform their immediate clients, inspectorates used a variety of media – leaflets, informational stands in their offices, Internet home pages, meetings with clients, provision of information on the phone or at the office. Some inspectorates (the State Construction Inspectorate, State Environmental Inspectorate, State Pharmaceutical Inspectorate) organized seminars in which current issues, requirements of the normative acts and changes in legislation referring to the sector monitored or controlled by the inspectorate are discussed.

Implementation of the client information strategies ensured that clients receive information and training on legal requirements, control and appeals procedures, reducing the number of infringements due to lack of information about the normative acts.

To evaluate the impact of informative materials on the business environment and to detect what kind of information businesses need, how useful the information included in the informative materials is, as well as how effective the dissemination policy is for the clients, the need for client surveys was recognized. Some inspectorates already have conducted their client surveys to evaluate the performance of the inspectorate (Sanitary Border Inspectorate, Lottery and Gambling Monitoring Inspectorate). For example, its client survey helped the Sanitary Border Inspectorate to determine which service provision areas require more attention, what clients would like to know and through which media. The Lottery and Gambling Monitoring Inspectorate used the survey to identify the main areas where the inspectorate could improve its performance. The State Labor Inspectorate used the Study on Employers' and Employees' Awareness of Labor Regulations to identify the information needs of the clients, the media preferences and the level of awareness and knowledge on selected legal aspects of labor relations.

#### *4. Creation of the System of Performance Indicators and Internal Control in the Inspections*

The Program envisaged creation of inspectorate performance indicators and internal control systems. On 25 April 2001 during the meeting of the Inspectorate Coordination Council it was decided that performance indicators and annual reports are priority areas. Taking into account that Latvian public administration institutions do not have the necessary experience to define performance indicators and develop related reporting mechanisms, the LDA and the BPAR approached the World Bank to provide guidance and assistance from international experts on this topic. The much needed assistance was provided and in November 2001 the School of Public Administration organized a seminar "Result-oriented Approach for Institutions / USA Experience" for representatives of public administration institutions. Representatives of 3 inspectorates took part (State Sanitary Inspectorate, State Labor Inspectorate, State Inspectorate for Monitoring of Precious Metals' Standards) in the seminar. The efforts were continued at the beginning of 2002 when a separate training program for inspectorates was prepared on how to define performance indicators.

Seven inspections established internal audit divisions, which carry out evaluations of internal control systems and provide recommendations on improvements in order to ensure effective public administration performance. In nine other inspectorates, internal audit is carried out by the internal audit unit of the respective ministry. Analysis of the public annual reports of inspectorates for 2002 indicates that recommendations of internal auditors for elimination of identified shortcomings and deficiencies have been useful and most have been implemented. Internal auditors have also developed several recommendations for improvements of the inspection procedures, which were accepted by the heads of inspectorates and have already or will help to improve the performance of inspectorates.

#### *5. Coordination of the Work of Inspectorates*

Before the introduction of the Inspectorate Improvement Program one of the key complaints was the lack of cooperation and coordination of inspectorates. Therefore significant attention was devoted to this issue in the course of implementation of the Program. The Inspectorate Coordination Council facilitated coordination with other inspectorates of similar competence and other institutions in order to improve information circulation and organize joint and coordinated inspections. Joint inspections are carried out by many of the inspectorates and they are regarded as useful because they save time for the enterprises and create an integrated picture of the operation of the businesses for the inspectorates.

### **III. Assessment of Implementation Experience**

The implementation experience of this reform effort clearly indicates the need for flexible approach, involvement of wide range of stakeholders and ability to assess the interim progress at various stages and to reformulate and reshape the reform measures as needed.

#### Role of stakeholders

The efforts in Latvia are characterized by the active involvement of various stakeholders at those stages when their contributions would be most effective to the overall efforts. The constellation of stakeholders included political leaders, technocrats, various state institutions, non-governmental organizations like business associations, and international institutions, in particular the World Bank. This experience demonstrates a model of flexible participation by each stakeholder, whose comparative advantages were used on an as-needed basis. The core constant underlying, coordinating and sustaining these efforts was the technocratic level staff at the LDA and the BPAR. Both institutions enlisted domestic resources like government experts and business professionals and regularly tapped into other sources, such as the political leadership or the World Bank as necessary.

#### Motivation for change

A crucial element leading to the success of the reform at the implementation stage was the motivation of the Heads of Inspectorates for change. This motivation was hard fought for and gained only after lengthy discussions and debates on the underlying problems and ways forward. It centered on the following:

- awareness of the changing external environment, including EU accession

- need to oversee implementation of a whole new set of standards and legal norms, including a shift away from an “enforcement orientation” (with focus on numbers of inspections, numbers of infractions found, revenues in fines received, etc.) to a “compliance orientation” focused on the goals of inspections, e.g., reduction in workplace accidents, in industrial fires, in environmental degradation (measurable in air and water quality), etc.
- the reform program empowered them, gave the training and supplied the lacking skills needed to respond to the pressures

### **Compensating losers**

On the assumption that many individual inspectors, at a minimum, were benefiting from bribes prior to the reforms (see above, pg. 5), it appears that such inspectors may have lost some revenue from the reforms, although this cannot be proven conclusively.

The dynamics of bribery associated with inspections fell largely into two categories:

1. Bribes extorted by inspectors from businesses who may have been innocent of serious wrong-doing: In many such cases, according to interviews with entrepreneurs, inspectors would seize upon minor, technical infractions and threaten major sanctions, and drop the threats only if they received a high enough bribe. Examples of “infractions” claimed by inspectors included *over*-paying taxes, submitting information on the wrong color form, etc.; and possible sanctions could include large fines, freezing bank accounts or suspending business activity.

This kind of extortion was made much more difficult, once all inspectors were required to make a written report after all inspection visits, with a record of any “infractions” and the outcome of the investigation. Targeting of “vulnerable” businesses was also made more difficult with the introduction of more systematic inspection schedules and risk-assessment targeting of inspections.

2. Bribes offered by businesses to inspectors to ignore or bend important regulations: including avoiding customs duties, pollution controls, or building standards. In this case, there is a greater degree of “mutual advantage”, but monitoring of outcomes, and the ability to relate outcomes to individual inspectors has at least a deterrent effect on inspectors who may be tempted to accept such bribes. For example, the ability to compare customs revenues received across different inspectors operating at the same customs post at the same time can reveal significant shortfalls associated with particular customs officers; monitoring of effluents encourages environmental inspectors to do their jobs properly. Unfortunately, in areas such as building standards, there is often a lengthy delay between actual construction activities, and incidents such as building collapse, such that monitoring is less likely to deter bribery to bend regulations in this area.

Either way, according to focus group discussions and survey data, it appears that the majority of bribes involved were relatively small. On the other hand, the heads of three of the main inspectorates indicated overall improved performance and morale. One of the more interesting sources of satisfaction was that the operational regulations

and information materials prepared as part of the whole effort actually ease the work of the inspectors since they can now refer people to these materials and the websites.

Finally, there is a concern on the part of entrepreneurs interviewed by LDA and FIAS during the update of the administrative barriers assessment in 2002, that corruption has not necessarily diminished, but may have become more subtle and sophisticated. For example, while petty bribery in the form of cash payments has, by all accounts, diminished greatly, there are still instances where investors are pressured to accept an unwanted business partner, or to hire an unwanted individual, at the behest of government officials, including inspectors.

#### **IV. Availability of resources**

In addition to main GoL staff resources, including the considerable LDA and BPAR staff-time, and other major in-kind contributions from the Inspectorates themselves, FICIL and other business associations, the following list of projects were the main external sources of support to the effort in Latvia:

##### **FIAS projects:**

FY99 Study of Administrative Barriers to Investment: \$135,600<sup>15</sup>

FY00-01 Implementation Assistance: \$211,800<sup>16</sup>

FY02 Self-Assessment update of Administrative Barriers ; \$139,200<sup>17</sup>

FY04 Assistance in Monitoring Impact: \$60,000<sup>18</sup>

##### **World Bank resources:**

FY00 PHRD grants: \$39,500

FY00 Finnish CTF: \$36,000

It should be noted that most the FIAS projects were not exclusively designed for inspections reform, but rather a portion of the financing was able to support these activities.

### **C. Impact of Reforms**

This section presents a more detailed analysis of the changes resulting from the above reform efforts and the impact of these reforms. Where possible the changes and the impact has been quantified, but the qualitative measures have also been used. The conclusions presented here are based on the following data and information:

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<sup>15</sup> Including co-financing from the LDA, drawing on EU/Phare, Swedish CTF and other resources

<sup>16</sup> Including co-financing from the LDA, EU/Phare and SIDA

<sup>17</sup> Including co-financing from the LDA and the Government of Luxembourg

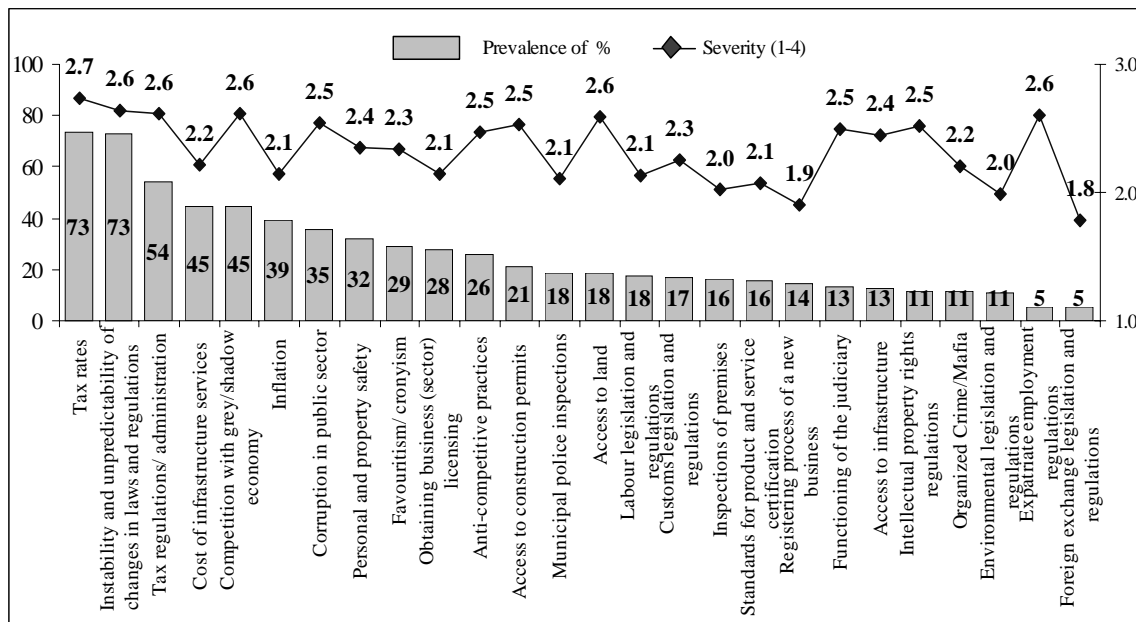
<sup>18</sup> Including co-financing from the LDA and World Bank (PREM)

- Results of the 2001/2002 and 2003/2004 Administrative and Regulatory Costs Surveys
- On-site inspection procedure templates completed by the key inspections as part of the Self-Assessment Study of Administrative Barriers to Investment, 2003
- Statistical information and performance indicators provided by the State Labor Inspectorate and the Fire Inspection Division of the Fire and Rescue Service for the purposes of this case study
- Report to the CM on the Implementation of the Inspectorate Improvement Program from June 2002
- Annual Public Reports of key inspectorates
- Interviews with the key stakeholders

So what has the impact of the Inspectorate reform been in Latvia?

The discussion of the pre-reform situation indicated that in the fall of 1998 the issue of on-site inspections was a key problem in the minds of businesses. By 2001, as captured by the Administrative and Regulatory Cost Survey (ARCS), it was found that the inspections ranked only 17th on the list of regulatory obstacles to business operation and development. As the graph shows, only 16% of businesses found that “inspections of premises” were a problem at all, and the level of severity was only 2.0 (on a scale from 1 (Minor) to 4 (Very Severe)).

Figure 1 Regulating spheres -- business obstacles



Base for 'Prevalence': all companies interviewed, N = 541; answers 'Not an obstacle' and 'Hard to say' not shown.

Base for 'Severity': Those who admitted it was an obstacle, excluding 'Hard to say/DK'. Mean on scale from 1 (Minor) to 4 (Very Severe).

**[Comparable Data from 2004 Survey here]**

Now we will try to unravel these overall positive changes in more detail by disaggregating the reform measures and attempting to identify their impact separately. Due to the nature of administrative reform (impact is often felt some time after the reform is introduced) the measures of success can usefully be divided into a number of stages:

1. The first stage is the one that is easiest to implement and measure: legislative change and any direct consequences of the legislative change.
2. The second stage is procedural or administrative change based on legislative change.
3. The third stage are the improvements that result from the legislative, administrative and procedural changes:
4. The fourth stage is the impact on the ground.

1. *Legislative change and direct consequences of the legislative change.*

1) Adoption of CM Instruction On the Preparation Of Internal Operating Regulations In Inspections

The Instruction was adopted on January 18, 2000. It was ultimately the result of consultations and discussions with the inspectorates themselves, and the implementation of the guidelines in the Instruction was one of the first concrete bases for cooperation among the inspectorates.

2) Adoption of internal operating regulations.

21 inspectorates adopted internal operating regulations, pursuant to the CM Instruction. The inspectorates are listed above.

3) Adoption of the Inspectorate Improvement Program

The Inspectorate Improvement Program was adopted on September 15, 2000 by the Cabinet of Ministers. Although much activity was already underway, this political support was a crucial success.

2. *Procedural or administrative change based on legislative change.*

1) Setting up an Inspectorate Coordination Council

The Inspectorate Coordination Council was a forum for exchanging experiences and ideas and it had begun to function informally even before its official creation on April 14, 2000 by decree of the Special Tasks Minister.

2) Training of employees

Under the aegis of the Inspectorate Improvement Program unprecedented training efforts were implemented. Altogether 492 inspectors attended the seminars organized within the framework of the Training Program for the Heads of Inspectorates and Inspectors. Training of inspectors was carried out in the following areas:

- on how to establish an internal audit environment,
- assess risks,

- prepare informational materials for the clients and
- create an information system, on client-oriented communication and strategic planning.

On an ongoing basis, the select inspectorates apply the following methods of communicating significant changes in legislation and requirements to their employees<sup>19</sup>:

Communicating requirements to staff Inspectorate	Copies of the amended legislation are distributed	Special training is provided	Manuals and instructions are updated	Employees familiarize themselves with the changes
Labor	x	x	x	x
Sanitary	x	x	x	
Firefighting and Rescue	x	x		
Construction Inspectorate	x	x	x	
Environmental	x	x		x
State Revenue Service	x		x	x

3) Training of business representatives and preparation of informational materials for businesses

The self-assessment templates of 2002 asked the responding inspectorates to identify which methods they use to communicate information on the requirements for this procedure to enterprises. The responses were as follows:

Communicating requirements to businesses Inspectorate	No additional information is disseminated, because the relevant laws and regulations are sufficient	Printed leaflets and brochures	Seminars and training are organized	Information is posted on the internet home page	Answering individual inquiries (by phone, with letters, in person, etc.)
Labor		x	x	x	x
Sanitary*				x	x
Firefighting and Rescue			x	x	x
Construction Inspectorate			x	x	x
Environmental		x	x	x	x
State Revenue Service		x			x

\* The Sanitary Inspectorate also uses the mass media to inform businesses about requirements.

<sup>19</sup> In response to the question “what is the method of communicating significant changes in legislation and requirements to the employees of this institution?” in the Self-Assessment templates of 2002.

As seen in the table, many of the inspectorates now have internet home pages with information on the inspectorate and its functions, such as:

- State Labor Inspectorate ([www.vdi.lv](http://www.vdi.lv));
- State Fire and Rescue Service ([www.vugd.gov.lv](http://www.vugd.gov.lv));
- State Construction Inspectorate ([www.varam.gov.lv/VBI](http://www.varam.gov.lv/VBI));
- State Environmental Inspectorate ([www.vvi.gov.lv](http://www.vvi.gov.lv));
- State Revenue Service ([www.vid.gov.lv](http://www.vid.gov.lv)).

4) Public relations/outreach/feedback

The self-assessment templates indicate that the inspectorates have used the following methods to received feedback from enterprises (and where applicable, the numbers are from 2001):

Feedback from enterprises Inspectorate	Suggestions and complaints submitted by enterprises	Feedback forms	Surveys	Meetings and workshops with business associations and non-governmental organizations	Analyses of information from mass media
Labor					
Sanitary	2		1	13	2
Firefighting and Rescue	“not counted”			“not counted”	“not counted”
Construction Inspectorate				6	10
Environmental				4	23
State Revenue Service					

5) Better understanding of their mission and the purpose of their procedures. In 2002 various inspectorates and audit institutions were asked to complete templates assessing their impact on the business environment in Latvia. The “purposes” of the on-site inspections activities were as follows:

Inspectorate or audit institution	Purpose of inspection/audit procedure
State Revenue Service	To check the correctness and compliance with normative acts of the calculation, payment and deposit in the budget of a particular taxpayer’s taxes.
State Labor Inspectorate	To ensure the observance of legislation relating to labor rights, workplace safety and monitoring of dangerous equipment, and as a result to reduce the number of those harmed in accidents as well as occupation illnesses.

<b>Inspectorate or audit institution</b>	<b>Purpose of inspection/audit procedure</b>
State Sanitary Inspectorate	To accomplish the implementation of normative acts defining public health and consumer safety on a nationwide basis in the areas of the inspectorate's authority, and to reduce possible risks to the health of the public and consumers.
State Fire and Rescue Service	To monitor that institutions, enterprises, organizations and inhabitants fulfill the requirements of normative acts regarding the reduction of fire hazards. To control that planning and construction organizations, enterprises and inhabitants comply with the requirements of design and construction standards, norms and regulations for any type of construction, reconstruction, and capital renovation, as well as technical modernization activities.
State Environmental Inspectorate	Control and monitoring of the implementation of normative acts in the area of environmental protection and use of natural resources.
State Construction Inspectorate	To carry out state control over construction and state construction expertise, to control the fulfilment of the requirements in laws and other normative acts relating to the quality of construction, the safety of hydrotechnical constructions in hydroelectric power stations.
State Language Inspectorate	To ensure the implementation of the State Language Law and other legal acts governing the use of the state language.

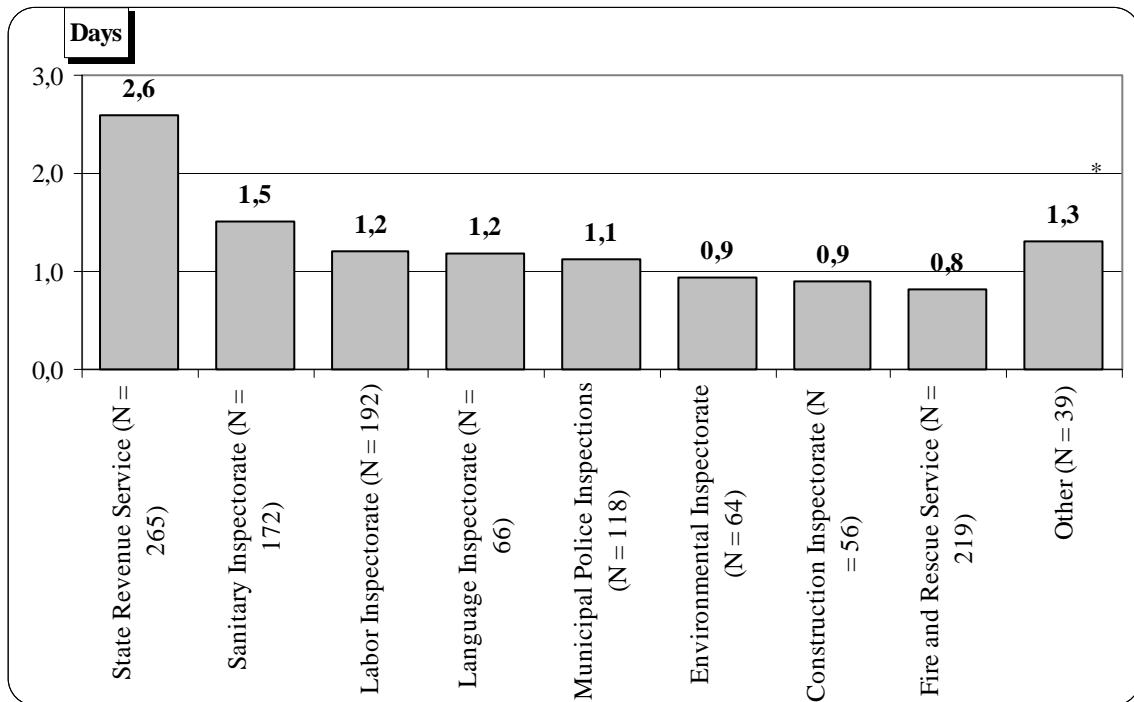
From the above table, it is clear that some inspectorate are still describing their "purpose" primarily in terms of enforcement of legislation, but most also note the overall goals (e.g., for the State Labor Inspectorate: "... to reduce the number of those harmed in accidents as well as occupational illnesses.")

3. *Improvements that result from the legislative, administrative and procedural changes.*

- 1) Changes in duration of on-site inspections.

The 2001 ARCS indicates the following in terms of on-site duration of inspections:

Figure 2. Average Duration of Inspections



*Base: companies that have been visited by respective inspection and have giving particular answer on number of visits, see 'N = ' in chart.*

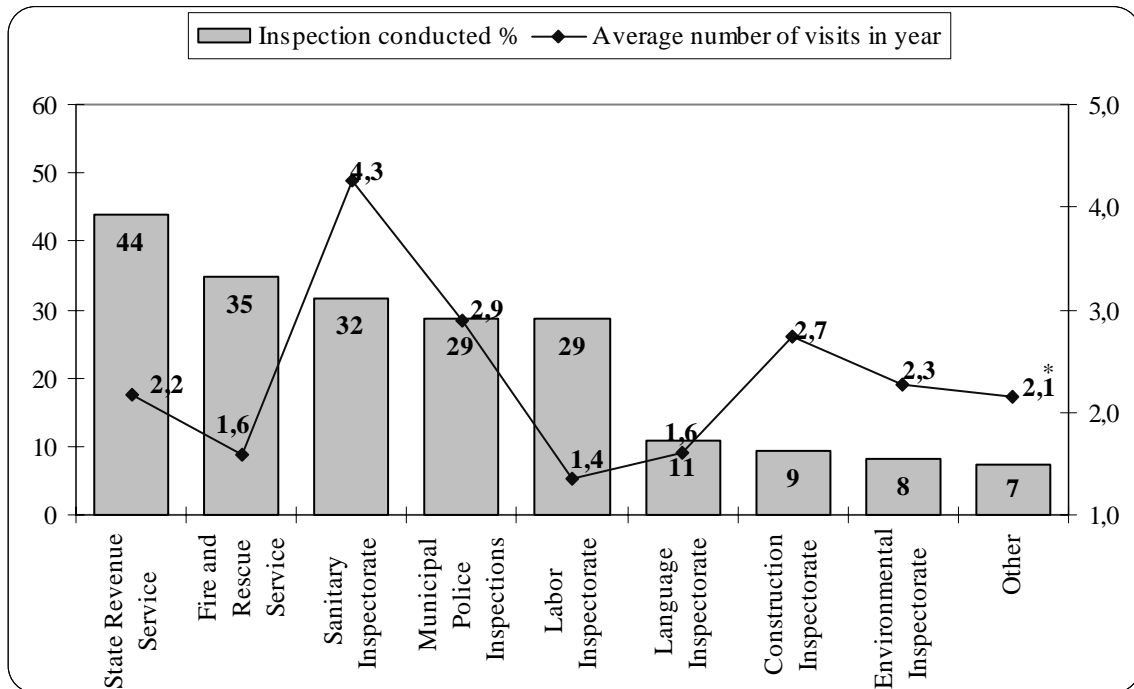
*\* The number of respondents is not large enough to interpret the obtained results (N<45).*

**[Comparable data from 2003 ARCS to be inserted here]**

2) Changes in frequency of on-site inspections

Date from the 2001/2002 ARCS indicates the average number of companies inspected by various inspectorates.

Figure 3. Percent of Companies Inspected and the Average Number of Inspections During Last 12 Months



Base 1 (Inspection conducted %): all companies interviewed, N = 541.

Answers “Inspection not conducted” and “Hard to say” are not shown.

Base 2 (Average number of visits in year): companies that have been visited by respective inspection and have given particular answer on number of visits. Labor Inspectorate N = 205, Sanitary Inspectorate N = 184, Fire and Rescue Service N = 240, Construction Inspectorate N = 58, Environmental Inspectorate N = 71, Language Inspectorate N = 71, State Revenue Service N = 283, Municipal Police Inspections N = 128, Other N = 41.

\* The number of respondents is not large enough to interpret the obtained results (N<45).

**[Comparable data from 2003 ARCS to be inserted here]**

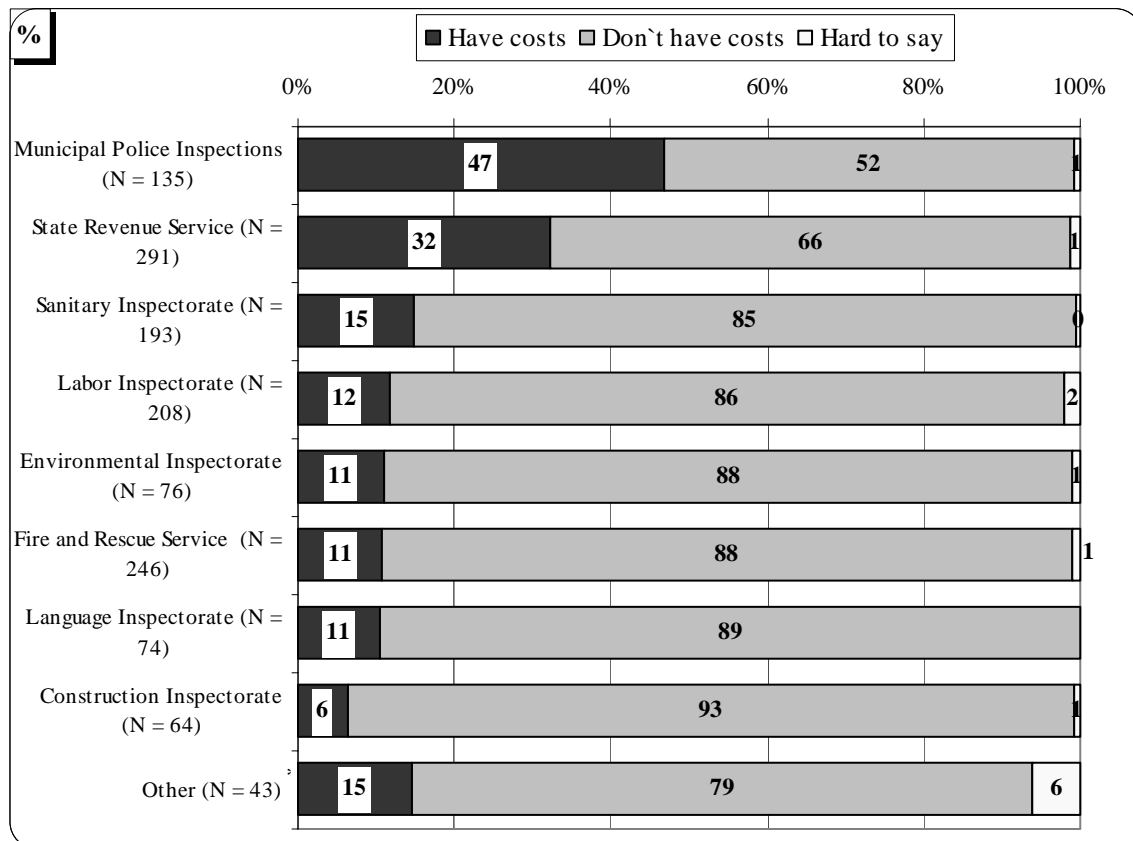
If we compare this information with the statistics provided by the inspections themselves we see reduction in the number of inspected entities and more targeted inspections as well. For example, data from the Labor Inspectorate (see table below) indicates that while the number of enterprises under its jurisdiction in 2003 has increased by 17% as compared to 2001, while the number of inspected entities in the same period has increased by only 5%, due to better “risk targeting”. It is also noteworthy that the number of inspectors has increased by only 2% (from 96 to 98 inspectors). The number of repeat inspections is fairly small – at 6,7 % for 2002 and has decreased by 3 % as compared to 2001.

**Table XX. PERFORMANCE INDICATORS OF STATE LABOUR INSPECTORATE (2001-2003)**

Select Indicators	% changes 2001 vs. 2002 (indicated where forecast data for 2003 was not available)	% changes 2001 vs. 2003 (forec.)
# of inspectors		+ 2%
# of identified organizations and enterprises under supervision		+ 17%
# of employees in the supervised organizations and enterprises		+ 25%
# of inspected organizations and enterprises		+ 5%
# of organizations and enterprises inspected more than once a year	-3%	

3) Changes in costs

Figure 4. Costs Caused By Inspections



Base: companies that have been visited by respective inspection, see 'N = ' in chart.

\* The number of respondents is not large enough to interpret the obtained results (N<45).

[Comparable data from 2003 ARCS to be inserted here]

**Table XX. PERFORMANCE INDICATORS OF STATE LABOUR INSPECTORATE (2001-2003)**

Select Indicators	% changes 2001 vs. 2002 (indicated where forecast data for 2003 was not available)
# of Financial Penalties Awarded	-23%
Amount of Penalties, Ls	-7%

**Table XX. PERFORMANCE INDICATORS FOR PREVENTIVE WORK OF FIRE AND RESCUE SERVICE (1999-2003)**

	% change 1999 vs. 2003 (forec.)
# of Administrative Penalties	-12%
Amount of Administrative Penalties, Lats	3%

- 4) Changes in number of different types of sanctions, including has there been an increase in the number of warnings?

**Table XX. PERFORMANCE INDICATORS OF STATE LABOUR INSPECTORATE (2001-2003)**

Select Indicators	% changes 2001 vs. 2002 (indicated where forecast data for 2003 was not available)	% changes 2001 vs. 2003 (forec.)
# of issued orders	-11%	
# of identified offences	-40%	
# of issued warnings for suspension of activities		<b>-22%</b>
# of suspended equipment		<b>-44%</b>

**Table XX. PERFORMANCE INDICATORS FOR PREVENTIVE WORK OF FIRE AND RESCUE SERVICE (1999-2003)**

	% change 1999 vs. 2003 (forec.)
Warnings on suspending operation of certain objects, equipment, etc.	-52%

5) Improvement in communication among the inspectorates

Interviews with some inspectors indicate that the communication among the various related inspectorates has improved substantially and is now part of the routine work process.

6) Improvement in communication with the business community

**Table XX. PERFORMANCE INDICATORS OF STATE LABOUR INSPECTORATE (2001-2003)**

Select Indicators	% changes 2001 vs. 2002 (indicated where forecast data for 2003 was not available)	% changes 2001 vs. 2003 (forec.)
Cooperation with mass media on the Labor Inspectorate issues		28%

**Table XX. PERFORMANCE INDICATORS FOR PREVENTIVE WORK OF FIRE AND RESCUE SERVICE (1999-2003)**

	% change 1999 vs. 2003 (forec.)	% change 2000 vs. 2003 (forec.)
Consultations in project design, construction and fire safety issues		2%
Materials published in printed media	66%	
Radio shows organized		5%
Fire Safety Sessions and Seminars organized in other organizations and institutions		66%
# of participants		51%
Information Prepared for Municipalities and Owners of Residential Real Estate on Fire Safety Conditions		31%
# of Reviewed Requests, Applications and Complaints		75%

7) Change in number of appeals or outcome of appeals

Based on the results of the self-assessment templates of 2001, only several inspectorates keep track of appeals and these tend to be relatively few. In fact, the

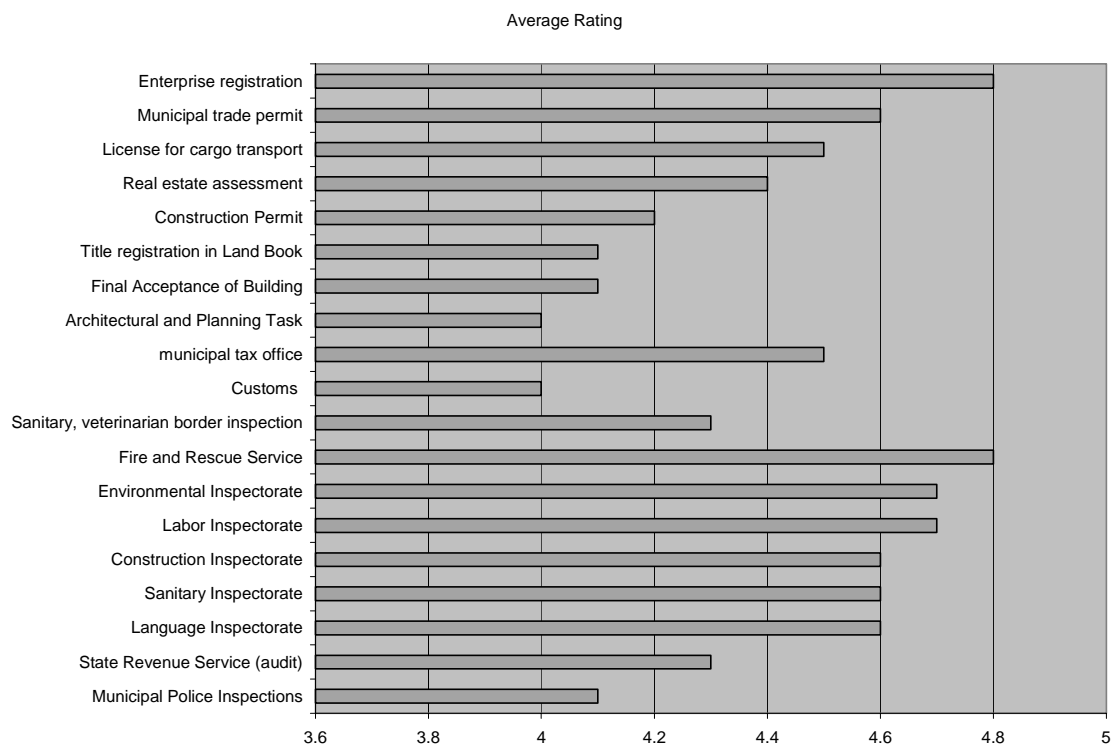
State Labor Inspectorate stated that it only started to keep track of this type of data from 2002. The Sanitary inspectorate, the Fire-fighting and Rescue Service, the Environmental Inspectorate were able to provide statistical information, but the cases of appeals were still very few. The State Revenue Service said that there were 804 appeals in 2001, but this may not be a great number due to the scope of the SRS's work.

4. *Impact on the ground.*

1) Improved client (enterprise) satisfaction with inspections procedures

As the following chart from the 2001 ARCS demonstrates, the inspectorates are some of the best rated government institutions.

Figure 5 Average Evaluation of Inspection Performance Quality



*Base: companies that have been visited by respective inspection and have given particular answer on scale from 1 'Very bad' to 6 'Very good',*

**[Comparable data from 2003 ARCS to be inserted here]**

- **Improved employee/staff satisfaction.**

Interviews with some inspectors indicate that the satisfaction with the job has increased, but any optimism in this regard is usually subsumed by the more critical issue of wages. On the other hand, if satisfaction has improved while wages remain miserable, this is an important indicator of success.

2) Improved compliance by enterprises with rules and regulations

Table 1. PERFORMANCE INDICATORS OF STATE LABOUR INSPECTORATE (2001-2003)

Select Indicators	% changes 2001 vs. 2002 (indicated where forecast data for 2003 was not available)	% changes 2001 vs. 2003 (forec.)
# of identified organizations and enterprises under supervision		<b>17%</b>
# of labor safety specialists in the identified organizations and enterprises		4%
# of inspected organizations and enterprises		<b>5%</b>
# of issued orders	-11%	
# of identified offences	-40%	

Table 2. PERFORMANCE INDICATORS FOR PREVENTIVE WORK OF FIRE AND RESCUE SERVICE (1999-2003)

	% change 1999 vs. 2003 (forec.)	% change 2000 vs. 2003 (forec.)
Overall Inspections	15%	5%
Follow-up Inspections	29%	15%
Selective Inspections		-33%
Warnings on suspending operation of certain objects, equipment, etc.	-52%	
# of Administrative Penalties	-12%	

3) Fewer instances of corruption reported.

As noted above, the World Bank's 1998 Report on Corruption in Latvia provides information on enterprises that "had contact" (which excludes those that were not visited by an inspectorate, for example), recording the percent of the relevant enterprises who reported that "unofficial payments" are required. For the inspectorates, the results are as follows:

- Sanitary inspections: about 12%

- Fire inspections: about 11.5%
- Inspection by tax authorities or audits: about 8%

The graph from the Report on Corruption records the results of two questions:

- “How frequently do firms like yours come into contact with government agencies or state enterprises providing the following services? (Daily, Weekly, Monthly, Quarterly, Semiannually, Yearly, Almost Never, Never) and
- “How frequently do the relevant officials require unofficial payments or make it known that they would like unofficial payments? (including gifts) (never, 1-20% of the time, 21-40%, 41-60%, 61-80%, 81-99%, always)

This is a quasi-perception question since the reference in the first question is to “firms like yours.”

The 2001 ARCS shows the following results for these inspections, from the question whether the business respondent paid a bribe or made a gift to various government agencies. There were two tiers of questions:

1. “Did you have to pay for [inspectorate]”
2. If yes, “Have you had...[number of types of payments, including] to give gifts or bribes?”

- State Revenue Service: 2% (n = 93)

It should be noted that the data from the two sources is not directly comparable due to different methodologies, different samples, different phrasing of questions. Nevertheless, with these caveats in mind, a comparison between the two results indicates that there has been improvement.

Data from businesses who had been inspected by the Labor Inspectorate and the Fire and Rescue Service were too low to yield valid statistics. Other agencies recorded in the 2001 ARCS include the following:

- Municipal Police: 9% (n = 51)
- Sanitary and Veterinary  
Border Inspection (import): 9% (n = 82)
- Sanitary and Veterinary  
Border Inspection (export): 1% (n = 55)

**[Comparable data from 2003 ARCS to be inserted here]**

## **“Winners and losers”**

Many reform programs tend to have “winners” and “losers” – those who ultimately benefited versus those who did not. As the 1997 World Development Report has noted, “resistance to reform is often triggered by the potential redistribution of resources among different groups, whose precise composition will depend on the reform in question.”<sup>20</sup>

The Latvian case, however, does not seem to have been predicated upon a “winners and losers” paradigm. As demonstrated above, many of the reforms relating to removal of administrative barriers in Latvia (including the improvement of the inspectorates’ activities) overcame the distributional problems inherent in this paradigm. This possible exception to a general rule can be attributed to two factors: first, the nature of the consensus to drive the reform efforts forward and second, the fact that many of the reform efforts were not sufficiently important or costly to any one interest group that such groups would act as an insurmountable source of resistance or, upon successful implementation of reform, become the clear (and sore) “losers”.

One of the primary factors that make the “winners and losers” model difficult to apply in Latvia was the underlying political consensus: EU accession. Related – and also generally accepted – goals included the improvement of the investment climate and the reduction of corruption. Through various outreach campaigns to stakeholders, the press and the general public, the term “removal of administrative barriers” came to be understood as an integral component in the nexus that leads to improvement of the investment climate and ultimately economic growth and development. These were the arguments that were developed at the beginning of the reform initiatives and became generally adopted by all stakeholders. In fact, one politician later stated, “the real “losers” were those institutions or organizations that did not participate in the reform process.”

Another factor contributing to the lack of resistance to the reforms (and therefore minimizing the possibility that there would be definable “losers”) was the nature of the reforms – they were sufficiently low-intensity, low-profile and cross-cutting that few politicians became excited about any one of these issues, whether reform of construction, inspectorates, border crossing, etc. A leading technocrat involved in the reform efforts noted that for there to be resistance to reform, the reform would have to be important or costly for someone. It appears that one of the characteristics of the reform of administrative procedures seems to be the relatively low costs involved.

## **Municipal Police**

The success of the Inspectorate Reform Program can also be demonstrated by contrasting it with the example of an “inspection” institution that did not participate in these reform efforts – the municipal police.

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<sup>20</sup> From the 1997 World Development Report, p. 146.

As mentioned above, the 2003 Self-Assessment of Administrative Procedures on Doing Business in Latvia found that the overall evaluation of the work of the inspectorates in Latvia is favorable and they do not create significant problems for enterprises. One exception, however, was found to be the municipal police; the report found evidence of abusive and corrupt behavior on the part of some municipal police.

The 2001 ARCS yielded evidence of two clear categories of problems associated with the municipal police: First, they were ranked among the highest of categories of public servants in the incidence of bribery, and second, they are ranked among the lowest of agencies within the public sector in terms of “quality of service”. This is particularly interesting in the context of this background paper because some inspectorate involved in the reform process received some of the highest satisfaction ratings in the 2001 survey, such as the Fire and Rescue Service, Environmental, Labor, Construction, Sanitary and Language inspectorates.

The municipal police were found to have an unclear and often overreaching mandate and poor coordination with other institutions. The municipal police were reported to often engage in inspections-type activities, but without the mandate to do so. As one entrepreneur noted: “This can be not only damaging to business activities, it may also lead to opportunities for corruption.”

The Self-Assessment Reports states:

“In focus groups, business representatives repeatedly expressed a notably negative opinion regarding the work of the municipal police. It was mentioned that the municipal police have a very broad mandate, that that mandate is unclear and that there is a lack of coordination in the institutional framework of the municipal police, as well as in terms of cooperating with state and other municipal institutions. Business representatives expressed concern that as a result they get visited and controlled often, with the municipal police searching for infractions, and if they cannot impose a penalty, they threaten to warn the relevant institutions that can.”

These complaints are almost identical to the ones that FIAS heard in 1998 to regarding state-level inspections.

The 2003 Self-Assessment Report recommended: “Other institutions may also benefit from these reform activities [of the inspectorates]. For example, the municipal police sometimes overstep their mandate and perform regulatory checks, thereby overlapping in functions with the respective inspections.”

Perhaps following the example of the reform activities undertaken by the inspectorates, the Riga Municipal Police reports (in a letter dated November 2003) that it has now undertaken the following reforms:

- The Riga Police have signed an agreement on cooperation with the State Police.
- The Riga Police have issued an instruction “On Work Organization”. The purpose of this instruction is to articulate and standardize the rights and

responsibilities of the municipal police when undertaking inspections functions.

- The Riga Police have set up a database of penalties imposed.

**“Costs and benefits”**

While the reforms of inspectorates represented only one aspect of a larger and broader set of reforms to improve the investment climate, the combined impact of all such reforms in Latvia has been very impressive. Table 3 and Table 4 below shows how Latvia’s ratings have improved across a large range of measures of the investment climate.

Business environment is measured in a variety of ways. There are numerous periodic indicators and ratings on various aspects of the environment for doing business, compiled, among others, by the Economist Intelligence Unit, the Heritage Foundation, the World Bank and the EBRD, A.T.Kearney, the World Economic Forum, etc. Many indicators, if not all of them, are based on the individual perceptions of respondents and are at times difficult to compare. Nevertheless, they represent the existing sentiment of the markets towards the business environment at a point in time. A rather representative indicator follows. Table 1 on the World Economic Forum’s Business Competitiveness Index shows that Latvia has made some of the largest improvements over the last two years of all the EU Accession countries.

**Table 3 Business Competitiveness Index**

Country	BCI ranking		Business environment		Company operations and strategy	
	2003	2001	2003	2001	2003	2001
Estonia	28	28	27	26	36	32
Latvia	29	41	31	42	29	35
Slovenia	30	32	34	35	27	28
Czech Republic	35	34	38	31	33	41
Hungary	38	27	37	25	45	33
Lithuania	40	50	41	47	41	47
Slovak Republic	42	40	42	36	44	57
Poland	46	42	44	40	43	55
Turkey	51	35	54	33	50	44
Romania	67	61	64	60	72	63
Bulgaria	68	68	67	65	73	70

**Table 4**  
**LATVIA: Summary of Ratings**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>Heritage Foundation's Index of Economic Freedom</b> 1/		3.05	2.95	2.85	2.75	2.65	2.65	2.5	2.45
<b>Transparency International's Corruption Perception Index</b> 2/				2.7	3.4	3.4	3.4	3.7	3.8
<b>EIU's Country Risk Service</b> 3/		75	51	53	53	50	43	41	
<b>Euromoney's Country Credit Ratings</b> 4/	31.09	47.12	57.71	37.81	50.41	53.11	52.56	58.84	62.11
<b>Institutional Investor's Country Credit Ratings</b> 5/	23.4	25.7	32.6	36.3	40.8	47.9	48	52	51.5
<b>EBRD's Transition Report</b> 6/									
a) EBRD rating of legal extensiveness (company law)			3.3	3.3	3.7	4	3.7		
b) EBRD rating of legal effectiveness (company law)			3	2	3	3.7	4		

1/ The Index is based on 10 broad factors of economic freedom (Trade policy, Fiscal burden of government, Government intervention in the economy, Monetary policy, Capital flows and foreign investment, Banking and finance, Wages and prices, Property rights, Regulation, and Black market).

Each country is given a score ranging from 1 through 5 for all 10 factors; then these scores are averaged to get its final Index of Economic Freedom score. Countries with a score between 1 and 2 have the freest economies; those with a score around 3 are less free; those with a score near 4 are excessively regulated and will need significant economic reform to achieve sustained increases in economic growth; and those with a score of 5 are the most economically repressed.

2/ All countries in the CPI obtain scores between 0 (very corrupt) and 10 (highly clean).

3/ Letter scores range from "A" (the lowest risk) to "E" (the highest risk). Overall scores are awarded in one-point increments, and can range from 0 ("A" category) to a maximum of 100 points ("E" category) for the highest-risk countries. The "A"

ratings category encompasses scores from 0-20; the "B" ratings category, 21-40; the "C" ratings category, 41-60; the "D" ratings category, 61-80; and the "E" ratings category, 81-100.

4/ To obtain the overall country risk Score, Euromoney assigns a weighting to 9 categories (political risk - 25%; economic performance - 25%; debt indicators - 10; debt in default or rescheduled - 10%; credit ratings - 10%; access to bank finance - 5%; access to ST finance - 5%; access to capital markets - 5%, and discount on forfeiting - 5%)  
The higher the obtained total score, the better the credit rating.

5/ Each country has been graded on a scale of zero to 100, with 100 representing those countries that have the least chance of default.

6/ The EBRD's Office of the General Counsel has developed measures to assess the extent to which key commercial and financial laws have reached internationally accepted standards (extensiveness) and the degree to which these laws are implemented and enforced (effectiveness). Scores range from 1 (bad) to 4+(excellent).