



Contract No. 114-C-00-03-00143-00

**An Action Plan for Administrative Barriers in  
Licensing, Standardization and Inspections  
(C.7.1)**

Prepared for:  
**Joseph Downey**  
Senior Private Sector Advisor  
Office of Economic Growth  
USAID/Caucasus

Submitted by:  
BearingPoint, Inc.

1676 International Drive—McLean, Virginia 22102, USA  
[www.bearingpoint.com](http://www.bearingpoint.com)

**APRIL 30, 2004**

*This report was prepared by Saba Sarishvili, Mikheil Khonelidze, Givi Petriashvili, Nia Sharashidze and Vanda Kakiashvili of the Georgian Business Confederation in collaboration with BearingPoint, Inc., prime contractor to the US Agency for International Development for the GEGI project.*

*“Georgia-Study of Administrative Barriers to Investment”, FIAS 2001 is a key reference throughout.*

## TABLE OF CONTENTS

---

1. Introduction.....	1
2. Licensing.....	3
2.1 Legal Framework.....	3
2.2 Licenses and Permits.....	5
2.3 Conclusions.....	5
2.4 Recommendations.....	6
2.5 Action Plan.....	7
3. Standardization.....	8
3.1 Legal Framework.....	8
3.2 Georgian Standards.....	8
3.3 Certification.....	9
3.4 Conclusions.....	9
3.5 Recommendations.....	10
3.6 Action Plan.....	11
4. Inspections.....	13
4.1 Legal Framework.....	13
4.2 The Financial Police, Tax Inspections, and the Chamber of Control.....	14
4.3 Inspections in Practice.....	15
4.4 Conclusions and Recommendations.....	16
4.5 Recommendations.....	17
4.6 Action Plan.....	17
INSPECTIONS OF GEORGIA AT APRIL 15, 2004.....	18

## 1. INTRODUCTION

---

The findings of various studies and surveys as well as anecdotal evidence indicate that the business environment in Georgia has not improved over the past couple of years. While there have been improvements in some areas (e.g. judicial system), thanks to specific policy initiatives, in other areas there has been stagnation and even a deterioration of the situation. One of the main problems is that, while direct costs of regulation may be going down, in many cases, frequent harassment by public officials and inspectors is increasing. Furthermore, the regulatory system remains highly unpredictable and therefore not favorable to the development of entrepreneurial activities.

The fact that similar studies and surveys in neighboring countries indicate significant improvements in the business environment puts Georgia at a comparative disadvantage. In response to this negative development and aiming at real improvement of the Georgian business environment, the authorities would need to put into place decisive and well concerted efforts to prevent entrenchment of corrupt practices and to provide businesses with a more predictable set of operating rules and their enforcement.

This is a difficult challenge for Government, the private sector and donors. Various donors have been supporting initiatives focusing on improving the performance of government agencies – fiscal, budgetary and judicial systems; business licensing and regulation; customs etc, with uneven success. Moreover, these activities have had limited positive effects in terms of generating the broad dynamics of overall improvement in the business environment.

The ultimate objective of any investor is to maximize profit and minimize risk. Accordingly, investors seek to avoid doing business in a costly and risky environment that is too bureaucratic, corrupt, or unpredictable. In addition to bureaucracy, corruption and unpredictability, geo-political instability in the region and especially in the country itself, plays an important role in deterring investment, especially foreign.

The present paper identifies some specific administrative issues that impede business activity, discourage investors, and increase the cost and risk of doing business in Georgia. Georgia needs to address these critical constraints in order to help improve the country's attractiveness for domestic and international investors. Yet these same administrative barriers are often considered by government officials as necessary and legitimate to support the business of Government. By drawing on the experiences of the private sector, the paper offers a perspective that is often lost to bureaucrats. It provides recommendations and action plans for simplifying and making more efficient necessary administrative procedures with the objective of improving both the delivery and quality of administrative services to the private sector, and the delivery and quality of economic activity from the private sector.

For the moment, in view of the overall situation in the country and region in general, administrative barriers primarily hinder domestic investment. But with the reduction of these barriers and the resolution of the larger geo-political problems, Georgia could attract more foreign direct investment (FDI).

So far, most of the FDI flows to Georgia can be attributed to pipeline construction and privatization. With its relatively small domestic population, low purchasing power, and comparatively limited resource base, Georgia is unlikely to be a very *a priori* attractive location for most investors. Since competition for these capital flows continually increases, Georgia must try even harder to look attractive for potential investors. Improving the investment climate (relative to its competitors) will be a decisive factor for Government in its efforts to increase the level of sustainable FDI.

Administrative procedures and the regulatory framework affect both domestic and foreign investors. Applying the principle of national treatment (i.e. equal treatment for foreign and national investors), this paper is intended to help strengthen the business environment for all investors, with specific reference to licensing, standardization and inspections.

The overall approach will be for the GEGI Trade and Investment Team to review existing analyses and develop action plans for positive reforms to the operating environment, in conjunction with stakeholder groups. This work represents the starting point of “red-tape analyses” which will identify specific administrative and procedural barriers in the existing investment regime which impede both foreign and domestic investment in Georgia.

The GEGI activity is designed to identify areas for policy reform in which the private, public and civil society constituencies can be mobilized and empowered to effect change. The team will continually work to identify new policy areas in which such constituencies can be mobilized and reform fostered. Further, the team will continually monitor reform progress in areas where GEGI is active, and discontinue support in areas where meaningful reform is not forthcoming despite GEGI assistance. In both cases, the team will formulate recommendations to USAID for redeployment of GEGI resources to areas where they can generate the greatest impact on the overall policy reform goal.

## 2. LICENSING

---

### 2.1 Legal Framework

The Law on Entrepreneurship (1991) introduced business licensing requirements to Georgia. Rapid proliferation of licensing at different levels soon prompted reform of the licensing regime and the creation of a unified legal framework, culminating in 1999 in the Law on Licensing and the Law on License Fees, and reducing licensing scope from 120 types of activities to 20. Under the 1999 Law on Licensing, Government used licensing to regulate for risks to personal safety, public health, public order, and state security.

The 1999 Laws established minimum requirements for businesses under licensed activities, and regulated the basic structure of the licensing procedure. In particular, they described documents required for license application, the decision time allowed issuing agencies, and requirements for record-keeping. Beyond these two basic framework laws, sectoral licensing regimes also apply in banking, insurance, design and construction, and the production and sale of pharmaceutical products. These laws and regulations establish sector-specific procedures and requirements.

In 2000, the Ministry of Justice sought to resolve a number of persistent problems associated with the licensing regime by amending the Law on Licensing as follows:

- Eliminating all amendments which narrowed the Law's applicability after its initial adoption by Parliament;
- Making consistent all separate laws on licensing that were passed or amended after the framework law was passed by Parliament;
- Addressing the issue of drafting new licensing conditions;
- Referencing the role of the Ministry of Justice in administering the Law.

The Law on Principles for Issuing Licenses and Permits for Entrepreneurial Activities was passed in 2002 and introduces a unified list of activities to be licensed. The Law received much attention and introduces a good framework for licensing. It defines the complete list of activities subject to licensing, the administrative bodies responsible for licensing and the rules for issuance, suspension, renewal and revocation of licenses in compliance with the General Administrative Code (1999). It further prohibits the introduction of new licenses beyond those described in the Law, and of instruments tantamount to new licensing requirements (Article 4). The Law provides guiding principles for licensing as follows:

- Equality before the law;
- Safety and protection of the life and health and living conditions of individuals;
- Protection of the entrepreneurs' interests;
- Protection of the state security and public safety;
- Protection of the rights and interests of the consumers.

**License issuing agencies:**

State Insurance Monitoring Service of Georgia;  
National Bank of Georgia; National Securities Commission of Georgia;  
Ministry of Labor, Health and Social Security of Georgia;  
Ministry of Urbanization and Housing of Georgia;  
Ministry of Education of Georgia;

Auditing Board under the Parliament of Georgia;  
Georgia State Department for Standardization, Metrology and Certification;  
Ministry of Justice;  
Maritime Transport Administration of the Ministry of Transport and Communications of Georgia;  
Customs Department of the Ministry of Finance of Georgia;  
Ministry of Environment and Natural Resources Protection of Georgia;  
Ministry of Agriculture and Food of Georgia;  
National Energy Regulatory Commission of Georgia;  
National Communications Commission of Georgia;  
Georgia State Oil and Natural Gas Regulatory Agency;  
Ministry of Economy, Industry and Trade of Georgia;  
Ministry of Environment and Natural Resources Protection of Georgia;  
Georgia State Department for Hydrometeorology;  
Georgia State Department for Geology;  
Ministry of Finance of Georgia;  
Aviation Administration of the Ministry of Transport and Communications.

Nevertheless, there remain some problems with implementation of the framework law. Some argue that certain licensing requirements have no legal or economic basis. Moreover, sectoral laws and sub-legislative acts impose unjustified preconditions and criteria, or vague and inconsistent procedures which foster corruption, arbitrariness and extra costs on business.

**Non-exhaustive list of activities requiring licensing:**

Insurance and insurance mediation;  
Banking and extra-banking depositing, currency exchange entities;  
Activities of regulated securities market agents, assets managing companies and special depositaries;  
Medical and pharmaceutical activities;  
Construction/designing activities;  
Educating activities;  
Auditing activities;  
Production and maintenance of metrological and measuring equipment;  
Production and maintenance of and trade in weapons and ammunitions;  
Maritime cruising;  
Customs-related activities (except customs warehousing);  
Nuclear and radiating activities;  
Production of food (including baby food) and tobacco products;  
Electricity generation (in the sense indicated in Article 33(1) of the Law on Electricity and Natural Gas), transmission, dispatching, distribution, export, import, re-export, re-import;  
Natural gas supply, export, import, re-export, re-import, transportation and distribution;  
Communications and mail service;  
Veterinary activities, production of and trade in biological and veterinary medicines, pesticides and agro-chemicals;  
Use and processing of oil and natural gas, oil transportation;  
Evaluating activities;  
Use of natural resources (except the use of oil and natural gas, land and forestry resources);  
Environment protection;  
Environment impact assessment;  
Mining and ore processing;  
Hydro-meteorological activities;  
Geological activities;  
Printing and keeping strictly registered documents;

Regular air transportation services.

## 2.2 Licenses and Permits

While the framework law provides for only 24 major licenses, up to 200 activities actually fall under licenses or permits. At the local government level, in addition to licenses, a number of business activities require permits. These permits are issued under the Laws on Local Self-Government (1999) and the Law on Local Charges (1998) and are either one-time permits issued for activities including construction, architectural/functional modifications, and use of public places; or permits for ongoing activities such as trade, local transportation, parking, and outdoor advertising. Each municipality issues specific regulations governing permits.

The Law on Local Charges and related normative acts (including municipal regulations) are unclear in defining the purpose and scope of permits. It appears that permits have a fiscal function and are used more as local taxation than as regulatory instruments similar to licensing. The criteria and conditions for authorizing and terminating permits are not clearly specified and as a result the enforcement of the permit system is arbitrary and empty of meaning. Banking and insurance license processes are exceptions, being relatively organized and transparent, with readily available information packages on required documentation and procedures.

The regulatory function of local permits is brought further into question by the poor compliance and assessment of violations. In construction, where permits do not have a fiscal function and where violations are relatively easy to monitor and sanction, interviews suggest that the number of violations is quite high. Violations of trade permits are even more frequent. This is possible due to widespread petty corruption among local officials and inspecting agencies. While the permit regime does not impede business in Georgia, it does create unequal conditions for newcomers and arbitrary enforcement can cause significant problems for individual companies.

## 2.3 Conclusions

As a result of extensive streamlining, current licensing procedures do not constitute significant barriers to investment and business, especially in comparison with other FSU locations. A recent survey<sup>1</sup> found an average processing time of 23 days (a doubling of the delay noted in 2000), with official costs of approximately \$145. It has been stated however that bribery often facilitates the licensing process, with widespread corruption in issuance and assessment, particularly at the local level.

A key problem is the proliferation of permits by local government. While the framework Law of 2002 provides a good overall environment for licensing, many of the sectoral licensing laws and regulations do not conform with its provisions. Permits are used to raise revenues for local government, since fees are not returned to the central budget. Non-conformity begins with the observation that local permits are not targeted at protecting safety, security, or the environment, as stated in the Law. It continues with procedural problems, such as inconsistencies in administration. The Law on Local Charges governs many permits, but many others are not governed by this Law.

---

<sup>1</sup> World Bank Administrative and Regulatory Cost study, May 2003



Yet businesses report that licensing is not problematic or indeed “too liberal”. Bribery has effectively robbed state licensing of any meaning. Any license or permit can be obtained by remitting official and unofficial payments. Clearly, this increases costs to business, but more fundamentally undermines healthy economic activity. While state licensing should be limited to areas with high economic incentives not to comply with the law and used to regulate for market failure, it should do so credibly. If the legal and economic prerequisites for a license are not met and yet licenses are issued, a discretionary, unequal system is introduced, while public health and safety are not protected. Moreover, any system where rules are established but not enforced introduces not only extra costs, but makes for an uneven playing field where compliance is of no benefit. This in turn discourages legal operation and depreciates the value of investing in quality resources. In the long term, careless state licensing may have a significant negative impact on Georgian human, and other, endowments.

It should be noted that state regulation is a burden to both business and the state. In many instances, the market or individual industry is better able to regulate. A poor licensing system imposes unnecessary burdens and impedes the development of normal, competitive economic activity. Unjustified government interference fosters corruption and furthers the distrust of the business community vis-à-vis Government.

## 2.4 Recommendations

A number of steps should be considered to improve the system of licensing (and permits), building on the Law on Principles for Issuing Licenses and Permits for Entrepreneurial Activities (2002). The following could be addressed in the short to medium term:

- Review of the framework law, to ensure a streamlined list of licenses in line with government policy on regulating only economic activity which may affect personal safety, public health, public order, and state security, and to avoid multiplication of laws and by-laws on licensing;
- Introduction of clear implementing regulations on the licensing regimes (including processing and enforcing);
- Introduction of clear implementing regulations on permits at the local level (including processing and enforcing);
- Rationalization of legally permissible permits to avoid proliferation of revenue-generating permits;
- Strengthening of the reporting and monitoring mechanism in the Ministry of Justice, to ensure consistent enforcement of provisions for licenses and permits;
- Publication of the list of legally sanctioned licenses and permits;
- Publication and dissemination of information on the regulations, criteria, procedures, documentation requirements, fees and appeals mechanisms for licenses and permits;
- Publication of the list of granted licenses and permits.

Some attention may also need to be given to the overall rules (including for recourse) for industrial licensing where public welfare is not at risk but industry want to issue licenses that somehow convey quality information or accreditation. Such industry licensing can sometimes fall foul of vested interests and act as a barrier to new entrants.

**2.5 Action Plan**

Based on the above recommendations, GEGI would form a stakeholders working group including members of the business community, the civil sector and GOG. The intention would be to foster dialogue and constructive debate on licensing policy and some specific issues. GEGI would also provide expert advice in drafting policy and/or legislation, as needed. It is recognized that while the working group can formulate a number of recommendations, final responsibility for changing the system will rest with GOG, whether in amending laws and other legislation, restructuring institutions in line with legal changes, or training its representatives to comply with any new rules and systems.

Action	Agent	Months		
		1-3	3-6	6-12
Framework law review	Stakeholders			
Rationalization of licenses and permits	Stakeholders			
Implementing regulations	Experts			
Strengthening of reporting	GOG			
Publication of regulations	Stakeholders/GOG?			
Training for licensors	GOG			
Regular public reporting	GOG			
Continuous monitoring	GOG/ stakeholders			
Consider framework for industry licensing	GOG/ stakeholders			

### 3. STANDARDIZATION

---

#### 3.1 Legal Framework

The Law on Standardization (1996) was significantly revised during WTO accession negotiations, resulting in a new Law on Standardization (1999) to complement the Law on Product and Service Certification (1996). Some harmonization with EU legislation was also undertaken on the latter. To date however, Georgian standards law meets only the minimum standards of the WTO, including the Agreements on Technical Barriers to Trade and on Sanitary and Phytosanitary Measures.

The intent of the legislation is to ensure the *quality* of products, processes, or services and to *protect* human life, health, and the environment. In this context, all goods imported into, produced in, or exported from Georgia have to meet Georgian standards. The State Department of Standardization, Metrology and Certification, Sakstandarti, holds primary responsibility for compliance and for enforcement of the numerous mandatory standards.

It is important to distinguish between mandatory standards, which are compulsory and meant to ensure safety, and a voluntary system which extends to quality. International experience suggests consumers will best influence (and regulate) the choice of voluntary, quality standards. Mandatory standardization is adopted where the market fails to protect the public good. As such, two aspects of standardization affect producers and investors: the actual standards of a country, and certification of conformity with these standards. Both of these constitute barriers to business and investment in Georgia at present.

#### 3.2 Georgian Standards

The law provides that a standard will apply only once sanctioned by Sakstandarti. In principle, any company, national, regional or international standard may be approved by Sakstandarti. In practice however, Georgia still enforces the GOST standards of the Soviet Union<sup>2</sup>. Most of these 26,000 standards are obsolete, unachievable or unenforceable, and inconsistent with international standards, while many products have no GOST standard.

The Law of 1999 introduced the notion of voluntary compliance with international standards. In this context, Georgia undertook to significantly restructure its legislation and institutions to reflect the move away from mandatory compliance, and to do so by 2003:

1. all GOST and regional standards in force would be voluntary for products imported from WTO, non-CIS countries,
2. GOST and regional standards would remain mandatory only for the products of Georgia and non-WTO CIS countries, and
3. GOST standards would be fully replaced by international standards by May 2002.

---

<sup>2</sup> As a party to the CIS Agreement on Coordinated Policy in the Sphere of Standardization, Metrology and Certification (1992), Georgia gives and receives recognition of GOST standards within the CIS.

This original three-year timeframe was overly ambitious, given the extent of the work that would have been needed. In the event, little of the substantive work had even been started as of January 2004, despite repeated declarations of intent and some piecemeal efforts<sup>3</sup>. There is at best confusion as to which standards apply, whether they are mandatory, or who guarantees compliance. Many reports suggest Sakstandarti has been less than proactive in making such information available.

### 3.3 Certification

By law, foreign certification is not recognized in Georgia<sup>4</sup>, though Sakstandarti may exceptionally recognize foreign certification of a specific import. Regardless of foreign certification, all imports require a certificate of conformity to Georgian standards. This certificate is required for all retail sales. Additional certification from Sakstandarti, required for customs clearance, must also be obtained at the border, in the form of a registration certificate.

Locally produced goods must also received certificates of conformity. There are nearly 60 Sakstandarti-accredited certification institutions and 80 testing laboratories. Serious concerns have been expressed over certification in Georgia. At the root of these concerns is the ability of most if not all accredited institutions to actually provide proper testing and thus return meaningful opinions. Many products cannot be tested with current facilities in Georgia, while serial production cannot be certified. Concerns extend to the multitude of accredited institutions which do not have the physical capacity to test products, and thus provide empty certification. To compound non-transparency, Sakstandarti reportedly directs producers/importers to laboratories which are unable to undertake the testing and charge more for their opinions than other (similarly incompetent) facilities. As this is considered common knowledge, there are serious doubts as to the effectiveness of the system in protecting consumers, or in promoting Georgian exports since certification will not be accepted abroad.

### 3.4 Conclusions

While conformity certification is mandatory, most importers do not consider this to be a complicated procedure. The central issue is whether there is any value added to having Sakstandarti issue dubious certificates, especially where there is international certification. It would appear such certification is really about generating revenues. Curiously, Sakstandarti reports that many goods are sold in Georgia without conformity certificates, which would suggest a failure to ensure any real compliance, mandatory or otherwise, and any consumer protection. Recognition of foreign certification and proper testing of local products might better safeguard public health.

It is generally accepted that most testing facilities in Georgia are unable to handle the tasks required for meaningful certification. One consequence is that the system fosters endemic corruption. The institutions deliver opinions based on unofficial payments, not analyses. Such certification is not only worthless, it is potentially harmful to consumers since it fails to check any risks, and damaging to

---

<sup>3</sup> The USAID-funded RAPA project has provided substantial assistance in translating the Codex Alimentarius, an initiative of the Ministry of Agriculture, while the USAID-funded SAVE project has supported introduction of the HACCP system for food safety from the producers side.

<sup>4</sup> Except CIS certification, see footnote 1.

Georgian exports since it cannot be recognized abroad. Such recognition will not be achieved so long as Georgia retains GOST standards.

Moreover, mandatory certification has been used by Sakstandarti as a means for groundless, at times illegal, inspections. By law, Sakstandarti may only enter an enterprise with a court order, based on a full motivation for inspection and under set procedures. In practice, it has been known to arrive unannounced, without court support or knowledge, inspect outside its scope of authority, and disrupt production as well as extort unofficial payment.

Indeed, a true commitment must be made to a changed approach. The list of products subject to mandatory standards should be significantly reduced, in line with WTO recommendations and international practice, and more stringent enforcement put in place for those remaining. Voluntary standards should replace the traditional “command-and-control” system inherited from Soviet times. Significant attention is also necessary to address the conflicts of interest flowing from Sakstandarti setting, testing, certifying, checking and enforcing the current system.

Consumers are best able to select the products they want and in export markets will state this requirement as part of an order. Voluntary standards do not mean the absence of standards however, and necessitate strong consumer rights protection. Significant legal and institutional changes will therefore be required.

### **3.5 Recommendations**

It is imperative for Georgia to truly move to international standardization as promptly as it is able. This will benefit both consumers and producers. While there are no restrictions as to which standards Georgia adopts, nor indeed the obligation to restrict adopted standards to a given country’s or group, it is recommended that Georgia consider the EU standards<sup>5</sup> and its “New Approach” to standardization.

Adopting EU standards is motivated by the risks associated with selecting standards different from one’s principal trading partners. Georgia’s attractiveness as an export production base will depend on its ability to produce goods that meet, and are recognized to meet, the standards of its customers. Potential investors will look both at Georgia’s ability to produce under given standards, and the credibility of its compliance.

International best practice centers on legislation that sets essential requirements for safety, health, and environmental protection for large groups of products and for risks that govern more than one product category. Smooth transition to international (EU) standardization in Georgia might best be achieved by following the so-called New Approach, whereby nations do not set rigid and detailed technical requirements for every product, but rather establish general essential requirements for entire product categories and leave it to producers to decide how to fulfill these more general requirements. In this context, private European bodies have drafted “satisfactory” voluntary standards, conformity to which allows products to be sold throughout the EU.

---

<sup>5</sup> Article 51 of the Partnership and Cooperation Agreement between Georgia and the European Communities and Their Member States provides for cooperation in the field of standards and conformity assessment and stipulates that Georgia will encourage the use of EU technical regulations and the application of European standards and conformity assessment procedures.

The principles of international standardization include:

- Mandatory standards are kept to a minimum, implemented by Government with participation from the private sector and civil society;
- Mandatory standards are aimed at ensuring safety and are dictated by the interest of the public good;
- Voluntary standardization seeks to demonstrate the quality of goods and services over mandatory requirements;
- Voluntary standardization is therefore managed by the private sector and civil society, with Government acting only as the final guardian of public welfare;
- Successful standardization can improve economic performance and foster innovation; and
- Standardization is best achieved in cooperation with international organizations, for setting standards, testing and accreditation, and recognition.

Clearly, moving to this type of standardization will require Georgia to move away from the traditional state “command and control” attitude with obsolete mandatory standards and meaningless certification. A new legal and institutional system will have to be introduced, which recognizes the voluntary nature of standardization, with consequent attention to basic requirements to ensure health and safety, conformity assessment (rules, agents, credibility, legal force) and supervision (joint private and public enforcement).

The actual structure of any new standards organization, or its legal and economic status, can follow a variety of formats. Denmark, Finland, Germany and the UK have private organizations as their central standardization body; Portugal’s is a public enterprise, Luxembourg’s a governmental body, Slovakia’s a government agency; Austria, Greece, Hungary and Poland have standardization structures that span the spectrum, but most countries have chosen standardization organizations which are national but independent. Given current conditions of low capacity and high corruption in Government, the best course for Georgia may be similarly to rest standardization with the private sector and civil society. This would however entail dual efforts on the part of Government to deregulate and to ward off restrictive attitudes and uncompetitive abuses.

### **3.6 Action Plan**

The move to meaningful international standardization will take some significant commitment from Government. It is a medium to long term effort, though there are no reasons to delay implementation. Indeed, the sooner adjustment work is begun, the greater the benefits to be reaped. Proper standardization improves consumer welfare, increases Georgian exports opportunities and economic performance, boosts Georgia’s attractiveness as an investment location, and can impact tax revenues positively.

The work at hand can be split into three broad areas: the overall framework for standardization, and specific issues for exports and for the local market. As stated above, there will be need for the general framework to be reorganized, under which aspects such as essential requirements and consumer rights might be considered across the board. Specific issues for exports include the ability to demonstrate that a good meets a given standard, while in the local market imports should enjoy recognition of foreign certification and local products should meaningfully demonstrate their (voluntary) compliance.

It is therefore envisaged that GEGI would form a stakeholders working group including members of the business community, the civil sector and Government, to review the overall framework for standardization and that this working group might subdivide on specific issues such as mutual recognition of certification or testing capacity in Georgia. GEGI would provide expert advice in drafting policy and legislation, as well as designing new or rationalizing existing institutions, as needed. It should be understood that while the working group will formulate a number of recommendations, and if voluntary standardization is indeed introduced in Georgia, implement a number of them through the private sector and civil society, final responsibility for true and lasting change will rest with Government, whether in amending laws and other legislation, restructuring institutions in line with legal changes, or training its representatives to comply with any new rules and systems. With this caveat, the following action plan is put forward.

Action	Agent	Months		
		1-3	3-6	6-12
Adopt true voluntary standardization policy	GOG/stakeholders			
Automatically accept foreign certification, with small negative list	GOG			
Review framework standardization legislation	Stakeholders			
Strengthen consumer rights legislation	Stakeholders			
Review anti-monopoly legislation in context of potentially restrictive production standards	Stakeholders			
Establish essential requirements for health, safety and the environment – consider EU standards and New Approach	Stakeholders			
Significantly rationalize mandatory standards	Stakeholders			
Enforce meaningful, credible accreditation of testing facilities – consider going to foreign accreditation body	GOG/stakeholders			
Seek mutual recognition of certification	GOG			
Provide clear, transparent information about the system, its procedures and requirements	GOG			

## 4. INSPECTIONS

---

### 4.1 Legal Framework

The legal framework for inspections comprises the General Administrative Code (1999), the Code of Administrative Proceedings (1999), the Civil Code (1997) and the Code of Civil Proceedings (1997), which set overall procedures for administrative acts including inspections. Under this framework, government agencies may set their own procedures.

The Law on Supervision of Entrepreneurial Activity (2001) establishes substantial and procedural aspects for private entity control by the state. It clearly stipulates that the purpose of an inspection is to control the financial and economic activity of an enterprise, to check the fulfillment of its obligations and its compliance with the law; also to impose sanctions in case of disobedience.

It follows that the rationale behind control is to ensure that businesses work properly and meet the requirements of the laws of Georgia in every respect. Thus the scope of controlling activity is very broad, opening the door to excessive intrusion of the state into private activity. The range of inspecting agencies is rather wide as well: the state, local government, self-government bodies and other administrative authorities are empowered to conduct controls. According to the Ministry of Justice, as of April 15, 2004 it has registered 44 controlling bodies<sup>6</sup>.

The rules for conducting inspections include:

- An inspecting agency may conduct control activity, namely, enter the premises of the enterprise, request any relevant documentation, interrupt the production process, arrange a site visit and inspect the quality of the product or the compliance of the enterprise activities with the environmental law only on the basis of a court order, motivated by sufficient evidence of violations and specifying the task to be performed by the control agency.
- The court order requirement does not apply to the scheduled audits by taxation bodies (the National Bank of Georgia, the Chamber of Control of Georgia, the Insurance State Supervisory Service, the Securities National Commission, Independent National Regulatory Commission, the Georgian State Agency for Regulating Oil and Gas Resources).
- The controlling body is obliged to provide the enterprise with a list of the enterprises' rights and obligations related with the process of inspection before the inspection starts.
- The same enterprise may not be inspected twice for the same issue, except by the Chamber of Control. While this protects entrepreneurs against double control, it is not sufficient to overcome the problem of duplication of inspections.
- Supervisory agencies are required to be registered at the Ministry of Justice of Georgia and the latter is obliged to maintain the state registry of supervisory bodies, thus precluding unlawful inspection by illegal agencies.
- Supervisory agencies are obliged to report to the President and the Parliament of Georgia annually, by January 25.

---

<sup>6</sup> See attachment.



## 4.2 The Financial Police, Tax Inspections, and the Chamber of Control

On February 24, 2004 a new law “On Financial Police” was enacted. This law is an effort to reduce the burden of the investigation process by reducing the number of enforcing and controlling agencies. In particular the Law envisages the consolidation of the resources of (1) the operational department of the tax department, (2) the anti-criminal service of the customs department and (3) the investigation department of the Ministry of Finance. Thus instead of these three controlling agencies, only the Financial Police will investigate delinquent taxpayers.

Recent amendments<sup>7</sup> to the Code of Criminal Proceedings give the Financial Police responsibility for investigating all financial and economic violations and crimes, the financial police possesses the absolute right to deal with these crimes, thus stripping this function from the Ministry of Interior and the Ministry of Security of Georgia.

The Financial Police is empowered to conduct investigative activity, preliminary investigation, search and seizure; to initiate criminal proceedings, act in any manner envisaged under the Criminal Procedure Code of Georgia; to stop and search transport facilities; to request and obtain information from tax authorities. The Law also grants the Financial Police authority to decide on conducting revision and inventory and require departmental inspections “when necessary”. As the phrase is not defined, it is rather vague and gives significant possibility for arbitrary decision and abuse of authority.

Besides the financial police, **tax authorities** are empowered to control entrepreneurial activity so as to ensure complete and timely payment of taxes. Correctness of tax calculation and timely payment of taxes, as well as tax administration and collection is to be checked by tax authorities only. Should other supervisory or law-enforcing agencies require an entity’s tax inspection, they should request the tax authorities to conduct such inspection. If the taxes related to import-export operations are determined according to the customs procedure, only then are the relevant customs authorities empowered to conduct inspection.

The **Chamber of Control** is another financial monitoring service. It controls the use and expenditure of state funds and assets. The Chamber is authorized to control and analyze the legitimate, purposeful and effective use of material and monetary state resources. While the state legislative, executive and judicial bodies are the principal agencies subject to monitoring by the Chamber, it is also authorized to control the activity of any physical person or legal entity related to state resources. This includes receiving and transfer of state funds, the use or administration of state property, tax and customs allowances, and loans under state guarantee.

Chamber of Control is authorized to conduct operative control, complex revision, focused inspection and expertise. Its activity includes both planned and unscheduled inspections<sup>8</sup>. Physical persons and/or legal entities are obliged to report to the Chamber of Control, and to submit to the Chamber’s decision and recommendations following inspection, though appeal is envisaged, either to a higher body within the Chamber itself or in court.

---

<sup>7</sup> #3381 of 24/02/2004.

<sup>8</sup> Unscheduled inspections occur only if initiated by the President, Parliament, temporary investigative commissions of Parliament or by a decision of the Presidium or the Regional Bureau Collegiums of the Chamber.

### 4.3 Inspections in Practice

A recent World Bank study<sup>9</sup>, computing the cost of doing business in Georgia assessed the burden imposed by inspections on the private sector. According to this study, an average Georgian company played host to 11 inspections in 2002, with inspectors spending an average of 14 days on a single enterprise. The table below presents inspecting agencies coverage. Tax inspectors are the most likely visitors, though other agencies frequently visiting include the police, sanitary authorities and fire inspectors.

	Inspected at least once	Times inspected	Duration each time (days)
Tax Inspectorate	84.1%	2.56	8.32
Fire fighting authority	53.2%	3.62	2.15
<b>Sanitary authority</b>	59.7%	5.83	2.24
State Security Agency	6.5%	3.77	1.51
Police (6th department)	8.5%	6.18	2.98
Environment protection bodies	14.9%	3.63	1.12
Licensing bodies	19.4%	3.10	1.97
State Statistics Agency	18.9%	5.08	2.08
Labor protection agency	10.0%	3.15	1.27
Standard control authorities	28.9%	3.02	1.91
Antimonopoly Committee	11.4%	5.57	2.31
Architecture Agency	4.0%	1.38	2.52
Department of Advertisements	20.4%	3.85	1.93
Healthcare Department	2.0%	1.75	3.75
Chamber of Control	2.5%	1.00	38.8
Other	3.5%	5.86	2.94

Source: Trends in the Business Environment in Georgia, World Bank, 2003

Interviews with 50 Georgian Business Confederation member companies, conducted in March 2004, suggested a slightly revised list of the most burdensome inspections as follows: Ministry of Interior, the police, the 6th division (fights against economic crime), State Security, and Sakstandarti. There was special concern with the police, security services, and the Chamber of Control, since they can really harm business. Few entrepreneurs complained about planned tax inspections. Interviewees said that tax officials follow the established procedure and no longer “invade” their businesses.

The World Bank study found the tax inspectorate to lead informal payments. High informal payments are reported with the fire department and health/sanitary authorities. For all three agencies, amounts paid informally exceed formal payments. The incidence of informal payment to other agencies appears small, even for those who visit frequently.

	Fines Paid (%)	Informal Payments (%)
Tax Inspectorate	42.8	36.8
Fire fighting authority	5.5	21.9
Sanitary authority	6.5	22.9
State Security Agency	0	2.5

<sup>9</sup> World Bank, Trends in the Business Environment in Georgia, May, 2003.

Police (6th department)	0	4.5
Environment protection bodies	1.0	3.5
Licensing bodies	0.5	5.5
State Statistics Agency	0.5	3.0
Labor protection agency	1.0	3.0
Standard control authorities	2.0	8.5
Antimonopoly Committee	0	3.5
Architecture Agency	0.5	1.0
Department of Advertisements	3.5	4.5
Healthcare Department	0.5	0.5
Chamber of Control	1.0	1.0
Other	0.5	2.0

Source: Trends in the Business Environment in Georgia, World Bank, 2003

## 4.4 Conclusions and Recommendations

Every country imposes certain accountabilities and standards to entrepreneurial activity. Many economic agents are also subject to licenses. Inspections are one tool for ensuring compliance. The state should use this tool to guarantee proper realization of the role and function of Government, the safety of activities of economic agents in terms of public health and the environment, the legitimacy of actions of entrepreneurial entities, and in special cases the proper application of public funds.

With proper analytical capacity, inspections can also help shape policy. For example, should the State Auto Inspection find that out of 1,000 automobiles checked in Tbilisi, all complied with the annual technical check and approval, Government might reconsider the State Auto Inspection.

Government should recognize that inspections are a burden for enterprises and significantly rationalize both the number of controlling agencies and the number of inspections, ideally keeping only those inspections that will ensure security of the public from health and safety hazards. Quality controls are best implemented by markets. Government should analyze the costs and benefits of each inspection and draw rational decisions:

- The costs and benefits of an inspection should be assessed in terms of its impact on an individual organization.
- The full costs of inspection should be identified and valued in monetary terms.
- The benefits of inspection may be quantified as improved performance and increased flow of revenue to the state.
- The results for each agency could be benchmarked against the average results of inspections.

The main purpose of inspections should be to ensure public safety and security. In no case can the main idea of inspections be the extraction of sums from businesses to fulfill budget targets. To earn the moral right to inspect, Government should ensure that it provides detailed, clear and understandable instructions on how to comply with applicable laws, get standards or obtain licenses.

Government should also seek to introduce standard working principles in controlling agencies, risk assessment, strategic planning, client orientation, conflict resolution, performance measurements, internal audit, penalty gradations, feedback mechanisms and administrative regulations.

## 4.5 Recommendations

To strengthen the inspections regime:

- Suspend any inspection outside registered controlling agencies;
- Articulate and publish the mandate of each controlling agency;
- Clarify information on violations and penalties, and the rights and responsibilities of both inspectors and businesses;
- Encourage the voluntary compliance of businesses, rather than a punishment culture;
- Introduce random selection of inspection subjects, using risk management techniques;
- Establish and enforce procedures for conducting on-site inspections, including written documentation for each site visit and the countersigned reports;
- Consider a code of conduct for inspectors, which encourages the conception of inspections for safekeeping the public good, not revenue collection;
- Channel the payment of penalties and fines through a central cashier to reduce corruption;
- Direct payments to the central budget, possibly with some performance-based redistribution, to minimize revenue-generating inspections;
- Improve the system for payments held pending appeal, so that advances do not “leak out”.

## 4.6 Action Plan

Based on the above recommendations, GEGI would form a stakeholders working group including members of the business community, the civil sector and Government. The intention would be to review the inspections system. GEGI could provide expert advice in drafting legislation. While the working group can formulate recommendations, final responsibility for changing the system will rest with Government, whether in amending laws and other legislation, restructuring institutions in line with legal changes, or training its representatives to comply with any new rules and systems.

Action	Agent	Months		
		1-3	3-6	6-12
Suspend illegal inspections	GOG			
Draft mandate of each controlling agency	GOG/stakeholders			
Clarify inspections information	GOG/stakeholders			
Encourage voluntary compliance	GOG/stakeholders			
Introduce risk management	GOG			
Establish rules for inspections	GOG/stakeholders			
Prepare code of conduct for inspectors	GOG/stakeholders			
Centralize payments	GOG			
Review payments advance system	GOG			

## **INSPECTIONS OF GEORGIA AT APRIL 15, 2004**

---

1. Labor Inspection under the Ministry of Labor, Health and Social Security of Georgia
2. State Inspection of Prices at the Ministry of Economy, Industry and Trade
3. Quality Inspection of Agricultural and flour Products at the Ministry of Agriculture and Food
4. State Supervision Inspection of Sanitary - Hygiene norms and procedures at the Ministry of Labor, Health and Social Security of Georgia
5. State Department of Standardization, Meteorology and Certification “Sakstandarti”
6. State Department of Statistics
7. State Sanitary Supervision Inspection at the Border Crossing Points of the Ministry of Labor, Health and Social Security of Georgia
8. Anti-Fire Service Ministry of Internal Affairs
9. State Service of Auto – Transport Control
10. State Department of Land Management
11. State Inspection of Technical Supervision
12. Ministry of Environment and Natural Resources
13. State Department of Geodesy and Cartography
14. State Antimonopoly Service under the Ministry of Economy, Industry and Trade
15. Central Architecture -Construction Inspection at the Ministry of Urbanization
16. Precious Metals and Stones Supervision State Inspection at the Ministry of Finance
17. National Bank of Georgia
18. Chamber of Control of Georgia
19. State Agency of Oil and Gas
20. Georgian Energy Regulation National Commission
21. Energy and Fuel Quality Monitoring Inspection Ministry of Fuel and Energy
22. Insurance Supervision State Service
23. Customs Department of The Ministry of Finance
24. National Commission of Securities
25. National Commission of Communication
26. Auditor Certification Council at Under the Parliament of Georgia
27. State Department of Geology
28. Phyto-Sanitary Quarantine Inspection at the Ministry of Agriculture and Food
29. Plants Protection Service at the Ministry of Agriculture and Food
30. Local Fees Collection Inspection at the Town Council
31. Tax Department of the Ministry of Finance
32. Department of Forestry of Georgia
33. Medicine Quality, Pharmaceutical Activity and Drugs Control Inspection Under the Ministry of Labor, Health and Social Security of Georgia
34. Auto - Transport Administration
35. Vet Department at the Ministry of Agriculture and Food
36. Kutaisi Local Transport Management and Regulatory Service
37. Rustavi land transport management service
38. Ministry of Finance
39. Food Products Expertise and Monitoring Service of the Ministry of Agriculture and Food
40. Production and Service Security Control state inspection under the Standardization, metrology and certification state department
41. State Sanitary Inspection of the Tbilisi’s City Service
42. Central and Regional Services of the State Central Sanitary Inspection of the Ministry of Labor, Health and Social Security
43. Social insurance united State Fund
44. Financial Police under the Ministry of Finance.