

Dealing with Construction Permits

Private sector participation in construction regulation

The world has witnessed an unparalleled expansion of cities in recent decades. The urban population of developing economies is projected to double by 2030, while the area covered by cities could triple.¹ In tandem with this trend, the construction industry is forecast to grow by more than 70%,² reaching \$15 trillion by 2025.³ With the population of cities rising around the world, municipal authorities are struggling to keep up with increased demand for their services. In developing economies, in particular, building departments operating under tight budgets and resource constraints are finding it increasingly difficult to enforce building codes, ensure that quality standards are met and adhere to efficient service delivery processing times.

In some economies, local municipalities have partnered with the private sector to supplement their strained capacity to oversee construction. However, faster and more efficient services provided by third-party inspectors inevitably cost more. *Doing Business* data show that the need to hire qualified third-party professionals on construction projects raises the cost of regulatory compliance by 1% on average in lower-middle-income economies and by 1.3% on average in upper-middle-income economies. The average cost of regulatory compliance in low-income economies without third-party involvement is 7.8% lower; the tradeoff is that it takes longer than in those with third-party involvement.

The use of independent, private-sector entities in construction regulation has provided a conduit for the increased participation of the private sector in the regulatory process and—when appropriate safeguards are in place—has offered an innovative way of addressing regulatory gaps. Low compensation for public sector regulators has resulted in a scarcity of qualified building professionals in

local governments. Hiring private sector experts has addressed this critical gap while improving the efficiency of the regulatory process. When it solicits the experts of private third-party engineering and architectural firms, the public sector taps into specialized skills that enable more robust compliance checks. These firms play a key role in monitoring the enforcement of building regulations and ensuring adherence to adequate standards of quality control at various stages of construction.

Initially pioneered in high-income economies—such as Australia, Japan and the United Kingdom—the trend toward involving private third-party engineers or specialized construction firms in public service delivery has been gradually gaining traction in lower-middle-income and upper-middle-income economies. Modern construction systems increasingly involve licensed or approved private engineers or firms, often enabled by the municipality and local enforcement agencies, to fulfill a building control function. Indeed, data show that 93 out of the 190 economies covered by *Doing Business* use



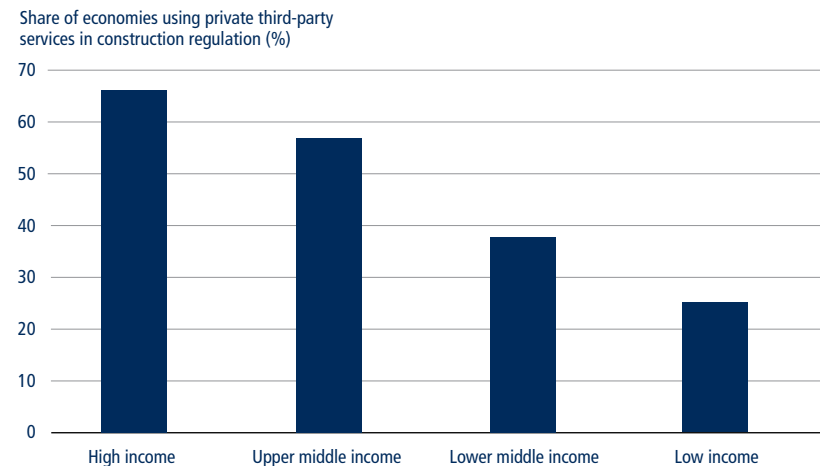
- Involving private sector engineers or firms in construction regulation is a trend that has been gaining traction in economies around the world.
- Some form of private sector participation in construction regulation is employed in 93 of the 190 economies covered by *Doing Business*.
- Private sector participation in building regulatory processes has shown positive results in achieving regulatory goals. However, the delegation of authority from the public to the private sector has generated significant challenges.
- Economies that employ some form of private sector involvement in construction regulation tend to have more efficient processes and better quality controls. Yet, they also exhibit higher costs and a propensity for conflicts of interest.
- The policy choice to integrate private sector entities in construction regulation should be accompanied by appropriate safeguards that favor the public interest over private profits.

some form of private third-party service in construction regulation. Of high-income and upper-middle-income economies, 66.1% and 56.9%, respectively, use third-party services in construction regulation, while 37.7% of lower-middle-income economies use third-party services. In contrast, only 25% of low-income economies make use of private third-party services in construction regulation (figure 5.1).

THE PRIVATE SECTOR'S ROLE IN CONSTRUCTION REGULATION

Over the past two decades, several models of private sector participation in building regulatory processes have emerged in economies around the world. Private participation in construction regimes can range from a very limited role for the private sector—such as in the Arab Republic of Egypt, where the Syndicate of Licensed Engineers merely certifies the qualifications of the supervising engineer—to a more comprehensive role where a private firm has complete authority over the entire process—such as in Australia, where private building surveyors directly oversee building design, control and inspection. In the United Kingdom, builders are given the option of either working with an approved private inspector or completing the required procedures with the public authorities. In other economies, such as France and the Republic of Congo, building controls are associated with an insurance-driven regulatory regime in which insurance and warranty firms engage private inspection firms in third-party reviews. While these two economies share the same insurance regime, there is a large disparity in terms of their performance on the quality control index, where France scores significantly higher than the Republic of Congo. At least two parties are held liable for any construction failure for a period of 10 years in 32% of high-income economies allowing third-party involvement, but this figure falls to just 9% for

FIGURE 5.1 Private third-party services are more commonly used in construction regulation in high-income and upper-middle-income economies



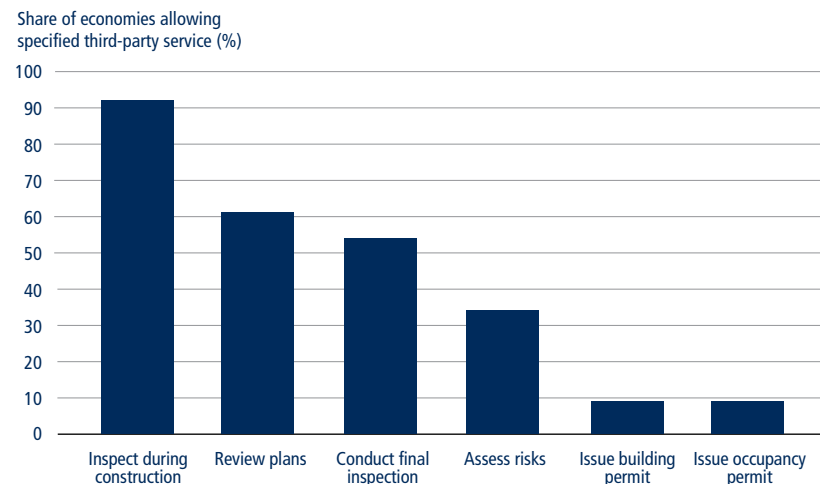
Source: *Doing Business* database.

low-income economies. Under this legal framework, only buildings deemed safe by independent third-party entities can be insured by an insurance company.

The degree to which the private sector is engaged in regulatory activities varies significantly across economies (figure 5.2). However, the primary function of private third-party entities involved in construction regulation tends to focus on

building inspections during project execution, as is the case in 92% of economies with private participation mechanisms. Of these economies, 61% engage private entities in reviewing building plans, 54% in conducting final inspections upon the completion of construction and 33% in conducting risk assessments of projects. Nonetheless, the issuance of building and occupancy permits remains largely under the purview of local authorities with only

FIGURE 5.2 Almost all economies employing private-sector regulatory support allow third-party inspections during construction



Source: *Doing Business* database.

9% of economies delegating these regulatory roles to the private sector.

BENEFITS OF THIRD-PARTY INVOLVEMENT IN CONSTRUCTION REGULATION

Economies can reap numerous benefits when private sector involvement is carefully implemented within a coherent regulatory framework. In most EU economies, there has been a complete shift from public to private governance mechanisms in building regulation, reflecting a desire to improve the quality of regulation, reduce the administrative burden for applicants and support a greater focus on risk mitigation.⁴

Public-private collaboration on construction regulation has shown positive results including improved compliance with building regulations, more rigorous quality control throughout the project lifecycle and better processing efficiency. *Doing Business* data show that private third-party involvement is associated with better building quality in construction as measured by the building quality control index.⁵ Private sector involvement in construction regulation can support the enforcement of building codes and other applicable regulations. It effectively promotes compliance with the existing legal framework, particularly in economies where clear, transparent rules and specific technical instructions are prescribed.

Economies that integrated the private sector into regulatory functions decades ago have seen notable improvements in building quality control. Japan, for example, suffers from an extremely high exposure to natural hazards such as typhoons and earthquakes. The authorities reformed building regulations in 1998 by introducing private third-party services to significantly expand its capacity to carry out building inspections. By doing so, it managed to increase the rate of final inspections to more than 90% in 2016

compared with just 40% before June 2000. By establishing a successful regulatory system that relies on third-party checks, Japan increased its capacity to detect deficiencies in building design and construction, offering timely and appropriate remedies. Private third-party firms now play an instrumental and dominant role in inspection works (figure 5.3).

Similarly, to improve the energy efficiency of its large stock of new buildings, in 2005 the Chinese government introduced an innovative private third-party mechanism to carry out compliance checks of green building code provisions, effectively tapping a vast and readily-available pool of private sector expertise. Five years after the reform, compliance rates with regulatory requirements had effectively doubled.⁶

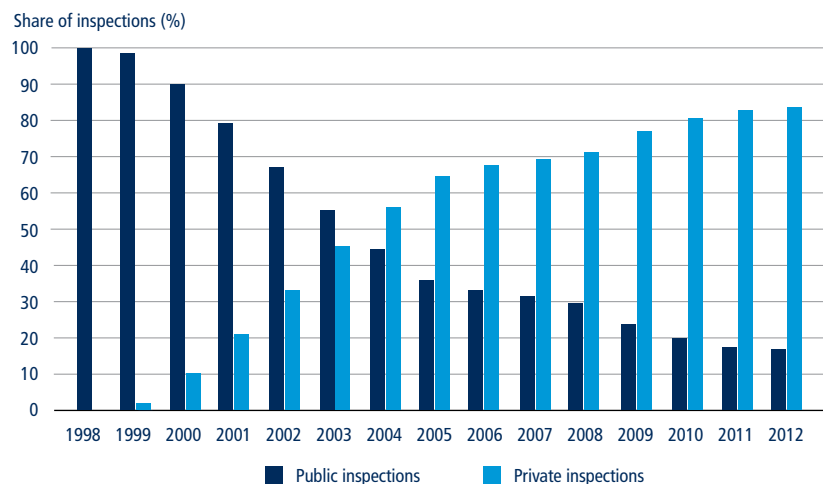
The former Yugoslav Republic of Macedonia initiated sweeping construction reforms in 2007/08 mandating the use of private engineers licensed by the Chamber of Engineers to undertake independent building plan reviews. Since then, FYR Macedonia has seen significant improvements in the efficiency of construction regulation as measured by *Doing Business*. The tradeoff has been an increase

in regulatory cost (figure 5.4). Even the Netherlands—one of the few EU economies that has maintained exclusive public enforcement of building regulation—is now preparing to shift toward a more hybrid system of enforcement involving private third-party mechanisms.

Introducing private third-party involvement in construction regimes can also expand regulatory capacity through efficiency gains. The use of private sector third-party services allows for the flexibility to hire specialized expertise that is usually scarce in local municipal governments, particularly in low- and middle-income economies. Local governments are often subject to hiring restrictions and operate with less competitive pay scales that limit their capacity to hire well-qualified staff or contain the high level of staff turnover. These limitations are usually compounded by a wide range of factors, including inadequate local tax bases to fund service delivery, limited transfers from national governments and institutional capacity constraints.

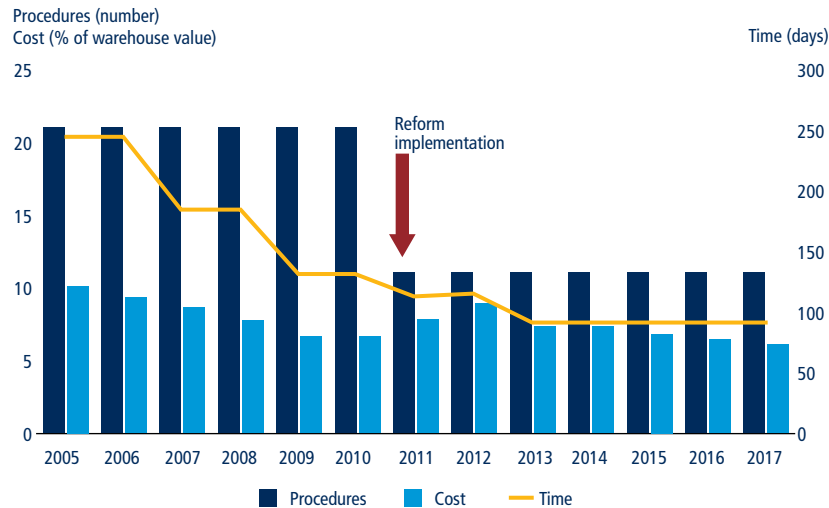
Doing Business data show that the process of dealing with construction permits tends to be faster in economies with private participation in construction

FIGURE 5.3 Private third-party inspection firms have become instrumental players in Japan



Source: Japan, Ministry of Land, Infrastructure, Transport and Tourism database (<http://www.mlit.go.jp>).

FIGURE 5.4 FYR Macedonia reduced the number of procedures and time it takes to build a warehouse following the introduction of private third-party building plan review



Source: Doing Business database.

regulation. High-income economies employing private sector regulatory support experience time savings of up to 60 days on average compared to economies that do not rely on third-party participation. Private sector involvement in building control activities has the potential to promote administrative efficiency, which in turn results in favorable economic outcomes. A study of the economic impact of expediting permit processing reveals that improving administrative efficiency results in a 16.5% increase in property tax collection, a 5.7% increase in construction spending and a 0.6% increase in the rate of financial return for the investor.⁷ In contrast, regulatory delays could undermine the profitability of building projects,⁸ adding a financial burden that amounts to 5% of total construction costs incurred by developers⁹ and reducing the likelihood of further investment.

Economies with the least efficient construction permitting procedures have enforcement systems that rely exclusively on public authorities. Conversely, some economies that have transitioned from a public approach to a more open system involving partnerships with the private sector have experienced significant

gains in efficiency. The planning office in Bogotá, Colombia, for example, reduced the average time needed to process a construction permit from three years in 1995 to 73 days in 2012 after it began using private professionals to carry out plan reviews and issue building permits. Given the successful integration of third-party professionals in building control activities, the authorities are now considering extending the use of specialized engineers to building inspections, which remain under the jurisdiction of local public officials.

CHALLENGES OF THIRD-PARTY INVOLVEMENT IN CONSTRUCTION REGULATION

Models of private sector participation in construction regimes vary. While third-party involvement in construction regulation can facilitate doing business in the construction industry by reducing the burden on local authorities, it comes with tradeoffs—including higher construction costs. Privatization of public services should be implemented carefully, with due regard to standards

of transparency and accountability. The delegation of such a key regulatory mandate to the private sector should always be coupled with strict oversight safeguards designed to hold public interest above private profits.

For the private sector to successfully assume such an important regulatory role, a robust vetting system should be in place. Private third-party entities carrying out controls on construction are entrusted to promote compliance with building codes and regulations and enforce rigorous safeguards in favor of the public interest. For such an arrangement to work as intended, the public sector should regulate private third-party professionals and firms. Public sector agencies do so by enforcing professional certification criteria that render individuals and firms eligible to take on a regulatory mandate. Insufficient qualifications of private individuals or firms would undermine the objective of such a regulatory mechanism as the quality of service provided by these professionals would fail to meet the required standards of safety.

Economies with third-party involvement in regulatory functions often adopt specific standards of eligibility for private sector entities to be able to fulfill such a critical regulatory role. These standards typically include a minimum number of years of professional experience, certification by a recognized professional body and proof of performance on previous contracts. When private certification requirements were not properly implemented in New Zealand in the 1990s, the authorities quickly abandoned the shift to private sector building controls and reverted to the traditional public sector regulatory role. New Zealand's attempt to adopt third-party inspections failed due to the lack of strong regulatory safeguards. This resulted in the "leaky building syndrome." In 2008, the cost to repair 42,000 leaky buildings was estimated around 11.3 billion New Zealand dollars (approximately \$8.3 billion).¹⁰ Third-party involvement in construction regulation holds the

promise of improving the regulatory framework, but it could also result in unintended adverse consequences if inadequately implemented. Although 22.2% of high-income economies with third-party involvement covered by *Doing Business* have standard eligibility requirements—including number of years of experience, a university degree and proof of performance on similar projects—only 3.3% of low-income economies require these standard qualifications.

Certifying agencies are mandated with monitoring the enforcement of professional standards. Government agencies represent the largest share of certifying bodies (68.5%) in those economies covered by *Doing Business*, followed by the national order of engineers (19.6%) and other independent bodies (13%) (table 5.1). In the United States, professional certification for third-party services is provided by the International Code Council (ICC), a non-governmental organization. Japan and China, by contrast, host this important function under central ministerial authorities.¹¹ The United Kingdom has mandated an independent organization—the Construction Industry Council—to administer the registration system for Approved Inspectors (AIs).

Having strict qualification standards in place is an essential and necessary element of a third-party regulatory regime, but this alone is insufficient to ensure that qualified professionals are delivering a satisfactory service. Special attention should be given to the effective enforcement of these professional certification

requirements. This may entail the introduction of oversight mechanisms, a liability and insurance regime and a disciplinary framework that accompanies the transfer of regulatory authority from public officials to third-party entities as part of an essential quality assurance mechanism of third-party providers. China, for example, directed the Ministry of Housing and Urban-Rural Development to certify private third-party companies to carry out compliance checks of green building code provisions. The ministry maintains a comprehensive online public database that contains information on certified third-party firms. It requires the management of construction inspection companies to maintain accountability and quality of service, enforcing penalties when violations are discovered by regular inspections of third-party firms.

When the regulatory framework clearly defines the roles and responsibilities of private service providers, third-party entities are aware of their rights and obligations under the law and can exercise their authority within a legally transparent environment. Furthermore, accountability provisions governing conflicts of interest should be put in place to minimize their incidence and promote unbiased and independent regulatory control. Regulations in 76% of economies that make use of third-party inspectors explicitly require the independence of third-party inspectors; they should have no financial interests in the project and should not be related to the investor or builder.

Without strong liability and insurance regimes and rigorous professional certification mechanisms, third-party involvement in construction regulation can become inefficient or fail to ensure high quality building standards. Moreover, builders could incur the high costs that often accompany private-sector regulatory control without fully benefiting from the advantages that this control is intended to offer. Some economies regulate the cost of such services to

acceptable levels by enforcing fee schedules (within suggested industry guidelines) or by requiring fewer external professionals to be engaged by investors or local construction companies. In the Republic of Korea, for example, an independent third-party may not charge more than 1.29% of the estimated construction cost, in accordance with the Regulation for Scope of Architect Services and Fee Standard. In other economies, the local building authority either conducts all construction oversight or absorbs the cost of engaging external third-party professionals in the process through outsourcing. In South Africa, local authorities can temporarily appoint external building inspectors to conduct inspections on behalf of the local authority.

CONCLUSION

Sound construction regulation can save human lives, improve health and safety and support a prosperous and sustainable building sector and economy.¹² It can help facilitate doing business by safeguarding lucrative investments, strengthening property rights and protecting the public from faulty building practices. Private sector involvement in the enforcement of building regulations has shown positive results in achieving regulatory goals.¹³ However, several challenges should be addressed before a policy of private sector involvement in construction regulation is pursued. The transfer of authority from the public to the private sphere could undermine the public interest. Public-private collaboration in building regulation has delivered successful results when authorities have enforced strict qualification requirements, effective oversight mechanisms and provisions on conflicts of interest, among other fundamental safeguards. A wealth of peer experience accumulated over the past 20 years is now available to economies considering integrating third-party entities in construction regulation.

TABLE 5.1 Distribution of certifying bodies for third-party entities involved in construction regulation

Certification agency for third-party entities in construction	Number of economies
Government	63
Order of architects or engineers	18
Other independent body	12

Source: *Doing Business* database.

NOTES

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1. UN-Habitat 2016.
2. Moullier 2013.
3. Global Construction Perspectives and Oxford Economics 2013.
4. Meijer and Visscher 2005.
5. For more on the building quality control index, see the data notes.
6. As reported by the American Council for an Energy-Efficient Economy. <http://aceee.org/research-report/i121>.
7. PricewaterhouseCoopers 2005.
8. Wrenn and Irwin 2015.
9. Hsueh 2010.
10. Lovegrove 2016.
11. The Ministry of Land, Infrastructure, Transport and Tourism (MLIT) in Japan and the Ministry of Housing and Urban-Rural Development (MoHURD) in China.
12. Van der Heijden 2009.
13. Moullier 2017.