

Licensing Procedures in Developing Countries: Should They Be Part of the Set-up Process?

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I. Introduction

As revealed in a World Bank study¹, developing countries tend to regulate the set-up processes for firms more intensively than developed countries and such heavier regulation does not obviously generate social benefits.² Here the business set-up process refers to all procedures that an entrepreneur needs to carry out in order to begin legally operating a firm involved in any industrial or commercial activity.³ Accordingly, there may be public interest arguments for developing countries relaxing their regulations in the set-up process on condition that the related public interest regulatory functions are not jeopardised.

There are two main types of regulatory controls in the set-up process for firms in developing countries: registration and licensing.⁴ Registration requires the actor to furnish the public authority with specific information prior to being allowed lawfully to engage in the business activity. The officials merely accept the information and keep it in files;⁵ there is no need to evaluate if applicants meet the substantive conditions. In contrast, licensing is intended to test the suitability of applicants and/or their circumstances against substantive conditions and involves some degree of decision-making discretion.

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¹ See The World Bank, *Doing Business in 2004, Understanding Regulation* (2004, Oxford University Press), 17-28; its overview is available at <http://rru.worldbank.org/Documents/DoingBusiness/DBoverview.pdf>

² S. Djankov, R. La Porta, F. Lopez de Silanes and A. Shleifer, 'The Regulation of Entry', (2002) 117 *Quarterly Journal of Economics* 1.

³ *Ibid*, 5.

⁴ See A. Ogus and Q. Zhang, "Licensing Regimes: East and West", (2004) 24 *International Review of Law and Economics* (forthcoming).

⁵ They may need to verify if all the required information has been provided.

The different characteristics of these regulatory controls suggest different possible deregulatory measures in developing countries. For registration requirements, a “one-stop shop” system and/or on-line registration or data exchange, if available⁶, can effectively reduce the number of registration transactions and the time spent on related processes. An applicant might then submit a single form containing all the information required by various agencies simply to a single agency. As regards licensing requirements, such a one-stop shop system might not work well,⁷ and deregulatory strategies need to be approached with caution. There are two main possibilities: 1) abolishing the licensing requirements or using less interventionist regulatory techniques such as registration or ex-post standards if the latter are better to serve the public interest regulatory purpose;⁸ 2) where a licensing requirement itself is justified on public interest grounds, separating it from the set-up process. The latter arrangement requires further explanation.

When a licensing requirement constitutes part of the set-up process, it must be met before an enterprise can lawfully exist and operate in any respect. Usually, there is at least one procedure in the set-up process to verify that the licensing requirement has been met and thus the authorities are satisfied with the quality of market participants. In contrast, if a licensing requirement has been separated from the set-up process, it merely requires authorisation for the particular activities that are to be controlled, which does not affect the right of the firm to exist and engage in other business activities.⁹ Where the licensing procedure is integrated in the set-up process, we call it “set-up licensing” (SL); where it is independent of the set-up process, we call it “independent licensing” (IL). As we will see, SL regimes impose more entry costs, particularly delay costs, on entrepreneurs than IL regimes, if we assume that apart from this procedural difference the arrangements are identical. Under IL regimes, the

⁶ Some developing countries may not have such an infrastructure for communication.

⁷ See F. Sader, ‘Do ‘One-Stop Shops’ Work?’, FIAS (Foreign Investment Advisory Services) working paper, available at <http://www.fias.net/documents/> (visited on January 2004)

⁸ For general discussion on this, see A. Ogus and Q. Zhang, above, note 4.

⁹ The distinction is made in J. Morisset and O. Neso, ‘Administrative Barriers to Foreign Investment in Developing Countries’, World Bank Policy Research Working Paper No 2848 (2002), available at: <http://econ.worldbank.org/files/> (visited on 7 July 2004)

set-up processes can run concurrently with the IL procedures. Therefore, the entrepreneur can complete both procedures more quickly (and the costs are lower) than when the procedures must be followed sequentially.

In section II, we classify SL regimes into two categories: general set-up licensing and sector set-up licensing. Then we contrast SL regimes with IL regimes in terms of costs imposed on the officials, entrepreneurs and consumers. In section III, we introduce some examples of the use of SL and IL in developing countries. We then, in section IV, examine possible public interest justifications for preferring SL to IL; and in section V, consider possible private interest explanations for SL regimes, exploring who can obtain rents from such systems. In section VI, we reach some brief conclusions.

II. Types of Set-up Licensing

As we have seen, a business set-up process consists mainly of those procedures that are required of an entrepreneur to obtain all necessary permits (licensing procedures) and to notify, and file with, all relevant authorities (registration procedures).¹⁰ Many different agencies are involved in the set-up process. Developing countries usually have more registration and licensing procedures than developed countries.¹¹ These licensing procedures are SL procedures according to our above definition.

In theory, the SL procedure can be classified into two kinds: general set-up licensing (hereafter GSL) and sector set-up licensing (hereafter SSL). GSL refers to a licensing requirement imposed on all entrepreneurs before they can establish any kind of businesses. In many developing countries, some form of GSL regime is imposed,¹² typically for zoning approval, environmental impact certificates, and approvals relating to working safety, building, fire, sanitation, hygiene, minimal capital

¹⁰ S. Djankov et al, above, note 2, 5-6.

¹¹ Ibid, 1.

¹² N. Devas and R. Kelly, 'Regulation or Revenue? An Analysis of Local Business Licences, with a Case Study of the Single Business Permit Reform in Kenya', (2001) 21 *Public Administration and Development* 382.

requirement.¹³ For example, in Gaborone city, Botswana, before the set-up process can be completed, as part of the application procedure for a trading or industrial licence, all firms must have their premises inspected by the health and environmental authorities to ensure compliance with minimum standards.¹⁴ In contrast, SSL applies only to those entrepreneurs wishing to engage in some sector industries. It requires entrepreneurs to obtain an approval for a sector business from a sector licensing authority before they complete the set-up procedure. For example, in Costa Rica, an entrepreneur wishing to run a restaurant must obtain a clearance from the fire department before fully finishing his business registration.¹⁵ Although not identified as such in the World Bank study,¹⁶ SSL regimes¹⁷ are often used in developing countries to regulate specific business sectors.¹⁸ For instance, in the Philippines, these include: retailer/wholesaler/manufacturing of veterinary products, feeds and veterinary clinics, retailer/wholesaler/manufacturing of pharmaceutical and food products, custom broker, real estate broker, auto repair shop, electronic repairs shop, telecommunication repair shops, vocational school.¹⁹

There are important differences between the SL and IL procedures. Since IL is independent from the set-up process, entrepreneurs can choose to engage in the IL procedure before, after, or concurrently with the set-up process. By way of example,

¹³ Ibid, 11 and see a World Bank database to be found at <http://worldbank.org/Doing Business/Topic Reports/EntryRegulations>. Some developed countries, e.g. France and Germany, also have their GSL regimes, notably, minimal capital requirements; more information in this aspect is available from the World Bank database.

¹⁴ More information about the set-up process in Botswana is available from the World Bank database, above, note 13.

¹⁵ T. Jansson and G. Chalmers, 'The Case for Business Registration Reform in Latin America', Inter-American Development Bank Sustainable Development Department Best Practices Series, MSM-110, 15-16, available at <http://www.iadb.org/sds/mic> (visited on 8 August 2004)

¹⁶ See the World Bank, above, note 1; and S. Djankov et al, above, note 2,

¹⁷ The study chooses a "standardized" firm which is exempt from the industry-specific requirement; see S. Djankov et al, above, note 2, 7-8.

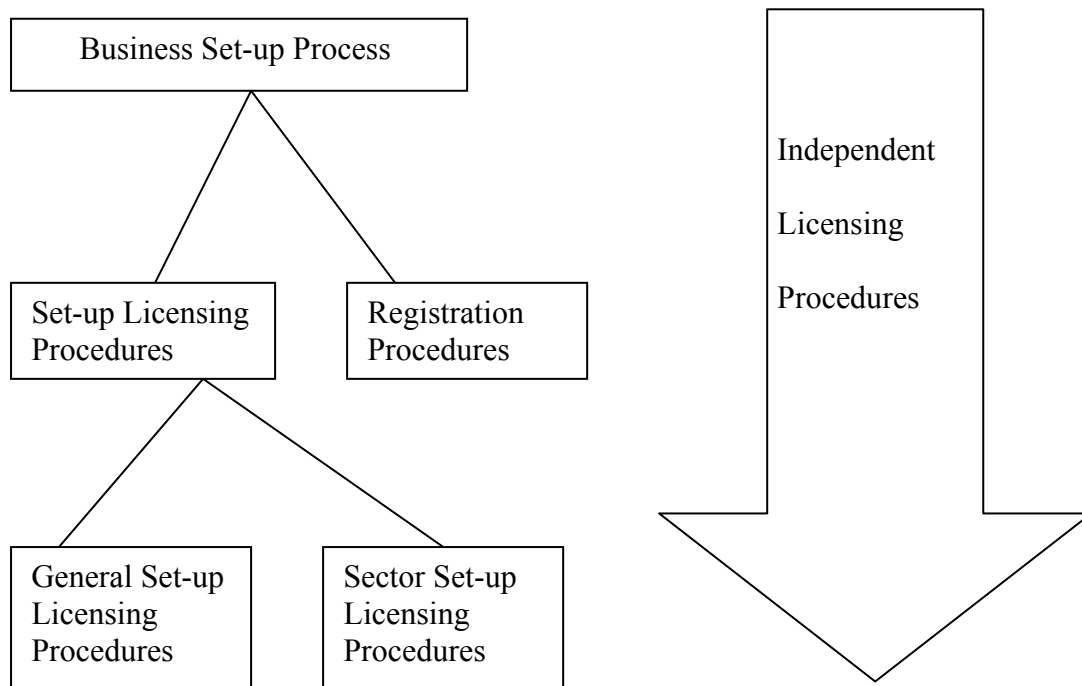
¹⁸ See the examples for Costa Rica and the People's Republic of China in this paper. For examples in Philippines, see P. Legaspi, "Local Regulatory Government in the Philippines: focus on Quezon City", paper presented at the CRC 2nd Annual Conference (2003), Manila, 12-14.

¹⁹ P. Legaspi, above.

take the different licensing procedures for the manufacture of pharmaceutical products in the People’s Republic of China, where SL prevails and the United Kingdom where IL is used. Let us assume that entrepreneurs decide to establish a limited liability company for this purpose. In China, the entrepreneurs cannot register with the Industry and Commerce Administration for the limited liability company unless they have first obtained a drug manufacturer’s licence from a branch of the State Food and Drug Administration at the provincial level.²⁰ In the United Kingdom, the procedure of registering with Company House for the same purpose is independent of the procedure for obtaining a drug manufacturer’s licence.²¹ Entrepreneurs can decide when to register with Company House and when to apply for the drug manufacturer’s licence.

We use Diagram 1 to illustrate the difference between the SL and IL regimes.

Diagram 1:



²⁰ Article 7, the Pharmaceutical Administration Act of the People’s Republic of China (2001).

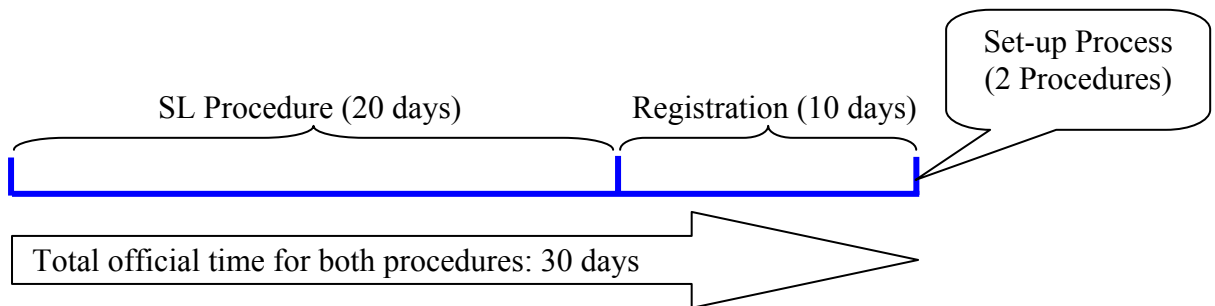
²¹ More information is available

<http://www.companieshouse.gov.uk/infoAndGuide/companyRegistration.shtml> (visited on 5 August 2004).

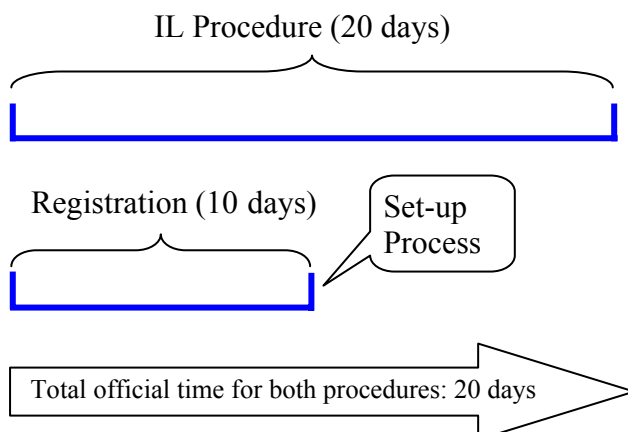
For further analysis, we need to compare the SL and IL regimes in relation to administrative costs, compliance costs to and other indirect costs incurred by, respectively, officials, entrepreneurs and consumers. To facilitate our analysis, we choose a simplified example, as illustrated in Diagram 2. We assume that, under a SL regime, the set-up process consists merely of two consecutive procedures. One is the SL procedure (taking 20 days); the other one is a registration procedure (taking 10 days), during which the responsible agency checks to ensure that a copy of the set-up licence has been supplied, but has no discretion to reject the registration application once the copy has been supplied. If, however, licensing is required under an IL regime, an entrepreneur may choose to engage in the IL procedure concurrently with the registration process, which is also a set-up process. Then we have two parallel procedures: one is the IL procedure (taking 20 days); the other one is the registration procedure (taking 10 days). For convenience, we assume that, in respect of matters other than procedure, the substantial conditions under the two systems are identical. The comparison is illustrated in Diagram 2:

Diagram 2:

SL Regime:



IL Regime:



The administrative costs incurred by officials include mainly the costs of processing the applications, inspecting and monitoring the entrepreneurs (including detecting and apprehending unlicensed entrepreneurs). Under the SL regime, the costs of processing the applications can be somewhat greater than those under the IL regime, because the officials under the SL regime have the additional task of checking that a copy of the licence has been submitted.

The compliance costs to the entrepreneurs include direct administrative costs in making their application, other capital investment in meeting both registration conditions and licensing conditions and lost profits resulting from the length of the application process (e.g. losses from delay and failure in marketing new products). Entrepreneurs incur different compliance costs under the two systems. If the SL regime is adopted, it takes entrepreneurs at least 30 days to complete the SL and registration procedures before they can lawfully begin the business. In contrast, under the IL regime, this can be done within 20 days. The reduction in time involves not only a saving of direct expenditure, but also on profits that can be earned during the period.

As regards indirect consumers' costs, these mainly include any welfare losses arising from barriers to competition caused by the above regulatory requirements. For example, the length of the application process for the license and registration certificates, may delay the marketing of new products. SL regime may therefore generate greater consumers' losses than the IL regime, because of the additional delay in making the products available to them.

Sometimes the distinction between the SL and IL regimes will be small if entrepreneurs wish to engage in other, unregulated business activity, in addition to that subject to the SL requirement. For example, in China, entrepreneurs can begin to operate other unregulated activity by registering the businesses with the Industry and Commerce Administration, while their application for a set-up licence from a sector agency (SSL) is being considered. However, under the SL regime, even if approval is obtained from the sector agency, they will not be able to begin the sector business

until they have re-registered the licensed business with the Industry and Commerce Administration.²² The re-registration also costs entrepreneurs time and money.

III. Some Experiences with Set-up Licensing and Independent Licensing Regimes in Developing Countries

1. Experiences with General Set-up Licensing Regimes in the Philippines and Kenya

In the Philippines, obtaining a mayor's permit is required as part of the general set-up process;²³ and, within that process, it is both the most significant and the most time-consuming (average at 21 days) of the procedures.²⁴ Applicants for a mayor's permit must normally supply the following documents:²⁵ a building permit from the Engineering Office for the construction of offices or buildings (if any such construction is desired); a barangay clearance (indicating that the village government approves the business operating in its area); a location clearance (if the business is within an approved zone area) from the Planning and Development Office; a certificate of occupancy from the City Building Office (or a certificate of electrical inspection from the City Engineering Office); a fire safety inspection certificate from the Fire Station of the Department of Interior and Local Government; a contract of lease or proof of ownership; a health certificate for employees and a sanitary permit from the Health Office; a Securities and Exchange Commission registration certificate; the articles of incorporation and a receipt of corporate community tax (for single proprietorship); a trade name from the Department of Trade and Industry; a receipt of

²² Article 8 and 15 of the Registration Regulation of Business Scope of Enterprises (issued by the State Industry and Commerce Administration of the People's Republic of China on 14 June 2004).

²³ A detailed description of the set-up process in the Philippines is available at the Database of World Bank Group, available at <http://rru.worldbank.org/DoingBusiness/TopicReports/EntryRegulations-Summary.aspx?regionid=153> (visited on 6th June 2004)

²⁴ Ibid. In practice, it often takes a business proprietor several months to get a mayor's permit. (See P. Legaspi, above, note 18, 24)

²⁵ There are often different document requirements in various cities; here we list only the commonly required documents.

business tax payment.²⁶

These documents *de facto* represent the licensing criteria for obtaining the mayor's permit. Furthermore, most of these licensing criteria themselves constitute independent licensing requirements. Since these licensing requirements apply to all entrepreneurs and all business sectors, they are GSL regimes according to our definition. In this case, the office responsible for issuing the mayor's permit serves to verify these GSL procedures. The mayor's permit regime has been strongly criticised for its excessive GSL requirements and cumbersome procedures.²⁷ Some changes, including the computerisation of systems and the streamlining of procedures to cut down service-processing time have been introduced in the Philippines.²⁸ But hitherto the reforms have not involved a shift from GSL to IL regimes.

In Kenya, before 2000, business proprietors had to demonstrate that they had complied with the planning, public health and safety requirements as pre-requisites for obtaining a business licence.²⁹ These requirements constituted a GSL regime. They could cause lengthy delays and in many cases applicants were incapable of meeting the requirements.³⁰ For example, before being issued with a health certificate, entrepreneurs might have to wait for an inspection by health officials but few such officials were available to carry out inspections.³¹ Licensing officials could easily find

²⁶ This summary is drawn from information on the mayor permit in three cities (Dipolog, Muntinlupa and Parañaque); and also see P. Legaspi, above, note 18; the information about documents required in the city of Dipolog is available at <http://dipologcity.gov.ph/feesandrequirements.htm>; for the city of Muntinlupa at <http://www.muntinlupacity.gov.ph/services/businesspermits.htm>; and for the Parañaque City at <http://www.pquecity.com/proc-buspermit.htm> (all visited on 6th June 2004)

²⁷ See P. Legaspi, above, note 18, 19.

²⁸ Ibid.

²⁹ For more information about the reform, see N. Devas and R. Kelly, 'Regulation or Revenue? Implementing Local Government Business Licence Reform in Kenya', Harvard Institute for International Development Discussion Paper NO.723 (1999), 21; and see C. Abuodha and R. Bowles, 'Business licence reform in Kenya and its impact on small enterprises', (2000) 11 *Small Enterprise Development* 16.

³⁰ N. Devas and R. Kelly, above, note 12, 385.

³¹ Ibid.

some reasons to reject an application.³²

A reform in 2000 changed these GSL requirements into IL requirements.³³ The requirements concerning public health and safety are therefore imposed not as a precondition of the (business) licence but rather on an ongoing basis: inspections are carried out at any time and in the event of contraventions, the law confers on the authorities the power to revoke the business licence on receipt of a written report stating that the business is jeopardising the community health and safety. It has been said that, “regular and random inspections are more likely to be effective than the requirements for an approval stamp on a licence application every year. In any case, most public protection issues are already enforced-insomuch as they are enforced-through process separate from local business licensing.”³⁴

2. Set-up Licensing Reform in China

In China, nobody can lawfully operate a new business without a registration certificate from the Industry and Commerce Administration (hereafter ICA).³⁵ If the proposed business is in a sector subject to a licensing requirement, the applicants must obtain this licence from the sector licensing agency and submit a copy of the licence as a supporting document in the application for a registration certificate.³⁶ This is therefore a SSL regime. Since 1998, the Chinese government has carried out some reforms of SSL regimes.³⁷ A number of SSL requirements have been removed from the set-up process.³⁸ In addition, some local governments have introduced reforms,

³² Ibid.

³³ Ibid; and also see N. Devas and R. Kelly, above, note 29, 21.

³⁴ N. Devas and R. Kelly, above, note 12, 386.

³⁵ For the set-up process for a limited liability company in China, see the World Bank Group Database, available at <http://rru.worldbank.org/DoingBusiness/TopicReports/EntryRegulations-Summary.aspx?regionid=42>. (visited on 8th August 2004)

³⁶ Article 19 of the Regulations of the People's Republic of China on Registration of Companies, 1994.

³⁷ See X. X. Zhang, *Research in Administrative Licensing Law* (in Chinese, Beijing University Press, 2004), 34-36; also see W. Cui, ‘Shenpi (Licensing) Reform from the Perspective of One Municipal Jurisdiction: Ideologies, Institutions, and Law’, (2003) 33 *Hong Kong Law Journal* 417.

³⁸ For example, in Guandong province, see Guandong Provincial Industry and Commerce Administration (hereafter GPICA), *Some opinions concerning Reform on Enterprise Registration* (endorsed by Guandong Provincial Government in October 2003); in Hubei Province, see Hubei

involving some shift from SSL to IL regime, the use of parallel licensing or joint licensing procedures in case of multiple SSL requirements and a conditional registration certification.

In 2002, in order to reduce the number of SSL requirements and thus improve administrative efficiency, all existing SSL requirements in the Hubei province were categorised into two types: A and B.³⁹ A type licensing requirements still have to be met before applying for a registration certificate and thus still constitute SSL requirements. They cover those business sectors affecting national, social and economic security, people's health and safety, exploitation of natural resources, allocation of public resource, and those sectors monopolised or exclusively controlled by the State. The remaining business sectors are subject to type B licensing requirements that can be met after business registration and thus belong to IL Regimes.⁴⁰ For example, in the agriculture and fisheries industries, after the reform, the sectors subject to type A licensing requirement include: the manufacturing of pesticides, the manufacturing and trading of veterinary medicines, the purchasing, selling, domesticating and breeding of wild aquatics under the first class or second class state protection. The sectors subject to type B licensing control include: e.g. seeds planting, seeds trading, the purchasing and selling, domesticating and breeding of wild animals under state protection.⁴¹

In the case of multiple SSL requirements, parallel licensing and joint licensing procedures have been used to shorten the set-up process. The parallel licensing procedure requires different licensing agencies to engage in processing applications

Provincial Industry and Commerce Bureau (hereafter HPICA), *Some Opinions concerning Reform on Entry Licensing regime of Industry and Commerce Enterprise Registration* (endorsed by the Hubei Provincial Government in August 2002).

³⁹ See HPICA and Hubei Provincial Legal Affairs Bureau (hereafter HPLAB), *A List of Entry Licensing Requirement for Registration of Industry and Commerce Enterprises* (jointly issued in September 2004).

⁴⁰ See Jinmen Municipal Government (Hubei Province), *The Implementation Rules concerning the Categorization of A and B Type Licensing for Registration of Industry and Commerce Enterprise* (issued in January 2003), available at <http://www.jmaic.net/zhengfushenpi.htm>. (visited on 7th August 2004)

⁴¹ See HPICA and HPLAB, above, note 39.

simultaneously instead of sequentially when the exercise of authority by one licensing agency does not depend on a decision from the other agency.⁴² And this is sometimes facilitated by creating a "one-stop" shop.⁴³ If an entry licensing agency's decision relies on the decision by another licensing agency, a joint-licensing procedure may be used.⁴⁴ Under this procedure, applicants submit an application and related materials in one transaction, pay a single fee, and obtain the necessary approvals from a single agency.⁴⁵ Officials from the relevant SSL agencies are then required to meet and make their joint licensing decision.⁴⁶

Further, some local governments have introduced an experimental system called "a conditional registration with the applicant's promise".⁴⁷ Under this arrangement, applicants wishing to operate a sector business under the former SSL regime can obtain their registration certificate from the ICA without submitting a copy of the licence issued by the sector licensing agency.⁴⁸ But there are two conditions for the above arrangement:⁴⁹ first, applicants must acknowledge the SSL requirements and promise not to operate the sector business until they obtain a licence from the sector

⁴² For example, in Shanghai, a parallel licensing procedure is required; see Shanghai Municipal Industry and Commerce Administration, *Shanghai Municipal Regulation Regarding Adoption of Parallel Licensing Procedure for Business Registration* (endorsed by the Shanghai Municipal Government in July 2001).

⁴³ W. Cui, above, note 37, 442.

⁴⁴ See, e.g. the joint-licensing centre of construction projects in Harbin City, Heilongjian Province, P.R.C. available at http://www.hrblszx.gov.cn/fwzn/fwzn_yxjz.htm; and the Joint-licensing serve centre of Ciqi City, P.R.C, available at <http://www.cixi.gov.cn/lpzx/index.asp> (visited on 6 August 2004)

⁴⁵ W. Cui, above, note 37, 442.

⁴⁶ The joint-licensing procedures may generate scale economies where almost all the information at the meeting is necessary for all the licensing agencies to make their decision and their face-to-face communications are crucial for their decision-making. The joint-licensing procedures may save the communication costs between SEL agencies, but it also increases the administrative costs including the costs in coordinating and holding the meeting.

⁴⁷ For example, Guandong Province, Shanghai City and Fujian Province.

⁴⁸ See, e.g. Fujian Provincial Industry and Commerce Administration, *Some Guidelines on Promoting and Helping the Development of Enterprises in Fujian Province* (issued in May 2004); also see GBICA, *Some Guidelines on Reform of Enterprise's Registration Requirements* (issued in November 2004);

⁴⁹ Ibid.

licensing agency; second, the registration certificate is provisional and applicants must return to the ICA for a formal registration certificate after they secure the licence from the sector licensing agency. This arrangement may, to some extent, reduce the applicant's compliance costs by shortening the time of the set-up process. For example, the applicant can, with the provisional registration certificate, complete other subsequent set-up procedures, e.g. registering with the tax authority and opening a company account in the bank. However, the requirements of promising and obtaining a formal registration certificate still impose more costs on the applicants than the IL regime.

At the very least, the above reforms imply that some developing countries have recognised that higher compliance costs are imposed by SL regimes, compared with IL regimes. However, most of their reforms seem not to aim at a complete shift from the SL to IL regimes. We will further discuss the possible reasons for these phenomena.

IV. Public Interest Justifications for Preferring Set-up Licensing to Independent Licensing Regime

1. Justifications for Preferring General Set-up Licensing to Independent Licensing Regime?

As we have shown in an earlier paper,⁵⁰ a public interest analysis of GEL regimes mainly involves choosing between an *ex ante* licensing requirement and regulation which does not control entry but rather is applied *ex post*, including information regulation (mandatory disclose) and/or on-going performance standards.⁵¹ Few GEL regimes can be justified on public interest grounds since it is almost impossible to identify a licensing requirement appropriate for all sectors, all firms and all activities. To elaborate, the condition for the licensing system to be justified is $C < pL$ where C denotes costs additional to those that would have been incurred with an *ex post* system, notably the costs of *ex ante* scrutiny required for the licensing process, p represents

⁵⁰ A. Ogus and Q. Zhang, above, note 4.

⁵¹ Ibid.

the probability of the losses occurring in the absence of such scrutiny and *L* is the losses which the scrutiny would prevent. In light of this reasoning, a licensing requirement can be justified only in some specific business sectors where there is a high value for *P* and/or *L* rather than for all businesses sectors.⁵²

For example, a new enterprise may decide to put its business place in a leased office of a building that has passed all fire safety inspections before its completion, and the business in that office involves no significant fire risk; it therefore makes no sense to oblige the new enterprise's office to undergo another fire inspection unless a new decoration or alteration generates significant fire risks. An efficient regulatory system might apply the fire safety licensing requirement only to those business activities with high fire risks, e.g. running a theatre. Take also the case where there is a GSL requirement relating to employees' health, e.g. a health certificate for employees from the Health Office in Philippines. The risk to employees' health may be significant in some business sectors, such as restaurants, but not in all sectors. In some sectors such as telephone services, the employees may have few opportunities of contact with clients face to face, and therefore with little risk of a negative externality, a contagious disease.

To take this analysis further we must consider the relative capacity of *ex ante* licensing regime and its *ex post* alternatives in deterring the activities involving substantial risks.⁵³ In many cases, even if, for example, there may be substantial health risks caused by employees, usually they cannot be effectively prevented at an *ex ante* stage; reliance must be had on *ex post* control e.g. on-going health examinations to monitor the employees' health condition.

Let us examine another popular GSL example involving the minimal capital requirement imposed on firms. It has been suggested that this requirement aims to protect creditors from the opportunism of some shareholders', especially exploiting

⁵² For more analyses in this aspect, see *ibid.*

⁵³ *Ibid.*

limited liability.⁵⁴ However, it is worth doubting whether the *ex ante* minimal capital requirement efficiently meets this aim. Opportunist shareholders easily evade the requirement if they are determined to do so.⁵⁵ For example, they can simply borrow money to meet the minimal capital requirement at the time of registration and then repay it. Moreover, the high compliance costs caused by this requirement can make the corporate form less attractive for small enterprises⁵⁶ or induce them to forge a proof of funds to obtain registration. It has been reported that of 201 enterprises inspected by the Shenzhen Municipal Industry and Commerce Bureau (China) in April 1998, at least 130 had forged their investment verification certificate, in order to meet the minimal capital requirement.⁵⁷ If the market mechanism or *ex post* remedies, whether civil remedies or criminal sanctions, are able to prevent or reduce this opportunism at less cost, then the minimal capital requirement as a licensing condition might not be justified. The same reasoning can also be applied to other GSL requirements of public safety and health, such as the certificate of electrical inspection, and the sanitary permit in the Philippines.

2. Justifications for Preferring Sector Set-up Licensing to Independent Licensing Regime?

A. Improving Compliance?

For convenience, we assume that, in terms of generating benefits, the SSL and IL regimes would be equally competent in meeting their regulatory aims, for example, reducing health risks if they were perfectly compliance. However, many developing countries are often afflicted by weak regulatory enforcement capacity and the

⁵⁴ See the arguments of the Danish authorities considered by the ECJ in its recent decision: *Centros v. Erhvervs-og Selskabsstyrelsen* (C-212/97, March 1999).

⁵⁵ Report of the Company Law Committee (Jenkins Committee, U.K.), Cmnd. 1749 (1962), Para. 27.

⁵⁶ See, e.g., J. Freedman, "Small Businesses and the Corporate Form: Burden or Privilege" (1994) 57 *Modern Law Review* 555.

⁵⁷ Available at <http://www.companyfaq.com/kujizhishi/shenji/60.htm> (visited in January 2004)

informal economy is typically large and growing.⁵⁸ The average size of the informal economy, as a percentage of official GNI in the year 2000, in developing countries, was 41%, in transition countries 38% and in OECD countries 18%.⁵⁹ There is evidence of large numbers of unlicensed traders operating in the informal economy in some countries.⁶⁰ For example, it is estimated that, there are 30,000-40,000 unlicensed taxis alongside 67, 000 licensed taxis in Beijing.⁶¹ As a solution, better regulatory enforcement is often advocated.

According to the famous Becker model⁶², enforcement may be problematic if potential offenders perceive that formal sanctions and other losses incurred as a consequence of apprehension and condemnation for regulatory contraventions, when discounted by the probability of apprehension and determination of liability, are exceeded by the utility they derive from the contravention. The condition can be expressed by the formula: $PD < U$, where P is the potential offender's perceived probability of apprehension and condemnation by a public agency, D represents the costs imposed on the offender, and U denotes the latter's perceived own benefits derived from the contravention.

When a licensing requirement is designed as set-up licensing, its enforcement can, at least in theory, be verified by one agency responsible for subsequent procedure(s). It might be argued that, in comparison with an IL regime, using an SSL system can

⁵⁸ See F. Schneider, 'Size and Measurement of the Informal Economy in 110 Countries around the world', Australian National Tax Centre Working Paper (2002), available at http://rru.worldbank.org/Documents/PapersLinks/informal_economy.pdf (visited on 6th August 2004)

⁵⁹ Ibid.

⁶⁰ See, e.g. E. Suhir and Z. Kovach, *Administrative Barriers to Entrepreneurship in Central Asia* (Centre for International Private Enterprise, 2003), available at <http://www.cipe.org/pdf/publications/> For evidence on the problem in the Philippines, see: http://www.sunstar.com.ph/static/zam/2002/12/06/news/fake_business_permits.in.use.html (visited on 7th June 2003)

⁶¹ S Li, 'Focusing on Unlicensed Taxis in Beijing', available at http://news.xinhuanet.com/fortune/2004-07/20/content_1617780.htm (visited on 6th August 2004)

⁶² G. Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 *Journal of Political Economics*, 169-217; and for a simplified and clarified version, see A. Ogus and C. Abbot, 'Pollution and Penalties' (2002) 20 *Research in Law and Economics*, 493.

significantly enhance the value of P , the probability of detecting the unlicensed activities;⁶³ and perhaps the argument has influenced regulatory policy in some countries. For example, in the Philippines, it has been said that the system of local business permit (mayor's permit) can be used to support the accreditation systems and reduce the opportunities for non-accredited companies to work with Chlorofluorocarbon (CFC) refrigerants, because the law requires the accreditations with the Department of Trade of Industry as one pre-condition for these companies (working with CFC refrigerants) to obtain the mayor's permit.⁶⁴

Perhaps another example favouring this argument is that of the above-mentioned Chinese reform, with its shifts from SSL to IL requirements. Although the Chinese government has not declared explicitly that the A type licensing requirements subject to the SSL regime must generate better compliance than B type licensing requirement subject to the IL regime, some comparison between what has been categorised may allow us to draw this inference. Those within the agriculture and fisheries industry subject to type A licensing requirements would generate much bigger losses than those subject to type B licensing control in the event of poor monitoring and enforcement. For example, "bad" pesticides might kill people, whereas "bad" seeds are likely to lead only to financial losses.

However, further consideration suggests that this compliance argument is somewhat problematic. It seemingly assumes that entrepreneurs always complete the set-up process before engaging in any business, which is often not true in practice. The verification procedure designed for SSL regimes will play no role if an entrepreneur decides not to engage in the set-up process, preferring simply to join the underground economy. More entrepreneurs are likely to behave in this way under an SSL regime than under an IL regime, because of the higher compliance costs incurred. Thus the benefits of participating in the underground economy, denoted as U , are increased substantially since more costs can be saved by avoiding the set-up process in an SSL regime. According to a survey in 2002, in Shenzhen city, China, there were more than

⁶³ According to a telephone interview with an officer in the State Industry and Commerce Administration (SICA), the People's Republic of China on July 26, 2004.

⁶⁴ See the Philippines Department of Environment and Natural Resources, Philippine National CFC Phase-out Plan, p.40, available at <http://www.sei.se/jobs/FinalNCPP.pdf> (visited on April 8, 2003)

8,000 business proprietors who operated underground without a registration certificate.⁶⁵ It has been argued that one major reason for this phenomenon is the existence of SSL regimes.⁶⁶

Let us return to the simplified example in diagram 2 and assume there are a certain number of applicants wishing to operate a sector business subject to the licensing control. Under the SSL regime, applicants have, in theory, three options. Some may go through the whole set-up process, including the SSL licensing and registration procedures. (Hereafter “option 1 under SSL regime”) Second, some may complete the SSL procedure but not the registration procedure. (Hereafter “option 2 under SSL regime”) However, it is reasonable to assume that an applicant will finish the registration procedure once the licensing application has been approved, since the marginal additional costs of doing this are low but the marginal benefits (e.g. lawfully engage in business) may be high. Third, due to high entry costs, some applicants may decide not to engage in any procedure and simply operate underground; or their application for a set-up licence is rejected with the same outcome. (Hereafter “option 3 under SSL regime”)

Under the IL regime, applicants may theoretically have the following options. Some may complete both the IL procedure and the registration procedure. (Hereafter “option 1 under IL regime”) Second, some may complete the registration procedure but not the IL procedure. (Hereafter “option 2 under IL regime”) Third, some may finish the IL procedure but fail to register. (Hereafter “option 3 under IL regime”). Again we assume that the applicants will not choose this because of the low marginal costs of registration and its high marginal benefits. Fourth, some will not engage in any procedure and simply operate underground. (Hereafter “option 4 under IL regime”)

We now consider whether fewer applicants are likely to complete both licensing and registration procedures under the IL regime than under the SSL regime. Some applicants choosing option 3 under SSL regime may probably shift to option 1 or

⁶⁵ X.D. Wang, “Untied the Tied Control: Shenzhen Seeking for a New Solution to Tackle the Unlicensed Businesses”, available at <http://www.saic.gov.cn/> (visited on 6th August 2004)

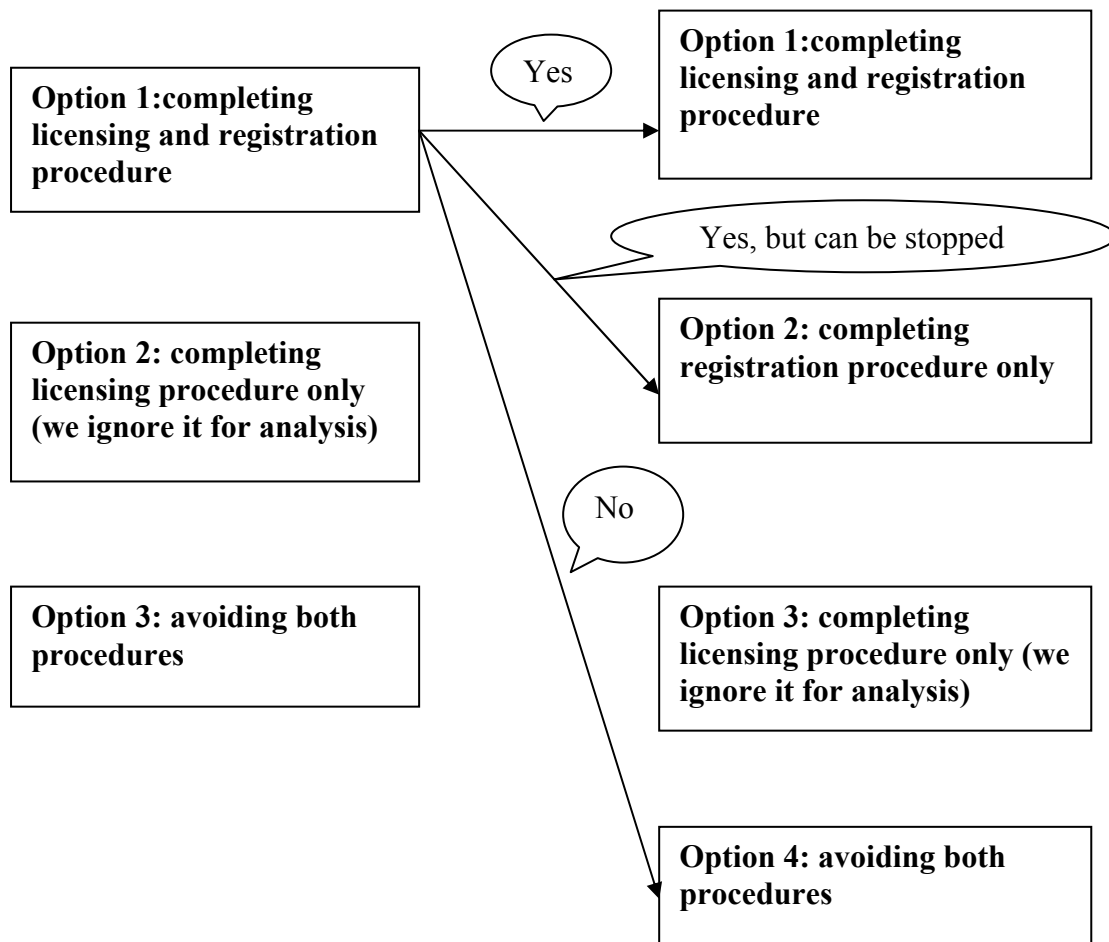
⁶⁶ Ibid.

option 2 under IL regime. This might probably increase the number of applicants choosing option 1 under IL regime. For facilitating our analysis, we merely consider whether some applicants choosing the option 1 under SSL regime will shift to the option 2 or option 4 under IL regime. If there is no such shift, the regulatory compliance under SSL regime will be better than, at least no worse than under IL regime. We now use diagram 3 to illustrate this possible shift.

Diagram 3:

Three Options under SSL Regime

Four Options under IL regime:



At first glance, it might seem that, under the IL regime some applicants are likely to complete the registration procedure without attempting to satisfy the licensing requirement; and this cannot happen under a SSL regime. This means that those applicants choosing option 1 under SSL regime now have a new option, option 2 under IL regime. However, they must not shift to the option 4 under IL regime for the following reasons: they might obtain fewer benefits (expressed as a smaller *U* figure)

from avoiding both procedures under IL regime than they will gain from avoiding both procedures under the SSL regime. But the perceived probability of apprehension and consequent costs to the offender, respectively expressed as p and D , are unlikely to differ as between the two licensing regimes (we assume if those avoiding both requirements is detected by one agency, either licensing agency or registration agency, for one contravention, the other contravention must be also detected easily).⁶⁷

If the enforcement mechanism operative in the IL regime can stop the applicants choosing option 1 under SSL regime from shifting to option 2 under IL regime, then the better compliance justification for SSL regime cannot be sustained. Furthermore, to stop this shift, we must ensure that, the potential offenders' perceived benefits from such shift, expressed as U_I , are exceeded by their perceived losses due to the apprehension and condemnation by an IL agency for their failure to get licensed, denoted by D_I , when discounted by the probability of apprehension and determination, P_I ; thus $U_I < P_I D_I$. The value of U_I is determined mainly by the following two variables: the potential offenders' perceived savings from avoiding the IL procedure (equivalent to the perceived costs that they would have incurred for securing the independent licence), minus their lost profits when some consumers, recognising that the business is unlicensed, refuse to purchase the goods or services. The value of P_I depends largely on the resources of the licensing agency available for policing and monitoring.

Let us remind ourselves that the applicants choosing option 1 under SSL regime must meet the following conditions: $U_2 < P_2 D_2$. Here U_2 is their benefits from avoiding both the licensing procedure and registration. Its value is largely determined by the following two variables: their perceived savings from avoiding the IL procedure and registration under the SSL regime (equivalent to the perceived costs that would have

⁶⁷ For resource reasons, the p figure (probability of apprehension) may sometimes be smaller under the SSL regime because: some of the resources used in an IL regime to detect contraventions of both licensing and registration requirements may, under an SSL regime, have to be allocated to a verification of the licensing requirement. However, the difference might not be substantial since the verification required to ensure that a copy of the entry licence has been supplied is a simple and low-cost task.

been incurred for obtaining the licensing and registration) minus their lost profits if some consumers recognise the illegality of supply and refuse to purchase the goods or services. P_2 is the perceived probability of apprehension and determination by both the licensing agency and the registration agency. D_2 is their perceived losses from apprehension and condemnation by both agencies for both contraventions.

Let us consider the above two inequality, $U_1 < P_1 D_1$ and $U_2 < P_2 D_2$. If the value of $P_1 D_1$ can be raised to at least that of $P_2 D_2$ and U_1 remains less than U_2 , then we will be able to stop the above shift. There are a number of practical steps by which this outcome might be achieved. First, the registration agency can be required to notify the licensing agency when it detects some unlicensed business activity, so that p_1 will approximate to p_2 ; or more resources can be made available to improve the P_1 figure. Second, policymakers can raise the value of D_1 in the IL regime to no less than that of D_2 in the SSL regime by imposing stricter punishments on those applicants who merely complete registration under the IL regime. For example, the registration certificates of these businesses could be revoked once the unlicensed activity is discovered. Thirdly, some education campaigns must be carried out to notify consumers of the shift from the SSL to the IL regime. The consumers would have to be informed that, securing a registration certificate under the IL regime does not guarantee that the holder complies with the substantial conditions of the licensing criteria. Of course, all these steps under the IL regime will increase the administrative costs to the government.

Without precise information on whether the administrative costs for those above measures, are or are not exceeded by the reduction of compliance costs and other indirect costs (falling mainly on entrepreneurs and consumers) under the IL regime, it is difficult to draw hard conclusions from this analysis.

B. Saving Compliance Costs on Other Procedures?

It might be argued that, compared with IL regimes, SSL regimes are able to reduce compliance costs arising from other procedures in the set-up process.⁶⁸ If

⁶⁸ See note 63.

entrepreneurs fail to obtain an SSL licence, they will not incur further compliance costs from subsequent procedures. In contrast, under an IL regime, they may well have completed the set-up process and paid all related compliance costs before being informed of the failure of the licensing application, at least if the licensing procedures take longer than the set-up process. As shown in diagram 2, under the SSL regime, entrepreneurs will not incur the costs of registration (at least the administrative costs of making the application) once they are informed of the unsuccessful licensing application. But under the IL regime, they might already, by this stage, have incurred the compliance costs of registration. In the light of this, it is better to slot in the more complex licensing procedure (often with less predictable outcomes) in the earlier stages of the set-up process. If the licensing application is not successful, then it makes no sense to go through subsequent procedures. This argument would be particularly strong if the compliance costs incurred for other procedures are substantial, if the rate of rejection of licensing applications is high, and if the entrepreneur only wants to operate the business which is subject to the licensing requirement.⁶⁹

However, the above argument ignores the fact that entrepreneurs can make their own choices to save compliance costs arising under IL regimes. If an entrepreneur is not confident about the success of the application and the compliance costs for the other procedures are high, the decision can be made not to proceed with the other procedures until there is information on the success of the licensing application. In theory, at least, the IL regime allows applicants to decide how to minimise compliance costs, notably by balancing savings from the shorter delay in beginning the business operations against possibly irrecoverable compliance costs incurred in completing other procedures. Since the probability of securing the licensing varies from case to case and entrepreneurs bear these compliance costs, it might be better to leave the decision to them. On this ground, IL regimes may be considered preferable to SSL regimes.

⁶⁹ If the registration procedure is not merely for the business subject to the SSL requirement (i.e. there exist some unregulated businesses), the losses from the compliance costs might not be so large, because the costs of the registration will be shared with the businesses not requiring licences.

C. Saving Monitoring Costs for Officials?

A third possibility is that SSL regimes generate scale economies of enforcement costs in the case of multiple SSL requirements.⁷⁰ So, before completing the set-up process, entrepreneurs may be required to demonstrate to an agency that they have already secured all necessary activity licences including e.g. a fire safety permit, a sanitary permit and a location permit. However, the same scale economics can be achieved by IL regimes, provided that a single enforcement agency is authorized to monitor the various IL requirements. In addition to requiring entrepreneurs to show their licence in the office, the enforcement agency can also make an investigation on its own initiative. Moreover, IL regimes have the added advantage of reducing the time to complete both the set-up process and IL procedures; under an SSL regime the procedure for checking the multiple requirements constitutes *de facto* a further barrier to entry.⁷¹

In summary, the above analyses may suggest that, the hypotheses favouring SSL on public interest grounds may not be justified. We turn next to possible private interest explanations for preferring SSL to IL regimes.

V. Private Interest Explanations

Private interest theory suggests that the regulation serves the interest of particular groups.⁷² And there are many studies which purport to show that specific licensing regimes benefit particular interest groups.⁷³ According to this theory, existing suppliers are motivated to influence the promulgation of licensing requirements which

⁷⁰ A. Ogus and Q. Zhang, above, note 4, 21.

⁷¹ Ibid, 19.

⁷² See R. Posner, 'Theories of Economic Regulation' (1974) 5 *Bell Journal of Economics*, 335-351; G. Stigler, 'The theory of Economic Regulation' (1971) 2 *Bell Journal of Economics*, 3; S. Peltzman, 'Toward a More General Theory of Regulation' (1976) 19 *Journal of Law & Economics*, 211-240; A. Ogus, *Regulation: Legal Form and Economic Theory* (Clarendon Press, 1994), 71-72.

⁷³ Surveyed in S. Svorny, 'Licensing, Market Entry Regulation', in B. Bouckaert and G. De Geest (eds.), *Encyclopaedia of Law and Economics*, Vol. III, (Edward Elgar, 2000), 309-314; and also see A. Ogus and Q. Zhang, above, note 4, 21-25.

can often limit competition and, in certain circumstances,⁷⁴ raise their profits. They are usually able to do this successfully since they typically face lower information and organization costs than dispersed consumers. Politicians may, therefore, be prepared to meet the demand of suppliers' groups for the licensing legislation in return for campaign contributions, votes and even bribes. Bureaucrats may use licensing regulations to obtain larger budgets, prestige, manpower and further employment conditions. Most importantly, the discretion involved in licensing decision-making creates opportunities for exacting bribes. Because of their key role in policy-making, such as controlling information, they are easily able to impose licensing regimes. In this section, we explore these hypotheses, to ascertain whether SL regimes can confer more benefits to the interest groups than IL regimes.

1. Set-up Licensing Agency

Under an SL regime, entrepreneurs who fail to get an approval from the licensing agency should not, at least in theory, engage in subsequent procedures to enter the market. The arrangement might, ostensibly, give a good excuse for the licensing agency to rely on verification by other agencies responsible for subsequent procedures and then relax its efforts to police unlicensed activities.

The delay involved in obtaining an SL licence often can impose more costs on entrepreneurs than its equivalent delay under an IL regime. In details, under an IL regime, so long as it takes the entrepreneur less time to complete the delayed IL procedure than the set-up process,⁷⁵ then such a delay by the licensing agency will not affect the total time for completing both procedures. But under an SL regime, any delay by the licensing agency will directly increase the total time for finishing both procedures. The higher delay costs imposed on the entrepreneur creates more

⁷⁴ For example, poor availability of substitutes goods and services in the market.

⁷⁵ Suppose that the entrepreneur begins both procedures at the same time.

opportunities for the licensing officials to extract bribes, because the entrepreneur's benefits from corruption are increased.⁷⁶

Take the case of Quezon City in the Philippines. Even after a change had been introduced aiming to reducing the burden on business of the mayor's permit regime in 2002, "a number of business proprietors still complain about that many requirements imposed. To them, there is too much paper work to be done. While the processing time of documents or papers in the Business Permit Licensing Office has been shortened, the processing time of documents in the other departments or offices (SL agencies) has not been that shortened. This is particular true in the case of the requirements pertaining to the fire safety inspection certificate, sanitary permit and occupational permit."⁷⁷

In some developing countries, the choice between SL and IL regimes is determined by bureaucrats once a licensing requirement has been established.⁷⁸ Even if politicians retain the decision-making power, the licensing agency might still be able to achieve its aim by uniting with some other agencies responsible for subsequent checking procedure. We will see how those agencies can benefit from SL regimes.

2. Agencies Responsible for Subsequent Checking Procedure

As we have seen, under an SL regime, the agency responsible for subsequent checking procedures (hereafter ARSCP) will verify if the SL requirement has been met. This ARSCP might be able to obtain more power, prestige, and even bribes than its equivalent in IL regime, since rejection of an application or delay in processing it can cause more losses to the entrepreneur. The entrepreneur might have invested a

⁷⁶ See S. Rose-Ackerman, "The Political Economy of Corruption: Causes and Consequences", Viewpoint of the World Bank, Note No.74 (1996), available at <http://rru.worldbank.org/Documents/PublicPolicyJournal/074ackerm.pdf>. (visited on 6 August 2004)

⁷⁷ P. Legaspi, above, note 18, 22-23.

⁷⁸ For example, in China, the central ministries have no right to set up a licensing requirement but they generally have right to decide if the system will be SL regime or IL regime; see Article 15 and 16 of the Administrative Licensing Act of the People's Republic of China (2003) (hereafter "the Administrative Licensing Act).

significant amount in the SL procedure before applying to the ARSCP. These are generally sunk costs which will be lost if the entrepreneur does not engage in the subsequent procedures. Under the IL regime, the entrepreneur may incur less sunk costs than under the SL regime when he applies with the ARSCP. Accordingly, it may be difficult for the ARSCP's equivalent agency in IL regime to obtain the same amount of bribes from the entrepreneur as under the SL procedure.

Perhaps some private interests of ARSCPs might be inferred from their great enthusiasms for SL requirements when the public interest justifications are not very strong. In China, there were (at least) 146 SSL requirements in the national level in 2000.⁷⁹ 29 of these, were imposed by the National People's Congress and its standing committee; 79 by the State Council; 38 by the National Industry and Commerce Administration (NICA) acting as an ARSCP or jointly by the NICA and another ministry.⁸⁰ It has been suggested that, the introduction in 2003 of the Administrative Licensing Act⁸¹ which abolished the right to impose SL requirements was, in part at least, to prevent the central ministries (including NICA) and local governments from establishing the regimes for their private interests.⁸²

3. Existing Suppliers

Existing suppliers may prefer SL to IL regimes. The longer entry time and higher entry costs can, at least to some extents protect them against competition from potential or new suppliers. The costs reduce the number of suppliers and thus consumer choice; they may also result in increases in prices and the profits (rents) earned by existing suppliers.⁸³ These latter effects rely on the availability of substitute

⁷⁹ The Enterprise Registration Bureau of National Industry and Commerce Administration of P.R.C., *Collection of Laws and Regulations concerning Prior Approvals for Enterprises' Registry* (2000), 712. There are 146 SSL requirements listed there but the list is still incomplete. For example, it does not cover the education industry.

⁸⁰ Ibid.

⁸¹ Article 14, 15 and 16 of the Administrative Licensing Act.

⁸² X. Y. Qiao (eds.), *An Commentary to the Administrative Licensing Act of the People's Republic of China*, (in Chinese, China Price Press, 2003), 88-94.

⁸³ A. Ogus and Q. Zhang, above, note 4.

goods and services in the market: the less willing consumers are to change demand to such substitutes, the higher the price increases and the more profits to suppliers.⁸⁴

If the costs of coordinating the existing suppliers are low, and there is an effective channel for them to affect policy-makers, the existing suppliers might be able to meet their goals very easily. In developing countries, the market is often dominated by relatively few, but powerful, incumbents, including state-owned enterprises, which can easily obtain the government's support in establishing the SL regimes to their advantages.⁸⁵ However, even if the above conditions cannot be met, the existing suppliers may be able to harness their demand for regulation to that of more powerful groups, for example, those representing consumers, who think that they will benefit more from the SL regime than the IL regime.⁸⁶

4. Politicians

In developing countries, the distinction between politicians and bureaucrats tends to be blurred and an alliance between the ruling elite and high-ranking officials has often led to an "oligarchy of power and privilege".⁸⁷ These groups may have some common interests in choosing the SL regime. Moreover, perhaps psychologically, *ex ante* preventions might be preferred by the public to *ex post* controls in reducing the risks. Accordingly, SL regimes might, more easily than IL regimes, enhance the reputation of politicians with the public because of the apparent aim of preventing social harm at an earlier stage. This may increase their prospects of re-election, or facilitate their rule.

Finally, it may be that these four interest groups can secure greater benefits from GSL regimes compared to SSL regimes, because the coverage of the former is wider, imposing licensing requirements on all business sectors.

VI. Conclusion

⁸⁴ S. Svorny, above, note 73, 301.

⁸⁵ A. Ogus and Q. Zhang, above, note 4.

⁸⁶ A. Ogus, above, note 72, 229-230.

⁸⁷ A. Seidman and R. Seidman, *State and Law in the Development Process: problem-solving and institutional change in the third world* (Macmillan, 1994), 152.

In this paper, we have investigated the use of licensing procedures in the business set-up process in developing countries. It seems that many developing countries still widely use SL regimes. We suspect that, the SL regimes impose more compliance costs on entrepreneurs, more administrative costs on officials and more welfare losses on consumers than IL regimes. Some developing countries have recognised the weakness of SL regimes and made some changes but many are still retained. Our principle aim has been to explore the public interest justifications for these SL procedures.

As we have seen, few GSL procedures can be justified since it is difficult to identify a licensing requirement appropriate for all sectors, all firms and all activities. Not all business activities involve substantial potential losses and at least some potential losses can be better addressed by *ex-post* systems of deterrence including information regulation (mandatory disclosure) and/or on-going performance standards. In contrast, the SSL regime might, in relation the sector concerned, be preferable to other regulatory techniques, but it is often difficult to rationalise its role as one step in the set-up process. The argument favouring SSL regimes for their role in improving compliance ignores a possibility that more applicants might thereby enter the underground economy without going through any official procedures. We have also suggested that, if an IL regime is adopted, better regulatory compliance can be achieved provided that some necessary measures are taken by government. And we suspect that, the related administrative costs of these measures sometimes might be less than the additional compliance costs and welfare losses of an SL regime. We also have reason to doubt the argument that SL regimes may reduce monitoring costs and compliance costs for other procedures.

It seems that private interest explanations are more convincing than public interest theory. The SL agencies, the agencies responsible for subsequent checking procedure, existing suppliers and politicians all can obtain better benefits from SL regimes than from IL regimes. Especially in developing countries, the powerful alliance of politicians and bureaucrats can exploit SL regime to secure greater benefits, and at the expense of new suppliers and consumers.