

DEVELOPING ALTERNATIVES

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# **Breaking the Rules that Bind!**



***Freeing Private Enterprise from  
the Shackles of Regulation***

Since 1970, DAI has explored alternative paths to development. DAI—which includes DAI Europe in London, ECI Africa in Johannesburg, and DAI Palestine in Ramallah—generates ideas through research, shares these ideas with the development community through publications, and tests the ideas in the crucible of development projects.

*Developing Alternatives* provides a forum for DAI's professional staff and collaborators to expose their ideas to a wider audience. Articles treat policy issues of topical interest and aim at promoting broad discussion.

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## A SPECTER IS HAUNTING THE DEVELOPING WORLD—THE SPECTER OF REGULATORY REFORM

Every fall, the publication of the new edition of the World Bank's *Doing Business* series and the World Economic Forum's *Global Competitiveness Report* triggers lively debates among policy makers and pundits. Countries rising in the rankings (and, in particular, their advisors) bask in the recognition. Countries that have slipped badly either dismiss the findings or question the methods behind the benchmark scores. Others pledge an all-out effort to lower administrative costs for businesses.

For more than a decade, there has been growing consensus that high administrative costs and heavy regulatory burdens choke enterprise performance and economic growth. Donors and governments have undertaken numerous investment climate assessments and cross-country benchmarking exercises. There are so many appraisals of “regulatory quality” today, in fact, that the World Bank Institute needs sophisticated econometric procedures to reduce them to a single measure (which, incidentally, represents one of the 16 indicators for eligibility for financial assistance from the Millennium Challenge Account).

Although these investment climate assessments and benchmarking exercises have been around for some time, they have recently emerged as major sources of policy guidance and yardsticks for policy performance. A growing commitment to take action to improve the business environment is sweeping the developing world and its donor partners. The Organisation for Economic Co-operation and Development countries have long been haunted by the specter of “regulatory reform”; it has now begun to make its appearance in development policy as well.

Regulatory reform is, of course, a most benevolent specter: it favors economic growth and development, and it has businesses around the world rattling their regulatory shackles in anticipation of its effects. But the image of the specter is appropriate, because despite their devotion to the principle of regulatory reform, those charged with effecting it often have a somewhat shadowy understanding of the appropriate tools and programs to do so.

This gap between knowing what is needed—a hospitable business climate—and doing what it takes to get there remains a problem, even in light of many successful experiences. These experiences have ranged from tinkering in the margins, through efforts to lower the administrative costs of businesses by consolidating functions—the “one-stop shop” principle—to more radical approaches: the “bulldozer” approach used in Bosnia, the guillotine approach promoted by DAI's partner Jacobs & Associates in Moldova and Ukraine, and others. There is now a body of knowledge that can guide policy makers and their advisors in untangling the thicket of administrative rules and regulatory constraints on business activity.

Building on these lessons learned, this issue of *Developing Alternatives* shows how to translate the commitment to raising competitiveness by improving the business climate into regulatory reform action. It identifies where the “low-hanging fruit” are (that is, where a simple administrative or policy decision—with the stroke of a pen, as it were—can lead to significant gains); how support programs come up with the right mix of incentives and institutional capacity development; and how to engage the judiciary in these initiatives.

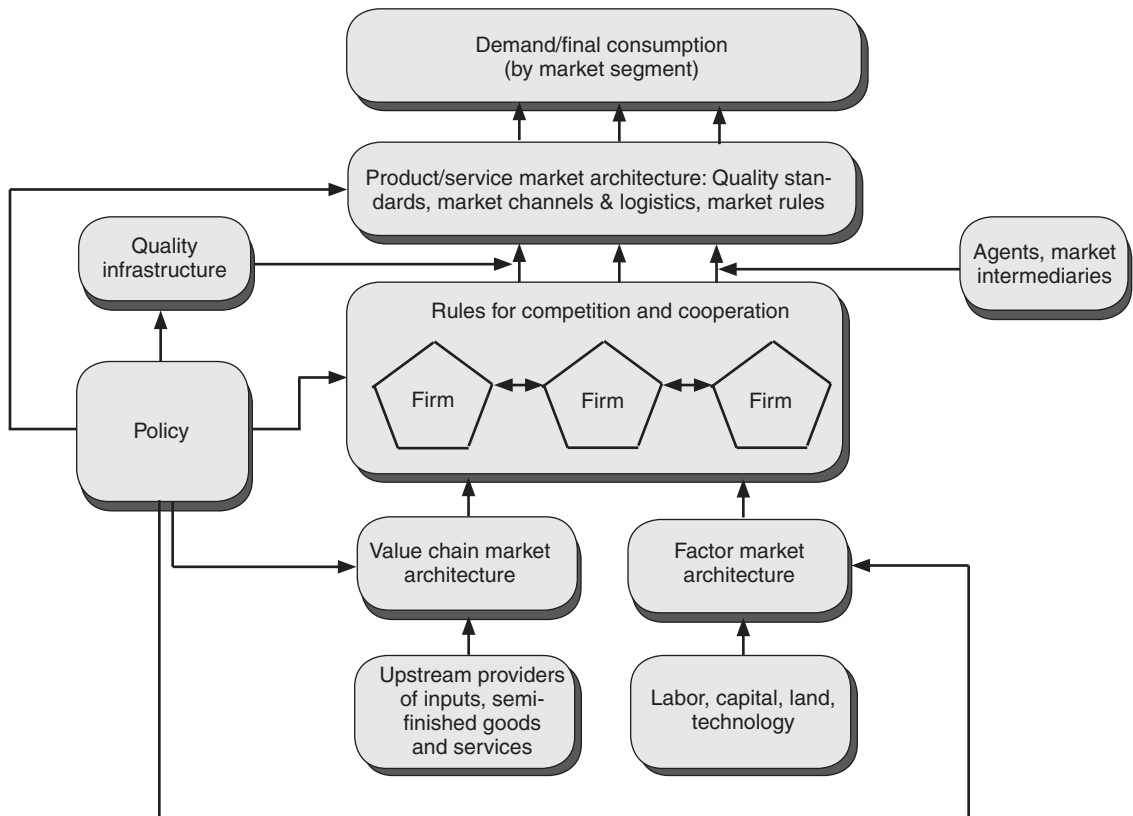
## The Targets of Reform: Building a Modern Market Infrastructure

Excessive red tape imposes real costs on business, raising the transaction costs associated “primarily with the transfer, capture, and protection of property rights.”<sup>1</sup> All other things being equal, enterprises in countries with high transaction costs are at a disadvantage vis-à-vis their competitors. Of course, other things tend not to be equal in a developing-country context, which leads to the paradox that the countries least able to absorb the transaction costs associated with regulations tend to be those with the most complicated regulatory frameworks, exacerbated by a lack of institutional capacity to enforce them or to keep down administrative costs.

Indeed, many public support mechanisms, ranging from registration to enforcement of contracts, raise the cost of doing business. Many of these functions are important, but inefficiency, duplication, verification, and administrative sloth impose major costs on businesses, often without providing much in the way of service.

Yet regulatory reform is not simply deregulation. Market failures—primarily associated with dominant market power and externalities—afflict any economy, and regulations correct for such failures. The ideal, however, is to wield the regulatory tools to create a domestic market architecture and appropriate adaptations to global market architectures that put the country’s private enterprises at least

### COMPETITIVE PERFORMANCE AND MARKET ARCHITECTURES



<sup>1</sup> Y. Barzel, *Economic Analysis of Property Rights* (Cambridge: Cambridge University Press, 1989), 2.

on an even footing with their competitors in other countries. The figure, Competitive Performance and Market Architectures, summarizes the key elements of such an effort.

The legal and regulatory framework affects both upstream markets, for factors of production, and suppliers of inputs and business services. For example, the rules for purchasing energy (one sector where the concept of “market architecture” originated) define the relations between businesses and energy suppliers. How the market for power purchases is structured, whether the enterprise is dependent on a monopoly supplier, whether it can negotiate with different providers, and whether it can sell any excess production from its own cogeneration plant—all of these factors determine the cost of energy and, therefore, overall productivity.

The World Bank’s *Doing Business* series focuses on some of the implications of rules and regulations in upstream markets. For example, the categories included refer to the hiring and firing of labor or getting credit—the rules and their implications for transaction costs.

Regulations and administrative support mechanisms also play a key role in structuring operations in the downstream markets for goods and services. In many instances, entrepreneurs and managers are unclear about how to deal with the rules and norms of the market, or even where to turn for advice in coping with market demands. This lack of knowledge creates additional costs and puts the prospective exporter in a poor negotiating position. Quality standards and norms in domestic as well as international markets—not just for the end producer, but for the entire value chain—are often not well understood. These standards impose requirements on compliance that are not just a whim of the regulator, but reflect the demands of consumers in key markets. They impose requirements on the performance of a country’s quality assurance system, ranging from the adoption of international standards to the certification or accreditation of laboratories.

Much of the regulatory thicket in many countries has its roots in attempts to respond to market failure. Yet market failure is also often used to justify existing regulations. At the same time, however, regulations can exacerbate market failures by creating barriers to entry or exit, which confers benefits to some groups at the expense of others. For example, standards for occupational qualifications can be used to create barriers to entry into relatively straightforward jobs (such as taxi driver).

The rigidities introduced by excessive regulations that try to maintain traditional market architectures in the face of globalization put regulated firms at a disadvantage and undermine the market’s ability to respond to external shocks. A prime example is the cost of closing a business. Modern market economies depend not only on rapid enterprise creation, but also on a speedy exit of companies that no longer meet the demands of the market. The longer it takes to close a business, the weaker the market’s ability to adjust.

### The Weeding-Out Process

Weeding the thicket of regulations—or bulldozing or guillotining it—has become a preoccupation of national and subnational officials in developing countries and transition economies, fueled by the healthy proliferation of international comparisons and benchmarks. (There are also, of course, officials who dismiss comparative indicators as misleading or based on an inadequate understanding of the local situation, and refuse to take action.) The weeding-out process has three components—throwing out unnecessary regulations, analyzing the remaining regulations to ascertain their efficiency, and developing procedures for streamlining the development, promulgation, and implementation of remaining regulations to lower administrative costs, both to regulators and to the regulated.

First, regulations are reviewed to determine their legal basis. In applying the guillotine approach in Ukraine and Moldova, for example, staff found that many regulations lacked legal authorization. Abolishing these regulations meant fewer risks,

fewer inspections, and fewer administrative costs for business.

Second, regulations that appear to be economically justified—that is, where market failure provides a sound rationale—are analyzed to determine their efficiency (the cost-benefit ratio) and the incidence of these costs and benefits. That generally is the task of regulatory impact analysis (RIA), which is needed both for preparing new legislation and for evaluating existing laws. Regulators in developing countries and transition economies have traditionally shifted all of the costs to businesses, even if the gains in business risk (consumer protection) are small. If there are risks associated with, say, externalities, an RIA must also include alternative scenarios of sharing these risks among the different parties. Similarly, in the case of market power, some regulators may decide that increased market power is acceptable if it benefits the consumer, while others may focus more on curbing market powers and ensuring competition.<sup>2</sup> Obviously, any changes that result from this continuing review have institutional implications: regulators need both incentives and the capacity to administer the revamped body of regulations.

Finally, there is a major revolution under way in dealing with the information requirements of drafting, interpreting, implementing, and complying with regulations. Information technology plays a major role, from providing access to relevant texts to assisting in vetting proposed regulations to ensuring that comparable situations have the same resolution—implementing a reliable rule-based approach to applying the existing body of regulations. While the institutional challenges of getting to that point are formidable, the administrative costs and risks of complying with regulations can be lowered significantly.

## A Guide to This Issue

Over the past few years, DAI and its partners have promoted regulatory reform in various settings. In Vietnam, the Support for Trade Acceleration Project has worked to align regulations with the Bilateral Trade Agreement with the United States. A companion project, the Viet Nam Competitiveness Initiative, developed the Provincial Competitiveness Index, which has stimulated competition among provinces to improve the business climate. In Ukraine and Moldova, the Support to Micro, Small, and Medium Enterprise Development Project (BIZPRO), implemented with our partner Jacobs & Associates, promotes the guillotine approach. In Uganda and elsewhere, DAI Europe, Ltd. (formerly Bannock Consulting) has championed the application of RIA to curtail excessive regulations. In Morocco, DAI is working with the World Bank's *Doing Business* team, the World Economic Forum's Executive Opinion Survey, and others to improve the country's business climate.

The articles in this issue of *Developing Alternatives* draw lessons from experiences across countries and environments. Scott Jacobs of Jacobs & Associates examines the impact of investment climate assessments on policy changes, drawing primarily on the experience of the World Bank's Foreign Investment Advisory Service. He distills this experience into seven “good practices” of highly successful regulatory reforms:<sup>3</sup>

- Adopt a multiyear time horizon;
- Give reform oversight and management authority to a body that spans the whole of government;
- Actively manage the reform process and support it with adequate funding and resources;
- Involve the ministries concerned;
- Maintain business-government dialogue;
- Institutionalize monitoring; and
- Work with expert international bodies.

<sup>2</sup> That, in a nutshell, describes the different approaches of the European Union and the United States to dealing with complaints about the market power of Microsoft.

<sup>3</sup> With apologies to Stephen Covey.



The next article, by Darren Welch of DAI Europe, assesses the lessons learned in applying RIA in a developing country. Based on experience applying RIA in Uganda, he concludes that the conceptual framework alone (even in light of standard data problems) can improve policy making and drive regulatory reform.

Benjamin Herzberg and Andrew Wright identify eight strategic activities to sustain effective business-government dialogue as part of the regulatory reform process:

- Reach out to small enterprises;
- Strengthen business associations;
- Map the partnership's structure to the government's;
- Aim for a two-tiered output, such as specific policy reform proposals with broader economic policy papers;
- Use branding and marketing;
- Appoint a dynamic coordinator;
- Manage expectations; and
- Be flexible about changing structures.

Next, Ulrich Ernst surveys the rapidly changing field of information technology and its potential

for reducing the administrative costs of preparing, promulgating, implementing, and complying with regulations. His paper is followed by an examination of different approaches to regulatory reform—first under a single project, BIZPRO, in Ukraine and Moldova, by Patrick Rader and Denis Gallagher, respectively—and then in Vietnam under the Viet Nam Competitiveness Initiative. David Ray, Edmund Malesky, and Linda Nemeč discuss the construction of the Provincial Competitiveness Index and its impact on competition among Vietnam's provinces to improve their business environments. As the World Bank's *Doing Business* team drills down to subnational assessments of the business climate and as other countries systematically link business surveys to these assessments, the experience of Vietnam's provinces will likely be repeated.

The final article examines a major institutional component of any successful regulatory reform: preparing the judiciary. Rémy Kormos of DPK Consulting, DAI's partner in the regulatory reform project in Morocco, focuses on specific issues in preparing courts to play their part in a revamped regulatory environment. ♦

# FREEING THE ECONOMY: LESSONS LEARNED

by Scott Jacobs

In most countries, new regulations proliferate even as old ones persist—following their own version of Parkinson’s Law<sup>1</sup> and strangling the economy with red tape. Red tape imposes unnecessary costs on business, sapping an economy’s competitiveness and condemning millions of entrepreneurs to the informal or grey economy. It reduces investment and trade across borders, diminishes competition, and fuels corruption. In many countries, gains from the historic transition toward market economies have failed to materialize because cumbersome administrative procedures shackle private enterprise and undermine economic growth.

To be sure, modern government could not function without using administrative procedures to collect information, finance public activities, and regulate markets as necessary to implement public policies. In fact, private enterprise depends on adequate administrative regulations setting market frameworks to ensure fair competition. As public concerns over safety, health, and the environment rise, governments turn to more stringent regulations—a process characterized by the Organisation for Economic Co-operation and Development (OECD) as “regulatory inflation.”

Yet in many instances, government bureaucracies see regulations and administrative procedures as a means to “manage the economy,” a modern version of old-style *dirigisme*. They weave a regulatory straitjacket for the economy that distorts market signals and wastes resources—both legitimate and clandestine—through corruption.

Poor administrative procedures have four kinds of adverse effects:

- They increase transaction costs for businesses through day-to-day compliance costs;
- They increase capital costs because of higher levels of uncertainty, risk, and corruption;
- They make it difficult to define and enforce property rights; and
- They weaken competition by deterring market entry.

Why is burdensome administration universal? It seems odd that governments claim to want foreign investment but actually hinder investment through administrative barriers. Indeed, the countries that most need entrepreneurs to create jobs and boost growth—the poorest countries—put the most obstacles in their way.

Part of the reason for this paradox is that governments try to achieve many objectives simultaneously. Moreover, developing countries and transition economies suffer from the legacies of over-control. The hidden costs of administrative procedures are never accounted for. Lack of coordination across multiple jurisdictions leads to excessive and overlapping demands on businesses. Finally, administrative formalities generate rents for many interests, and every administrative barrier is fiercely guarded by lawyers who sell services to help businesses, civil servants who sell favors such as faster processing, and incumbent producers who want to reduce entry. Politicians can expend vast political resources fighting these interests for little gain.

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<sup>1</sup> Work expands to fill the time available for its completion.



## The Costs of Red Tape

In 2004, the Foreign Investment Advisory Service (FIAS) reported that an investor starting a business in a developing country may need to comply with as many as 53 procedures that may take 443 days and cost US\$6,000 (often 10 times the annual income of the average citizen in that country).<sup>2</sup> The World Bank's *Doing Business in 2005* noted that businesses in the poorest developing countries face three times the administrative costs and nearly twice as many bureaucratic procedures and delays as their counterparts in industrialized countries. Chad, for example, requires 19 procedures to register a new business, compared with two in Australia. In the Democratic Republic of the Congo, it takes 155 days to register a business. In addition, businesses in poor nations have less than half the property-rights protection available to businesses in rich countries. In Angola, it takes more than three years to enforce a contract.

Small and medium-sized enterprises—often operating on the fringe of the formal market—are particularly hard-hit by a high-cost regulatory environment. Heavy regulation and weak property rights exclude the poor—especially women and younger people—from doing business. FIAS notes that reducing administrative barriers creates opportunities for those who have traditionally been excluded from the market—whether they are the poor or foreigners.

Based on figures generated by the OECD, total government red tape in Europe costs more than 3

percent of European gross domestic product (GDP) each year, or more than the annual value-added of Europe's agriculture, forestry, and fishing sectors combined. More recent estimates place the cost of red tape in Europe even higher, as much as €340 billion per year, or almost 7 percent of European GDP.<sup>3</sup>

Administrative barriers also affect trade, and these technical barriers to trade are a major issue in trade negotiations. As early as 1994, the United Nations Conference on Trade and Development (UNCTAD) estimated that the average customs transaction involved 20 to 30 parties, 40 documents, 200 data elements, and the re-keying of 60 to 70 percent of data at least once.<sup>4</sup> By 2003, UNCTAD observed that the processing of transactions still had a long way to go. In 2000, the Asia-Pacific Economic Cooperation's (APEC) Economic Committee estimated that measures to reduce transaction costs of cross-border trade could generate economic gains of 0.26 percent of total real regional GDP—or US\$45 billion, almost double the expected gains from tariff liberalization—and that the savings in import prices would be 1 to 2 percent of import prices for developing countries in the region.<sup>5</sup> In 2002, the OECD reported that estimates of trade transaction costs ranged from 2 to 15 percent of the trade transaction value. The World Trade Organization (WTO) estimated that the post-Uruguay weighted average tariff of developed countries is 3.8 percent.<sup>6</sup> Guasch and Spiller argued that monopoly port service providers and inefficient regulation of port operations give rise

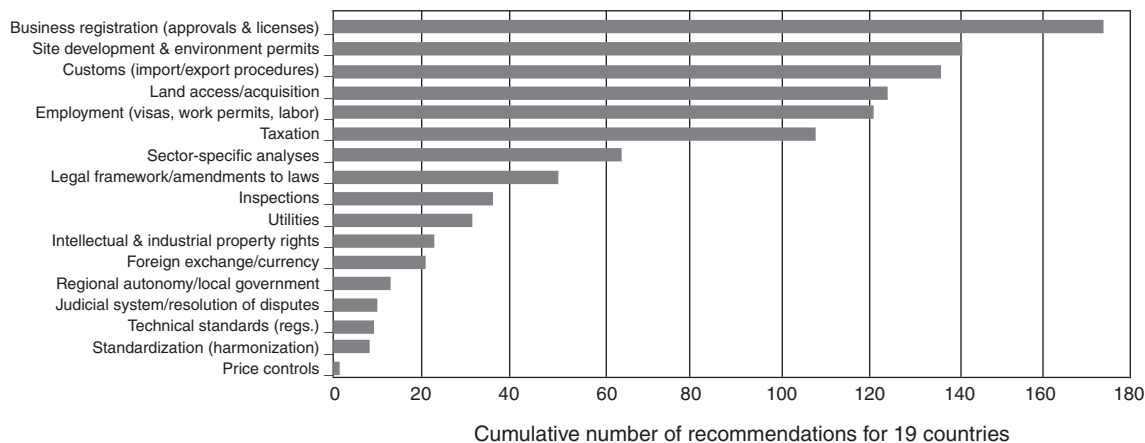
<sup>2</sup> FIAS, *FIAS 2004 Annual Report* (Washington, D.C., 2004), 18.

<sup>3</sup> Government of the Netherlands, "Fostering Growth by Reducing Administrative Burdens" (presented to the Informal ECOFIN, September 10–11, 2004).

<sup>4</sup> UNCTAD, "Fact Sheet 5" (presented at the United Nations International Symposium on Trade Efficiency, October 17–21, 1994).

<sup>5</sup> APEC, 12<sup>th</sup> APEC Ministerial Meeting, November 12–13; Media Background Notes, 8<sup>th</sup> APEC Economic Leaders Meeting, November 15–16, 2000.

<sup>6</sup> OECD Working Party of the Trade Committee, *Business Benefits of Trade Facilitation* (Paris, 2001).

**TOTAL NUMBER OF FIAS RECOMMENDATIONS BY TOPIC**

to implicit tariffs of 5 to 25 percent on exports in Latin America.<sup>7</sup> Investment flows are also affected by administrative burdens. A 2002 FIAS study of 32 countries estimated that each reduction of 10 percent in the average costs of administrative procedures affecting investors would increase foreign direct investment (FDI) by 5 percent.<sup>8</sup>

As the dimensions of the problem become better understood, diagnostics have moved from broad and general appraisals to assessments of specific issues. For example, FIAS's work in 60 countries has begun to shed light on the most pressing reform priorities, as illustrated in the figure above.

Another emerging issue for FIAS is the quality and efficiency of inspections—a phase of the administrative process highly vulnerable to corruption because of lack of transparency, accountability, and due process—and overlap among government agencies.

### A Growing Commitment to Action

The quest to be competitive in domestic and international markets and the competition to attract FDI have triggered action. Today, almost all industrialized countries and dozens of emerging markets and developing countries have created programs aimed at reducing administrative barriers to entry and administrative burdens on businesses. Much of the growing commitment to action derives from obligations under trade agreements. International trade and investment frameworks focus more and more on administrative barriers—seeking transparency and professionalism in customs and regulatory environments and harmonization of standards in compliance with international or regional regulations. The Doha Round of WTO negotiations aims to remove structural barriers by developing stronger General Agreement on Trade in Services disciplines on regulatory transparency, removing barriers that deny “effective market access,” and binding the resulting liberalization.<sup>9</sup> In effect, trade facilitation

<sup>7</sup> J. Luis Guasch and Pablo Spiller, *Managing the Regulatory Process: Design, Concepts, Issues, and the Latin America and the Caribbean Story* (Latin American and Caribbean Studies, World Bank, 1999).

<sup>8</sup> J. Morisset and O. Lumenganeso, “Administrative Costs to Foreign Investment in Developing Countries,” *Policy Research Working Paper Series* (World Bank, May 2002).

<sup>9</sup> Sydney J. Key, *The Doha Round and Financial Services Negotiations* (Washington, D.C.: AEI Press, November 2003).

efforts have moved “inside the border” to domestic policies and institutional structures.<sup>10</sup>

Bilateral investment treaties and fiercer competition for FDI are also driving national reform programs. Facing diminished FDI inflows, many governments have accelerated the liberalization of FDI regimes. These efforts involve not just financial incentives and investment promotion, but increasingly the investment environment.

Providers of technical assistance have responded to the growing search for good practices. The WTO today gives priority to assisting developing countries to implement existing WTO obligations. The World Bank Group and the OECD launched initiatives a decade ago to tackle administrative barriers to competitiveness. The U.S. Agency for International Development and other U.S. agencies have become increasingly engaged in the context of trade negotiations and free trade agreements.

Countries around the globe are moving forward on a broad front with reforms. *Doing Business in 2005* noted that in 35 countries it became easier for entrepreneurs to launch a new business last year. Some countries consolidated and streamlined procedures required to register companies. The top 10 Starting a Business reformers cut procedures during 2003/2004 by 26 percent, time by 41 percent, cost by 56 percent, and minimum capital requirement by 8 percent, on average.

### Progress is Neither Simple nor Fast

It is necessary to put such success stories in perspective. There is little evidence that, overall, administrative barriers are shrinking. While the relative position of countries is changing as reform proceeds,

no business survey in any country shows that net administrative burdens are falling. In Transparency International’s 2003 corruption index, 9 out of 10 developing countries still score less than 5 on a scale of 1 to 10, indicating medium to high levels of corruption. Industrialized countries also are struggling just to slow the growth of administrative burdens, rather than shrinking them. A recent OECD report on the fight against red tape in industrialized countries found that “governments seldom have a detailed understanding of the extent of the total administrative burdens imposed on businesses, citizens, and government itself nor of the cost-efficiency of many of the administrative simplification tools applied.”<sup>11</sup> These conclusions apply even more to developing countries.

All claims to the contrary, reducing administrative barriers is neither simple nor fast. A recent review of the FIAS work on administrative barriers concluded that within three to five years after the FIAS diagnostics were completed, FIAS client countries had launched action to implement, on average, 20 to 30 reforms, or 50 percent of the FIAS recommendations. Each had finalized legal action to implement, on average, a dozen reforms, or 20 percent of the recommendations.

The reactions to FIAS recommendations suggest that a multiyear time horizon is needed for reform to work. Of the 20 percent of FIAS recommendations that were fully implemented, a little more than 2 percent were implemented in the first year after the FIAS report was issued, 6 percent in the second year, and 11 percent in the third year or after. Start-up takes time. Monitoring mechanisms should, likewise, stretch over a three- to four-year period.

<sup>10</sup> John S. Wilson, Catherine L. Mann, and Tsunehiro Otsuki, *Assessing the Potential Benefit of Trade Facilitation: A Global Perspective*, World Bank Policy Research Working Paper 3224 (February 2004).

<sup>11</sup> OECD, *From Red Tape to Smart Tape: Administrative Simplification in OECD Countries* (Paris, 2003), 9.

Despite the number of reforms, quantitative evidence of impacts on business costs following reform of administrative barriers is limited.<sup>12</sup> Anecdotal information about the effectiveness of solutions is expanding, although much of this information should not be generalized. Such evidence suggests that, when reform works, the payoffs can be significant and can appear quickly.

### The Seven Habits of Successful Reforms

Sustainable change requires not only marginal reforms to procedures, but new institutional capacities and a shift by the public administration from a culture of control to a culture of client services. In fact, reducing administrative barriers is an integral part of policies to create an enabling environment for domestic markets. Successful efforts change market incentives, in welcome contrast to the investment incentives, trade zones, and other top-down supports for investment projects that are common in developing countries. They follow a “good governance” agenda, rather than a simplistic deregulatory or small-state agenda.

The key success factors for regulatory reform can be enumerated in terms of seven *good practices*.

#### *Good practice 1: Adopt a multiyear time horizon for implementation*

Results do not materialize overnight; successful reforms sustain momentum over at least three years, when results begin to appear. The most vulnerable period appears to be year two, when political attention begins to wane and bureaucratic interests take control of the reform process. Surprisingly, actions that do not seem to predict sustainability over time include the development of an action plan and the creation of committees or other ad hoc groups with responsibility for implementing the reforms.

#### *Good practice 2: Give reform oversight and management authority to a body that cuts across the whole of government*

The presence of a high-level official at the center of government or a high-level committee accountable to the center is a success factor. For example, in Latvia, the Prime Minister operated as the “champion” of the reform effort. In Turkey, implementation suddenly accelerated when oversight of the reform process shifted from a career civil servant to the influential Minister of Economy. In Senegal, a high-level investors advisory group was needed to overcome bureaucratic inertia. Reforms managed by line ministries or investment promotion agencies without clear authority over other ministries seem to slow down and stop in a year or two. Ad hoc working groups are inappropriate unless they are stepping-stones to a more permanent structure.

The easiest approach and the natural tendency for governments is to find a champion—usually a strong, reform-minded minister. That strategy is tempting, but risky. The most frequent explanation for why administrative barrier projects produce few results is that ministers change, or elections change the government. Getting results requires not only a vocal minister, but also an institution that is able to promote change and commitment to a multiyear program that extends through the planning and implementation phases. The central authority guiding the reform process seems to be more effective if it has the following characteristics:

- *A longer-term agenda and mandate.* Sustainability in focus and influence is key where the policy environment tends to be driven by personalities and where tenure of office is often unpredictable and brief.
- *An active interministerial component* to bring in the stakeholders who will have to actually implement reforms over the course of the project.

<sup>12</sup> This is because 1) the marginal impact of administrative procedures on investment decisions is unclear; 2) the contribution of the costs of the procedures that are reformed to total administrative costs on investors is unknown; and 3) the implementation of reforms is poorly documented and, hence, results in terms of lower costs are usually unknown. We would have to know all of these elements to quantitatively assess how reforms actually impact business costs.

Top-down instructions to other ministries, such as by the ministry of finance, may suffice to set up meetings, but are not an effective basis for reforms.

- **Authorization, connection, or accountability for results to the center of government** to strengthen policy coordination and oversight capacities.
- **Strong relations or an active involvement with the private sector**, including those parts of the government that are champions of private-sector development. In Croatia, for example, the Presidential Commission on Support of Private Business—whose members included the American Chamber of Commerce, the International Chamber of Commerce, the Tax Payer’s Union, and the Ministries of Finance, Economy, and State Revenues—played a supporting role in a difficult environment.
- **Credibility among donor organizations on the ground** to improve the chances of longer-term financing and technical support.
- **Ability to command the resources needed to get the job done**, including a dedicated secretariat with the right skills and financing to move reform forward.

**Good practice 3: Actively manage and support the reform process**

Active management of the reform program is another signal of success. Active management is best characterized by a dedicated and accountable secretariat, backed by political oversight over time.

- In Russia’s Tomsk oblast, several status reports were prepared on the comprehensive action plan as implementation proceeded, and changes were made by politicians to correct emerging problems.
- In Latvia, a strong and active layer of “technocrats” maintained continuity as governments changed, provided intellectual input, and handled the details of the reform process.

**Good practice 4: Actively involve the responsible ministries**

The nature of the diagnostic process makes a difference in the receptiveness of the responsible ministries to the reforms. The key difference seems to be the level of effort made by the government to involve ministries in active discussions about the problems and reforms. Governments that obtain ministry input on the diagnostics and solution design appear to have more success than those that produce top-down reforms that the ministries know nothing about or do not agree with.

**Good practice 5: Carry out ongoing business-government dialogue**

The intensity and institutionalization of government-business dialogue throughout the reform process seems to be linked to the depth of reform. In many developing countries, there is little or no tradition of constructive dialogue and cooperation between the government and the private sector. However, such dialogue changes the political economy by empowering allies of reform, and enlarges the “reform space” by increasing awareness of the scope and depth of the problem.

There are two main reasons why the involvement of private-sector organizations increases the quality and results of these reforms:

- **Information collection.** Businesses are the only actors that understand the reality of implementation issues and the cumulative impacts of administrative procedures across ministries. Governments should always meet with business interests in collecting information for administrative barrier diagnostics. In Turkey, FIAS worked closely with industry and investor associations such as YASED and TÜSIAD to provide a “reality check” on how procedures work in practice.
- **Support for the reform process.** The private sector is, or should be, an important constituency for reform.

Involving the private sector might require building capacity among reform-minded business representatives. The private sector is often too badly organized to sustain attention to the reform agenda. Worse, the most powerful parts of the private sector are often those closest to the public sector, and, hence, are the least likely to criticize the lack of reform or to support reforms that open markets to new competition. The reform-minded parts of the private sector are often the newer organizations with the fewest skills and least influence. This neglected stakeholder group is needed during the implementation and monitoring processes.

*Good practice 6: Institutionalize monitoring*

There are three main arguments for developing and institutionalizing a monitoring strategy:

- If a government is to be results-oriented, it must know more about results.
- Governments are likely to show more and faster progress if a credible monitoring strategy is in place, because reformers are strengthened by accountability and transparency. This support for the reform constituency is especially important in developing countries that are characterized by unstable political institutions. Monitoring can help sustain a program when a minister or government changes—a frequent cause of program failure.
- Monitoring speeds up the learning process in governments by clarifying reasons for success and failure.

Governments do not have to do this monitoring themselves, and indeed should not. A more effective and credible approach might be to help develop private-sector monitoring capacity. Private-sector representatives could assist in keeping reform on track, assessing the quality of work done, and informing the government of the situation on the ground.

Two of the most successful FIAS clients—judged not only in terms of what they have accomplished, but also in terms of the sustainability of the reforms over two years or more—are Latvia and the Tomsk oblast in Russia. In each jurisdiction, the government conducted a baseline business survey and a follow-up survey to track impacts on the ground.

*Good practice 7: Work with expert international bodies knowledgeable about good practices used in countries facing similar problems*

Success is related to a longer-term presence of an external, expert body to assist the government in diagnosing problems, designing solutions, and bolstering the efforts of reformers. To find solutions to problems, governments must know more about best practices in a wider range of relevant countries. Access to best practices and cross-country experiences is often gained through a relationship with an international organization with cross-country expertise. Governments working with FIAS often request workshops to discuss best practices. ♦



# REGULATORY IMPACT ASSESSMENTS TO IMPROVE THE BUSINESS CLIMATE

by Darren Welch

Over the past 20 years, the process of regulatory impact assessment or analysis (RIA) has taken root among Organisation for Economic Co-operation and Development (OECD) countries as a means of improving their regulatory environments to alleviate the administrative burden on business. The United States, the European Union (EU), Australia, Japan, Canada, and New Zealand, among others, have in effect institutionalized RIA as part of their policy frameworks. Their experience with the benefits of RIA has encouraged them to make it increasingly a feature of their policy assistance to developing countries and transition economies as a means of ensuring a hospitable business environment.

The 2005 *World Development Report*<sup>1</sup> provides an example of that trend, with some explicit advice to reduce the burden of regulation. It notes that most countries have huge scope for improving regulation (and taxation) without compromising broader social interests. In addition, the World Bank's *Doing Business* series aims squarely at stimulating healthy competition among countries to address weaknesses in their business climates.

A survey conducted by the Centre on Regulation and Competition at the University of Manchester in the United Kingdom indicates the extent to which RIA has spread to developing countries and transition economies.<sup>2</sup> The response rate to the survey was relatively low (40 percent for countries, and only 17 percent of the government officials

selected as respondents), and self-selection bias is likely—people and institutions who knew about RIA were probably more likely to respond. Even so, the responses suggested that there is growing understanding of RIA. Ten of the 40 countries reported that some form of RIA was a legal requirement, and another 20 reported that RIA was used in some form.

## What RIA Does

Regulatory impact assessment is a systematic approach to weighing the impacts—both costs and benefits—of proposed (as well as existing) regulations, and communicating the results to decision makers. It provides a framework for a high-quality, participatory policy development process, guiding users through steps designed to address the main stages in the development of high-quality policy. These stages include a thorough analysis of options available to government for addressing a policy problem, and a calculation of the costs and benefits to ensure that new measures are fully justified.

The use of this decision tool depends, of course, on the nature of the overall policy process. To a certain degree, RIA presupposes the existence of a coherent and participatory policy-making structure. According to Scott Jacobs,<sup>3</sup> the methods used by regulators in OECD countries can be grouped into five categories:

<sup>1</sup> World Bank, *World Development Report 2005: A Better Investment Climate for Everyone*, Chapter 5. [http://siteresources.worldbank.org/INTWDR2005/Resources/07\\_WDR\\_Ch05.pdf](http://siteresources.worldbank.org/INTWDR2005/Resources/07_WDR_Ch05.pdf).

<sup>2</sup> C. Kirkpatrick, D. Parker, and Y.-F. Zhang, "Regulatory Impact Assessment in Developing and Transitional Economies: A Survey of Current Practice," *Public Money and Management*, vol. 24, 5 (2004), 291–7.

<sup>3</sup> Scott Jacobs, "An Overview of Regulatory Impact Analysis in OECD Countries," in *Regulatory Impact Analysis: Best Practices in OECD Countries* (Paris: OECD, 1997), 3.

- **Expert**—The decision is reached by a trusted expert, either a regulator or an outside authority, who uses professional judgment to decide what should be done.
- **Consensus**—The decision is reached by a group of stakeholders who agree on a common position that balances their interests.
- **Political**—The decision is reached by political representatives based on partisan issues of importance to the political process.
- **Benchmarking**—The decision relies on an outside model, such as international regulation.
- **Empirical**—The decision is based on fact-finding and analysis that define the parameters of action according to established criteria.

Each of these approaches (or any mix of them) in turn defines the scope and methods of RIA.

Although there is diversity among countries' RIA frameworks and the role that RIAs play in the policy process, there is also significant commonality. The OECD has issued best practice guidance on RIA as part of its regulatory reform practice area.<sup>4</sup> The U.K. framework is typical in that it contains the core elements recommended in best practice guidance and to be found in most other frameworks.

### RIA Benefits

The benefits of RIA have been well documented by the World Bank, the OECD, the EU, national governments, and other organizations:

- *Improving the quality and efficiency of government interventions:* RIA increases the information brought to bear on the policy-making process and is an important contributor to rational, evidence-based policy making. It provides politicians with better information on which to base their decisions and, therefore, can contribute to better governance for citizens and to a business environment conducive to enterprise-led growth and poverty reduction. RIAs help governments devise efficient regulations that address market

### TYPICAL COMPONENTS OF AN RIA

1. Title of Proposal
2. Purpose and Intended Effect of the Proposal
3. The Policy Problem
4. Options
5. Impacts
6. Distribution of Impacts
7. Results of Consultation
8. Enforcement and Sanctions
9. Monitoring and Evaluation

failures and bring private incentives in line with public policy objectives.

- *Enhancing competitiveness:* Unnecessary regulatory burdens directly reduce the competitiveness of individual businesses, and indirectly reduce national competitiveness in the global economy. They reduce the resources available for investment in equipment and human capital and reduce economic efficiency. Developing a strong competitive position becomes increasingly important as regional and global economic integration picks up pace. Business flourishes where the regulations necessary to give businesses and citizens the stability, predictability, and confidence to invest are not unnecessarily burdensome. A systematic RIA helps governments strike the right balance.
- *Increasing transparency and accountability:* RIA also contributes to transparency in government by encouraging policy makers to set out the reasons for their policy decisions, the government's procedure for addressing an identified and quantified problem, and the anticipated costs and benefits. RIA should also analyze whether particular groups gain or lose disproportionately from the regulatory proposal.
- *Reducing opportunities for corruption:* The more complex and open to interpretation a regulatory obligation is, the greater are the opportunities for corruption. Enforcers can use their discretion to extract bribes, and the regulated businesses are incentivized to pay bribes as a way of circumventing more costly bureaucratic requirements. By encouraging minimum burdens on business and

<sup>4</sup> OECD, Regulatory Reform: Policy Principles. [http://www.oecd.org/document/38/0,2340,en\\_2649\\_37421\\_2753254\\_1\\_1\\_1\\_37421,00.html](http://www.oecd.org/document/38/0,2340,en_2649_37421_2753254_1_1_1_37421,00.html).

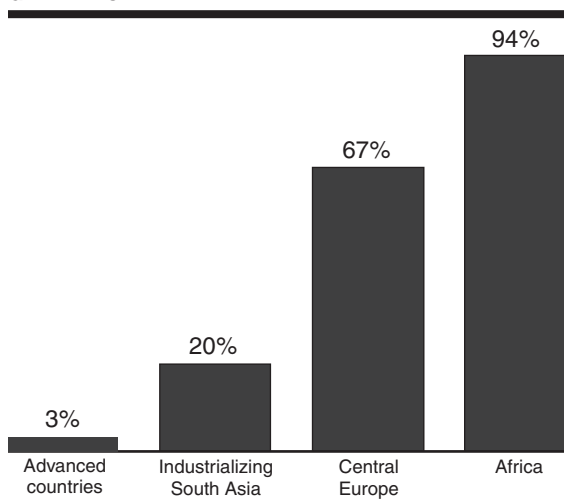
promoting simple, clear regulations, governments can reduce corruption.

- *Strengthening policy monitoring and evaluation:* After a regulation has been passed, RIA can serve as a benchmark for monitoring and evaluation and thus help:
  - *Governments* review the effectiveness of their interventions;
  - *Businesses* advocate for improvements if the regulation turns out to be more burdensome than anticipated; and
  - *Citizens* hold their governments to account for delivery of the benefits promised.

The problems that RIAs seek to address are more acute among developing countries, so the advantages are correspondingly greater. First, many developing countries (and transition economies) are emerging from a history of heavy-handed socialist regulation. Their regulatory systems are ill-adapted to support a flourishing market economy that will create growth and jobs. In a 10-country study carried out in 2002,<sup>5</sup> Bannock Consulting (now DAI Europe, Ltd.) found that the costs and barriers imposed by regulation in developing countries are not only higher than they were in the developed world when it embarked on industrialization, but are higher in some cases than in the advanced countries today. Taking business entry costs as a proxy for all regulatory costs, the report suggested that these costs in Africa, in relation to gross domestic product (GDP) per capita, are much higher than those in other parts of the world.

Second, microenterprises—owned and operated mostly by the poor—and small enterprises that provide jobs to the poor constitute the majority of businesses in many countries. They are more vulnerable to regulatory burdens than larger firms because they cannot take advantage of economies of scale in reducing the relative impact of regulatory burdens. On average, the informal economy in Africa was estimated to account for 42 percent of GDP in

**BUSINESS ENTRY COSTS AS A PERCENTAGE OF GDP PER CAPITA**



1999/2000; Zimbabwe, Tanzania, and Nigeria were at the high end with 59.4, 58.3, and 57.9 percent, respectively.<sup>6</sup> By discouraging formalization, regulatory burdens can deny economic actors the benefits of legitimacy, such as collateralized lending and freedom from harassment by inspectors.

Third, corruption is more pervasive in many developing countries than in the OECD countries. Clear and simple laws create certainty for businesses and reduce the capacity of officials to seek bribes. Currently, in many countries, the proportionately greatest burden is borne by those businesses that succeed, thereby creating a disincentive for entrepreneurs to invest and grow their businesses.

Fourth, in multiethnic societies, the focus that RIA brings to the distribution of impacts can be particularly enlightening and encourages policy makers to identify whether one ethnic or religious group loses disproportionately from regulatory change. In Africa generally, societies can be less homogeneous than in other parts of the world. In the pilot RIA that DAI Europe is guiding in Uganda, the government will examine the distributional impact of regulation on

<sup>5</sup> <http://www.bannock.co.uk/PDF/ee.pdf>.

<sup>6</sup> Friedrich Schneider, *Size and Measurement of the Informal Economy in 110 Countries Around the World* (July 2002). [http://rru.worldbank.org/Documents/PapersLinks/informal\\_economy.pdf](http://rru.worldbank.org/Documents/PapersLinks/informal_economy.pdf).

tribes, religious groups, and regions. For example, a proposed bill to regulate domestic relations has been contested by some of that country's Muslim population.

Fifth, vulnerable groups in developing countries have needs especially relevant to the fight against poverty. RIA can help ensure that these groups' special needs are taken into account. In Uganda, the RIA will require policy makers to consider the needs of the very poor and people living with HIV/AIDS, as well as gender issues.

### Adapting RIA Systems for the Developing-Country Environment

Kirkpatrick and Parker<sup>7</sup> have noted that OECD RIA systems may not transfer readily to the developing-country context: very few developing countries have adopted RIA. In adapting an RIA approach to developing countries, the *basic elements of the RIA framework do not need significant adaptation, but practitioners should change the way the framework is applied*. The framework itself is flexible in that it allows policy makers to assign weights to their own values and concerns—for example, by selecting the groups that warrant special consideration in the distribution of costs and benefits. For Uganda, the RIA also has to address the likely impacts on those sectors that the government has selected for development as part of the Medium-Term Competitiveness Strategy.

In countries where it has been practiced for some years, RIA has evolved into something of a science. The United Kingdom's guidance on RIA has been revised several times over the past decade and covers 90 pages, with a large volume of supporting material from the Treasury on calculating costs and benefits. Developing countries, of course, have fewer resources available for RIA. Even so, almost any attempt at a systematic RIA can add value to a policy process. In a developing-country environment, there is clearly a balance to be struck between

making the analysis as robust as possible and overloading the system. There is a danger of the best becoming the enemy of the good.

In developing a system that is both simple and useful, it is essential to keep the RIA requirements to a minimum and to produce simple guidance in collaboration with government officials. The institution responsible for administering and supervising any new RIA system must act collaboratively with ministries rather than confrontationally.

The effort put into an RIA should be commensurate with the importance of the policy proposal and its likely impact. If the proposal is likely to have a limited impact, there is no point in producing a long and sophisticated RIA. Common sense must prevail. Above all, the RIA does not need to generate a long, technical, complex document to have value. At almost any level of complexity, the structured policy analysis embodied in an RIA will improve policy making by requiring the policy officials to answer questions that will steer their decisions toward an efficient solution. There is no "right" standard for the analysis performed under an RIA. The important thing is for the level of analysis to be proportionate to the likely impact and for the quality to improve over time.

### The Challenges of Implementing RIA

DAI Europe has encountered various impediments to institutionalizing RIA:

#### *Lack of awareness and acceptance of RIA*

A different way of making policy and of governing, the evidence-based RIA approach is new to many developing countries and challenges established procedures. Reformers must build awareness of how the process can contribute to national development goals, underscoring that RIA is not synonymous with deregulation, which has—rightly or wrongly—become identified with a naïve, unreconstructed "Washington consensus" approach to unfettered

<sup>7</sup> Colin Kirkpatrick and David Parker, *Regulatory Impact Assessment: Developing Its Potential for Use in Developing Countries*, Working Paper No. 25 (Centre on Regulation and Competition, 2003).

markets imposed by the developed world on developing countries.

### *Lack of resources and data*

This discussion has already touched on lack of resources and capacities. Lack of reliable data is a similar problem. Policy makers must be creative in the way they ascribe values to the impacts of regulations. Consultation is crucial to gain information on impacts and their distribution, and DAI Europe has been exploring user-friendly techniques for arriving at shadow prices.

In Uganda, for example, many useful reports by donors, consultants, nongovernmental organizations (NGOs), and international financial institutions go unused. Building links to research units in other countries in the region may enable governments to judiciously borrow from analysis undertaken in similar environments in order to draw out lessons and maximize the use of available comparable data.

Training is key, for both the users (decision makers) and the analysts. The Ugandan government established an RIA Unit to help ministries reach a reasonable standard for RIAs—a standard that will be raised over time as capacity is strengthened. We produced a policy evaluation tool that enables the Ugandan government to assess how well proposals comply with RIA criteria so that a benchmark can be established. Capacity building at the Uganda Management Institute will enable it to deliver training in RIA to Ugandan officials.

Civil society organizations and business associations also need training. In Uganda, DAI Europe strengthens the capacity of business organizations and NGOs so they can contribute to consultation exercises and understand the information on compliance costs that government will be asking them to solicit from their members. RIA skills will strengthen the capacity of business associations to articulate the argument for pro-business regulatory reform.

## Key Lessons Learned

Introducing a formal RIA system usually involves a shift in the balances of power along three dimensions:

- *Institutions at the center of government.* RIA systems can strengthen the hand of institutions given the task of policing the system, giving them a new power of veto over proposals. It may also be that central ministries previously free to make proposals suddenly find themselves constrained by the requirement for an RIA enforced by another central institution. In Uganda, we are suggesting that RIA is placed on the agenda of the monthly meetings of policy analysts hosted by the Prime Minister's Office and attended by the Cabinet Office.
- *The center of government and line ministries.* Similarly, RIA can act as a brake on the regulatory activities of line ministries once they are required to overcome an additional hurdle in the policy process and satisfy the requirements of the center of government. If not carefully managed, this requirement can breed resentment and encourage ministries to disregard the RIA system.
- *Ministers and officials.* Ministers do not always welcome the introduction of an additional bureaucratic hurdle that can be perceived as a challenge to their right to govern. While they may understand and espouse the need for better regulation and policy advice, in practice ministers sometimes see the RIA as an obstacle to their own policy proposals. The systematic RIA approach, with its emphasis on rational policy making and justification of costs, interferes with the normal way of doing business, which may involve maintaining vested interests. Officials used to adopting a passive stance are not always ready for the creative thinking that goes into RIAs, especially the requirement to consider all policy options. It is important to emphasize that RIA is a tool to assist politicians' decision making, not to mechanize the policy process in a way that reduces their discretion.



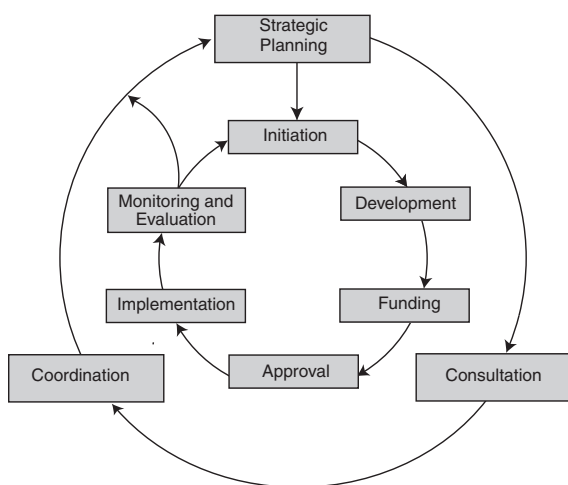
## Building a Coherent, Evidence-Based, and Participatory Policy Process

Establishing an RIA system improves the policy-making process and supports a regulatory best practice approach to governance. For example, it can prevent policy makers from rushing into drafting legislation before the requisite policy options have been considered. However, RIA can only contribute so far. It is important also to consider the wider policy process into which RIA fits, a process that can be divided into the following stages, although the process is more dynamic than this list implies:

- Strategic planning and prioritization;
- Initiation;
- Policy development;
- Funding provision;
- Policy approval;
- Policy implementation;
- Policy monitoring and evaluation; and
- Coordination and consultation—ongoing activities.

Graphically, the process can be represented as follows:

### THE POLICY PROCESS



RIA directly improves:

- *Policy development:* By facilitating consultative, rational, evidence-based policy development.

- *Monitoring and evaluation:* By providing a benchmark against which policies can be monitored and evaluated; for example, are they delivering the benefits outlined in the RIA? Are the costs as anticipated?
- *Coordination and consultation:* By encouraging policy makers to involve all those likely to be affected.

These improvements, however, leave a large part of the policy process untouched. For example, there is little point in enabling business associations and NGOs to carry out RIA if they are unaware of the government's legislative agenda and unable to prepare analyses in time to influence the policy debate. RIA must therefore be part of a wider program of policy reform and capacity building.

### Conclusion

RIA can help all governments improve the way they regulate to ensure regulatory efficiency, minimize barriers to business growth, protect citizens, and reduce opportunities for corruption. These benefits are particularly valuable to developing countries where the poor suffer most from corruption and from a business environment hostile to growth and job creation. DAI Europe's experience in Uganda and elsewhere suggests that the core RIA framework needs little amendment for the developing-country context, although practitioners must take into account the level to which the analysis is taken. Resource constraints should not be a barrier to adoption of RIA; RIA can help improve policy at almost any level of complexity. In order to reap the full benefits of RIA, practitioners should build capacity through a staged approach, including awareness raising and skill building before the system is made a formal requirement. Training is required within government, but also among government's main interlocutors so that they are well placed to respond to consultation exercises and able to argue for policy reform on the basis of evidence. As with any significant change, there will be institutional factors to consider. Similarly, RIA must be considered as one part of the policy reform process—an essential part, but one whose impact will be limited in the absence of wider reform. ♦



# FOSTERING COMPETITIVENESS PARTNERSHIPS

by Benjamin Herzberg and Andrew Wright

Competitiveness partnerships are structured dialogues between the public and private sectors aimed at improving the investment climate. Although they vary according to context, many face similar challenges. Summarizing a longer paper that draws on the experiences of 38 countries, this article makes a case for building competitiveness partnerships and offers insights into how practitioners can avoid common pitfalls.

Competitiveness partnerships take many forms. They can involve informal input from a few leading corporations or wide-ranging consultations with small and medium-sized enterprises (SMEs), business groups, labor unions, and civil society. The dialogue mechanisms can be initiated by governments, lobbied for by businesspeople, or driven by donors. They can be local, national, or regional, structured along industry lines or organized according to crosscutting topics. What they all have in common is that they give formal structure and expression to the common desire of businesses and governments to create conditions in which the private sector can flourish.

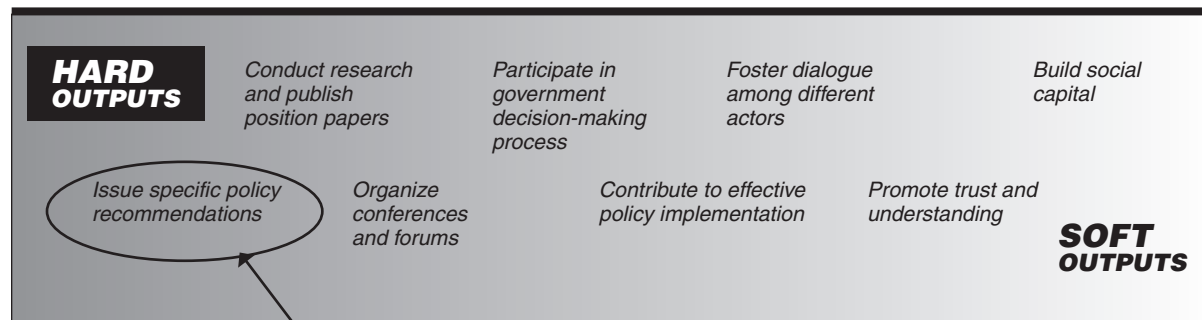
Implementing business-enabling environment programs requires effective cooperation among

the private sector, the government, and donors. Competitiveness partnerships serve as the umbrella under which existing energies can be better channeled, leveraged, and organized. Their core value is twofold: governments that listen to the private sector are more likely to design credible and workable reforms, while entrepreneurs who understand what a government is trying to achieve with a reform program are more likely to be constructive and supportive. Dialogue reveals to governments the microeconomic foundations for growth, but it also creates a sense of ownership of reform programs among the business community, which makes policies more likely to succeed in practice.

## The Payoffs of Partnership

What can successful competitiveness partnerships achieve? Sometimes they initiate and drive through reforms. More commonly, however, they provide the focus and energy to crystallize, expedite, and facilitate reform proposals that have been discussed but not legislated. The Bulldozer Initiative in Bosnia and the President's Council for Investment in Senegal are recent examples of the impact of competitiveness partnerships.

### FUNCTIONS OF COMPETITIVENESS PARTNERSHIPS



Focusing on this goal sets the stage for reaching the others

Just as importantly, competitiveness partnerships can help to ensure that reforms that are passed actually get implemented. They do this by providing a mechanism to disseminate awareness and gather feedback.

Aiming for “hard” outputs such as policy reforms can also yield valuable “soft” outputs—good governance, trust, and social cohesion. Competitiveness partnerships give businesses a platform from which to challenge government corruption, which in turn puts pressure on the businesses to improve corporate governance; in Mauritius, for example, dialogue led directly to a new code of corporate conduct. Structured dialogue also encourages the business community to adopt a more holistic view: in Cambodia, the Private Sector Forum helped to give self-centered lobbying a focus on improving the economy as a whole.

The Vietnam Business Forum is one example of structured dialogue improving the public image of businesspeople. Entrepreneurs had traditionally been viewed as greedy and untrustworthy; their contribution to society is now recognized in an annual “Entrepreneurs Day.” Furthermore, because the investment climate cuts across ethnic divides, competitiveness partnerships have the potential to build civil society and channel energy in post-conflict situations.

### Different Ingredients and Common Threads

In building and maintaining a competitiveness partnership, practitioners face various commonsense trade-offs: for instance, having many and diverse participants tends to add legitimacy but hamper dynamism, and holding frequent meetings reduces the risk of inertia but increases the risk of overburdening busy participants. Different balances are

#### COMPETITIVENESS PARTNERSHIPS IN ACTION

COUNTRY (PARTNERSHIP)	ACTION	BEFORE	AFTER
Bosnia (Bulldozer Committee)	Slashed statutory capital requirements when registering an LLC	Requirement for registration = \$6,500	Requirement for registration = \$1,300; increased number of registered companies (doubled in some areas)
	Simplified registration of foreign companies	3 institutions, 3 applications, 3-month process	1 institution, 1 application, 1-month process
Vietnam (Vietnam Business Forum)	Eased labor restrictions for expatriate employees	Number of foreign employees limited to 3% of total staff, with a cap at 50	Management excluded from the limitation, cap removed given special permissions
Turkey (YOIİK - Coordination Council for Improvement of the Investment Climate)	Updated 1954 foreign direct investment (FDI) law with better conditions for FDI	FDI permission system, many approval requirements, no specific legal rights	FDI monitoring system, no prerequisites to invest, international settlement
	Amended law on company registration process	19 steps to register, 2.5-month process	1 step (8 procedures) to register, 9-day process
Botswana (National Business Conference and High-Level Consultative Council)	Set institutional means for economic empowerment	Public grant program marred by corruption, no investment guarantee agency, poor venture capital access	Citizen Entrepreneur Development Agency; direct link to Ministries of Finance and Planning; subsidized loans, venture capital, joint ventures, 50 applications/week

required in different political circumstances; there is no one-size-fits-all prescription.

More important than the form a competitiveness partnership takes is the will that lies behind it. Little can be achieved without a genuine openness to engage on the part of government at the highest level. Even with that willingness, however, partnerships usually need a sense of crisis, the strong personality of a champion, or input from an international donor to get started. A sense of urgency can be deliberately and artificially generated—for instance, by setting a highly publicized target such as the “50 reforms in 150 days” adopted by Bosnia’s Bulldozer Initiative.

Once in motion, partnerships can be maintained in many ways; again, there are no universally applicable criteria. However, partnerships can be conceived of in terms of four dimensions:

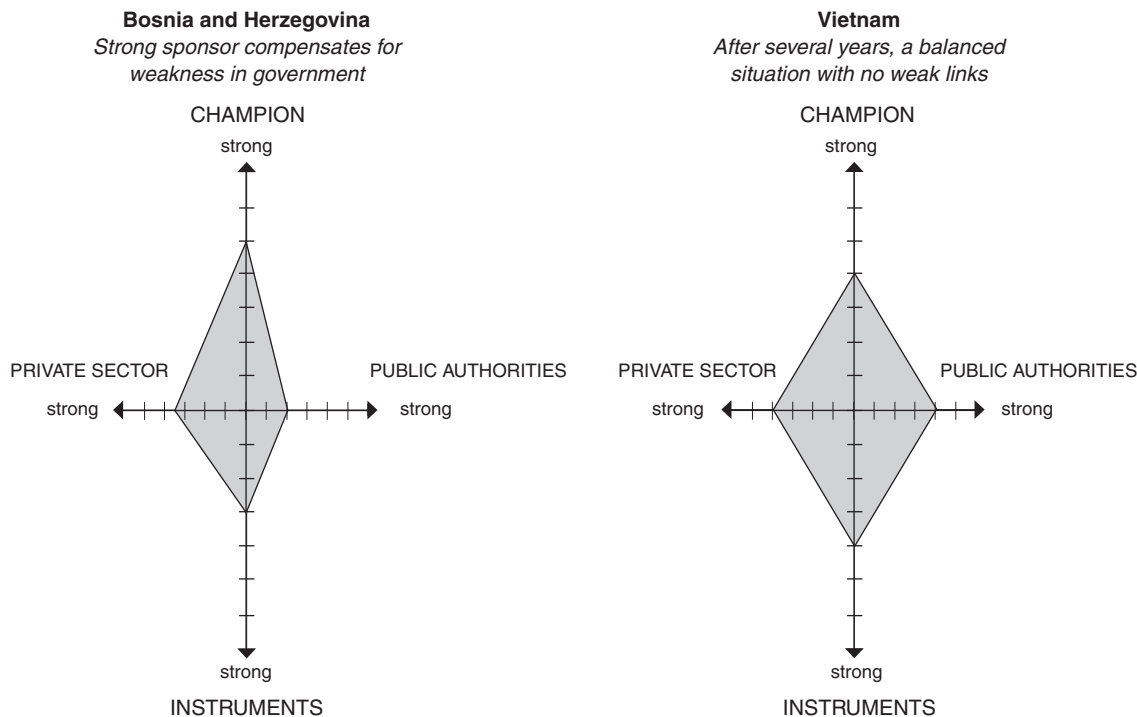
- *Government:* The public sector must display sufficient capacity, political will, and leadership to engage.

- *Business:* The private sector must be organized, well led, and comfortable speaking out to government without fear of penalty.
- *Sponsor:* A champion needs credibility, expertise, and the ability to get media attention.
- *Instruments:* Logistical facilities and seed funds are required.

Mapping the strengths and weaknesses of these dimensions can help to identify the potential for success in a competitiveness partnership. The figure below illustrates the strengths and weaknesses of two competitiveness partnerships. The four axes go from weak at the center to strong on the exterior; weakness in one dimension can be compensated for by strength in another. In Bosnia, the low capacity of the fledgling post-conflict government was overcome by exceptional support from donor sponsors. The Vietnam Business Forum is an example of a process that has, over the years, become well balanced between the four dimensions.

Winning the confidence of the business community is a common initial hurdle. A visible and verifiable short-term commitment on the part of govern-

#### MAPPING PARTNERSHIP STRENGTHS AND WEAKNESSES



ment can help: in Malaysia, civil service reforms convinced skeptical entrepreneurs that the government was serious about policy dialogue. Identifying influential and respected entrepreneurs to serve as champions among their peers can also be critical. Such individuals should ideally be representative of both local investors and the FDI community.

There are common features among most successful competitiveness partnerships: they build on existing institutions whenever possible; membership is voluntary and there are clear criteria for involvement, avoiding the appearance of arbitrariness and favoritism; participants are dynamic, open-minded, committed, and willing to voice their opinions; and the partnership has the favor, and preferably the active personal involvement, of the country's president or prime minister.

Successful competitiveness partnerships tend to be structured into working groups organized by a secretariat. These working groups can be issue- or industry-based, but they support more frequent activity than plenary meetings. The partnerships aim initially for low-hanging fruit to build momentum, and are flexible enough to revisit their structure when enthusiasm wanes. Further, when donors have been involved in establishing partnerships, they attempt to transfer ownership to the participants as soon as practicable.

### Strategies for Success

A review of experiences in 38 countries revealed that similar difficulties arise in many instances. Following are eight key strategies for success. Not all are applicable to every partnership, and while some are supported by experiences in several places, others are suggested because they have worked well in one location and offer the potential for replicability.

#### *1. Reach out to small enterprises*

A common failing of competitiveness partnerships is that they focus on large multinational enterprises because these organizations' views tend to be more homogeneous and, therefore, more easily repre-

mented to politicians than the views of large numbers of diverse SMEs. This emphasis risks recommending reforms that favor large enterprises, whose priorities do not always coincide with those of smaller domestic entrepreneurs. Additionally, the narrower the base of consultation, the greater the potential risk of individuals capturing the process and reinforcing vested interests.

Even when these risks are not deemed significant in practice, the dominance of multinationals can still create skepticism about the partnership among the domestic SME community—and this, in turn, can hamper the partnership's ability to craft reforms that will be broadly accepted and therefore workable.

To create a more favorable public image, especially when there are ethnic tensions in a country, it is crucial that all minority groups are visibly represented. In addition to ensuring advocacy on gender issues, making an effort to include women can pay dividends in public relations. Outreach to small businesses—by inviting them to submit reform proposals and participate in road shows or forums—can prevent a partnership from becoming too closely identified with a particular political faction—a significant risk in countries where business and political leaders move frequently between the two spheres. Finally, creating bottom-up support helps competitiveness partnerships persist when key individuals move on, which has been a common cause of partnerships losing impetus.

#### *2. Strengthen business associations*

A complementary strategy to direct outreach to small entrepreneurs is to strengthen business associations. In many countries, competitiveness partnerships are needed precisely because representative business associations, such as chambers of commerce, are moribund or ineffective. Whenever possible, such institutions should be strengthened—for example, by encouraging the government to offer incentives such as tax breaks or training opportunities for businesses that join organizations; this strategy has seen 95 percent of Japanese businesses join an association. When business associations are

vibrant, with leaders who can express the views of their members and communicate the government's views in return, competitiveness partnerships can reach more entrepreneurs more efficiently.

### 3. *Map the partnership's structure to the government's*

Because competitiveness partnerships exist to influence a government's thinking, it makes sense for the partnership to map the structure of the government. Japan's "deliberation councils," for instance, are tied to particular ministries. Although top-level political support is crucial, basing a partnership in the office of the president may confuse lines of communication with ministries. Mapping to governmental structure is also important in a geographical sense: when local or supranational layers of government have the power to enact investment climate reforms, partnerships should operate at those levels. A national partnership with regional working groups is also a model worth considering to prevent influence becoming concentrated among entrepreneurs in a capital city to the detriment of those in provinces.

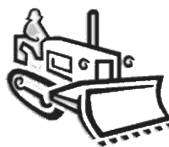
### 4. *Aim for a two-tiered output*

Recommendations that emerge from competitiveness partnerships must be clear, well researched, and compellingly presented. A model applied in Nigeria was to develop a two-tiered output: a set number of specific policy reform proposals (these could be called, for example, "business roadblocks"), together with a smaller number of high-quality, research-based economic policy papers (for example, "business roadmaps"). The roadblocks promise concrete outcomes and instant gratification, while the roadmaps build credibility by putting the roadblocks in context.

### 5. *Use branding and marketing*

Competitiveness partnerships need a clear mission statement linked to a solid communication strategy. When partnerships have neglected these elements, businesspeople are more likely to be wary or uninvolved. Careful consideration of branding, with an evocative name and logo, can pay dividends. In Bosnia, the name "Bulldozer" and the bulldozer

## BOSNIA BULLDOZER INITIATIVE



The Bulldozer Initiative is a mechanism to bulldoze away the roadblocks to a good business climate. It has two goals:

1. Improve the business climate by enacting much-needed reforms
2. Organize the business community into an active lobby for reform

logo were major contributors to the initiative's success because they vividly communicated the notion of demolishing unnecessary obstructions. In Nigeria, the Competitiveness Forum Working Group had new life injected into it after being rebranded as the Better Business Initiative, a name immediately suggestive of positive change through private-sector leadership and advocacy. Moldova's logo for its regulatory reform drive clearly linked the campaign to the country's European aspirations (see Denis Gallagher's article in this issue).

### 6. *Appoint a dynamic coordinator*

The individual chosen to lead a competitiveness partnership's coordinating secretariat is critically important. In addition to possessing a good understanding of the investment climate and legal issues, as well as strong skills in project management and negotiation, this individual should be a skilled communicator, entrepreneurial and innovative in approach, and socially adaptable—he or she should be equally comfortable talking to prime ministers and microentrepreneurs. Credibility is important, and, in this sense, a foreigner free of local "baggage" can sometimes be a good choice.

### 7. *Manage expectations*

Competitiveness partnerships often lose steam after a successful start. This pattern is usually unavoidable, especially when partnerships pursue the sensible strategy of aiming for relatively easily achievable reforms in their initial stages. But the risk of lost momentum can be minimized by managing expectations from the start: in Bosnia, after a remarkable 100 percent success rate for the first round of Bulldozer proposals, some members became disillusioned when the success rate fell to 60 percent. Experienced observers knew this was still an impres-

sive achievement but failed to communicate this fact to participants in advance. In short, although setting clear goals helps to build momentum, excessive fanfare at the launch of a competitiveness partnership risks raising unrealistic expectations.

### *8. Be flexible about changing structure*

Some competitiveness partnerships must start as private-private dialogue before they can involve the public sector. Some partnerships—in Eastern Europe, Asia, and South Africa—involve labor unions, academics, and civil society. In other cases, however, this approach is not feasible: it can be difficult enough to get government and business talking without including others. In such cases, participation can be broadened once a two-way dialogue is established.

Competitiveness partnerships should always be prepared to revisit their structure when momentum is slipping away. Winding up some working groups and inaugurating others, or changing the mix of participants, can breathe new life into a partnership. But there can come a point where a partnership has served its purpose and should be allowed to die its natural death, to be replaced by a new structure of public-private interaction. Participants should remember that any specific incarnation of a competitiveness partnership is ultimately only a means to an end. ♦



# FROM E-GOVERNMENT TO E-GOVERNANCE: DEPLOYING INFORMATION TECHNOLOGY TO ADVANCE REGULATORY REFORM

by Ulrich Ernst

Regulatory reform generally involves two elements: weeding out the regulations affecting businesses and reducing the cost of complying with the remaining regulations. Weeding out involves both legal and economic tests. The former asks whether existing regulations are compatible with the existing legal framework—in particular, basic elements such as the country's constitution. Regulations failing that test are either eliminated or suspended until a legal basis can be established.

The economic (and social) test considers the relative impact of costs and benefits, often resulting in a decision to change their allocation. For example, if a health regulation imposes high compliance costs on businesses, but only slightly reduces risks to the consumer, eliminating the regulation may lower transaction costs to the consumer at a higher (but still negligible) risk to the consumer.<sup>1</sup> This process of regulatory impact analysis (discussed by Darren Welch in this issue) builds a better basis for determining whether regulations are needed, what they should be, and how existing and proposed regulations affect business activity and innovation.

After the weeding-out process, a body of regulations will remain. Even in the United States, with its emphasis on deregulation and market forces, regulatory agencies and subagencies collectively issue more than 4,500 rules each year. In fact, as Cary Coglianese points out, “over the past several

decades, regulatory agencies [in the United States] have adopted about 10 times more rules than Congress has passed, even though both have the same binding legal effect on regulated agencies.”<sup>2</sup>

For the significant body of regulations that persists, the emphasis for reform must be on reducing compliance costs and associated risks for businesses. Effective application of information and communications technology should play a major role in this effort.

Before reviewing the prospects for using information technology (IT) in regulatory reforms, let me offer a few words on technological infrastructure and level of sophistication, because the principal target countries for such reform in the context of development assistance do not always offer the best environment for effective IT deployment. In Timor-Leste, for example, the lack of communications facilities means that small business owners must travel to the capital, Dili, for registration and other interaction with the bureaucracy.<sup>3</sup> Yet rapid technological progress is reducing the costs of investing in adequate facilities. The establishment of internet kiosks in India and elsewhere demonstrates one cost-effective way to address these issues.

In addition, the adaptation of applications for developing and transition countries is happening in “real time.” Partly as a result of this real-time

<sup>1</sup> Of course, higher risk as perceived by the consumer may also affect buying decisions. For example, the private standards promulgated by European supermarkets (EurepGAP standards) impose higher compliance costs on agricultural producers than official standards. Similarly, the introduction of the airbag in cars was driven originally by regulation, but automobile manufacturers now offer different configurations as safety features.

<sup>2</sup> Cary Coglianese, *E-Rulemaking: Information Technology and the Regulatory Process*, Regulatory Policy Program Working Paper RPP-2004-02 (John F. Kennedy School of Government, Harvard University, 2004), 5.

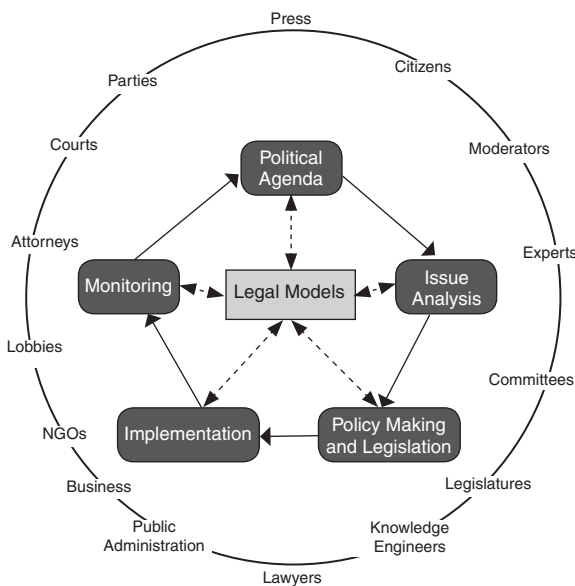
<sup>3</sup> The one-stop shops currently being established may remedy that situation soon.

connection, many of the advanced technologies this article touches on, including software solutions, can be made available at little cost to the agencies involved in enforcing regulatory compliance. For instance, Perinform, a comprehensive database of norms and standards for 22 countries, will consider special arrangements for developing countries. These options suggest that donors and governments should look toward the future rather than feel constrained by the existing IT infrastructure.

### Structuring the Governance System

Following Macintosh,<sup>4</sup> Gordon<sup>5</sup> sees the development and implementation of regulations as a kind of control process involving many actors and six elements, as shown in the figure below.

#### THE GOVERNANCE CYCLE



Source: Gordon 2005.

At the core of this system are the legal models, a topic this paper will return to below. The other elements of the process are:

- *Agenda setting*: Specifying issues and problems identified in the monitoring phase;
- *Analysis*: Finding, collecting, and structuring information about stakeholders and assessing options to best balance their interests;
- *Policy making and legislation*: Translating these best options into specific policies through legislative and regulatory texts;
- *Implementation*: Putting the policies and legislative and regulatory texts into practice; and
- *Monitoring*: Checking whether the policy, legislation, or regulation and its implementation are producing the planned results.

All of these elements involve interaction between regulators and the regulated, as well as with independent observers. Against this background, this paper will touch briefly on several aspects of deploying IT solutions to improve the regulatory framework:

- Improving access;
- Streamlining “e-rulemaking”—facilitating effective participation in rule development;
- Improving the implementation of existing regulations;
- Lowering the cost of regulatory compliance; and
- Introducing legal and regulatory knowledge systems.

There is a certain progression in these elements as one moves from e-government—improved access to relevant texts, or bringing public services online—to e-governance, using IT to facilitate the supervision of economic activities.

<sup>4</sup> A. Macintosh, “Using Information and Communication Technologies to Enhance Citizen Participation in the Policy Process,” in *Promises and Problems of E-Democracy: Challenges of Online Citizen Engagement* (Paris: OECD, 2004).

<sup>5</sup> Thomas F. Gordon, “Information Technology for Good Governance,” Fraunhofer FOKUS, in *French-German Symposium on Governance, Law and Technology*, ed. D. Bourcier (University of Paris, September 2005), 87–95.

## Improving Access

The most rudimentary approach to e-government is bibliographic—providing access to legislative and regulatory texts online. A web portal can be a route to relevant texts so citizens no longer have to obtain the information on their own or from legal experts.

Access to legal and regulatory texts can be a valuable service in itself. For example, providing online access to technical norms—both for domestic and target export markets—can inform decisions to invest and trade. However, the sheer complexity of such texts and their linkages may make it difficult for users to take full advantage of such a service, especially users at the small enterprise level. Small enterprises rarely have the legal and regulatory expertise to piece together appropriate rulings from existing texts or precedents.

## Supporting Effective Participation

Going beyond mere improvement of access to official texts, the deployment of basic IT presents the means to encourage or facilitate participation in e-rulemaking—the process of developing, reviewing, and implementing legal and regulatory rules. In fact, much attention has focused on the interaction between users and regulators in e-rulemaking,<sup>6</sup> the aim being to facilitate review, analysis, comment, and the integration of these comments into the final rules, and to open the process to continuing monitoring and evaluation—the feedback loop sketched above.

While many countries allow affected citizens and businesses, or their representatives, to comment on proposed legislation, regulations, or standards, the forbidding procedures often deter input and take a long time to complete. Putting proposed rules on a website, under appropriate markup language, will

likely enhance understanding of the rules' implications, encourage participation in rule development, and shorten the process.

In Morocco, for example, DAI manages a project to improve the business climate. We support efforts to enable industry associations to comment on technical standards proposed by the national standards organization, relying primarily on existing groupware.<sup>7</sup>

Using appropriate IT solutions, reform practitioners can significantly increase the reliability and speed with which regulations can be implemented. But standard software solutions, such as markup languages, may still present a major challenge to those affected by new regulations, as well as to the regulators themselves. In many instances, even after a thorough weeding-out process, the remaining thicket of rules makes it difficult for even the most experienced and dedicated staff to administer particular regulations. Internally, the drafters of the regulations may need guidance to ensure that the appropriate legal underpinnings and scientific evidence are fully considered. Regulators may well experience information overload, leading to an expanding body of regulations characterized by a lack of coherence and efficiency. Fortunately, help may be at hand—for regulators and regulated alike—in the shape of rapidly evolving artificial intelligence applications, used to create legal and regulatory knowledge systems, as discussed below. Incorporating this legal and scientific backup into the presentation of the proposed regulation online provides those affected with the necessary background to comment effectively.

Yet the effects of IT are not limited to better regulations. At a conference sponsored by the Regulatory Policy Program of the Kennedy School

<sup>6</sup> For a good summary of many aspects of e-rulemaking, see Coglianese 2004.

<sup>7</sup> The Improving the Business Climate in Morocco project emphasizes the deployment of IT for judicial reform (improved access to prior rulings and precedents) and, in the financial sector, for strengthening credit information, registering liens against movable and real property, and supporting advances in tax administration.

of Government at Harvard University, participants listed the following goals for citizen and business participation in e-rulemaking:

- *Increase democratic legitimacy:* Facilitating access to proposed rules and their legal and scientific background will shed light on the activities of rulemakers who are normally neither elected nor otherwise accountable to the regulated.
- *Improve policy decisions:* Following a rigorous review process goes a long way toward a formal regulatory impact analysis; both the support mechanism for the drafters of the regulation and the enhanced public transparency are likely to lead to better regulations—those that address the problem in the least costly way and balance the benefits and costs and their distribution among different groups.
- *Decrease administrative costs:* With better access to and understanding of the legal and scientific background, drafters of regulations gain in terms of administrative costs; similarly, participation by the regulated becomes easier, with lower transaction costs; and, finally, IT plays a key role in managing the process of reviewing, responding to, and integrating public comments—groupware greatly facilitates that process.
- *Increase regulatory compliance:* The effective deployment of IT also facilitates compliance, as discussed below.

### Improving Implementation

While improved access to information reduces the administrative costs of drafting, vetting, and finalizing regulations, it also makes it easier for regulators to respond to specific situations—and the need for that is great. For example, a feasibility study for the development of a legal knowledge system in Germany (focusing on administering financial support for the elderly) found that the clerks, although well-trained and experienced, provided unreliable information: 26 percent of their responses to inquiries were deemed legally indefensible.

Some of the regulations that shape the business climate—such as those relating to starting a business, acquiring licenses, or closing a business—may require relatively simple decision structures. Even so, the focused use of IT can speed up the process. For example, verifying that the business to be registered is unique depends on the ability to search existing databases. Similarly, data on creditworthiness are needed to speed up the closing of a business. Yet other procedures captured by business climate indicators, such as registering property, getting credit, or enforcing contracts, often present regulators—even those with a favorable disposition toward markets—as well as the judicial system with significant challenges.

In that context, it may be worth remembering that “bureaucracy,” as introduced by Max Weber, was originally a positive or at least neutral term. Bureaucracy, the development of precise decision rules for the administration of government functions, served to take away the discretion that had reigned before. The problem, of course, is that the proliferation of regulations, whether economically justified or not, has overwhelmed the ability of bureaucratic rules to yield predictable and reliable results. As a consequence, businesses and citizens are affected by regulatory decisions that offer great opportunities for using discretion, and this discretion invites corruption. Developing and enforcing “bureaucratic” decision rules that encompass relevant legal and other factors through use of IT cuts down on opportunities for “irregular payments” and reduces the overall cost and risk to the regulated. Rule-based regulatory decision making can be a major component in any drive to tackle corruption.

In November 2004, the Australian government published *Best-Practice Principles for Automated Assistance in Administrative Decision Making*, a report that examines the possibilities and pitfalls of deploying legal knowledge systems and similar IT solutions to streamline administrative functions.<sup>8</sup> Australia has had considerable experience in this

<sup>8</sup> Administrative Review Council (Government of Australia), Report to the Attorney General, Report No. 46 (November 2004).

area, starting with the implementation of a rule-based system for its Department of Veterans Affairs in 1989. That system directly addressed the problems of inconsistent and inadequately supported decisions and, according to the vendor, improved productivity by 80 percent.

Deploying IT to guide regulators and administrators results in greater adherence to the rules. Obviously, such an approach requires considerable up-front effort to ensure that the bureaucratic decision rules are coherent. The challenges for decision makers are to weed out unnecessary or duplicative regulations, ensure that the remaining body of rules covers all eventualities, and ascertain that similar situations yield the same decisions. From an administrative point of view, this task is formidable, but it can be facilitated by using legal knowledge systems.

Moreover, the approach pursued by the World Bank's *Doing Business* series can become an anchor point. That approach, using specific situations or business tasks to explore the impact of current practices, can help to highlight particular bottlenecks and assess the consistency of existing regulations and administrative procedures.

### Lowering the Cost of Regulatory Compliance

Generally, e-government and e-governance are designed to lower the costs of complying with administrative procedures. A growing range of public services is offered online. Once access exists—and the technological opportunities are expanding rapidly—small business owners, for example, can register without spending time and resources on travel. The web portals serve as one-stop shops for users looking to comply with the various regulations for, say, registering a particular investment project. Depending on the legal treatment of key issues, such as encryption or the validity of digital signatures, documents can be downloaded, completed, and submitted. More complex transactions require further processing, with the support of knowledge-based systems.

The decision to provide certain services online can itself trigger major advances in regulatory reform. Most business services involve multiple procedures, registries, and compliance provisions. In some cases, a single and unambiguous framework for all agencies involved in service provision is required. For example, in many developing countries, business registrations are scattered across different institutions—the ministry of justice, the tax authorities, and others, each with its own system of identification. Streamlining that process requires agreement among the public-sector entities on the principal business registry and the adoption of a single identifier. Assigning lead registry responsibilities, with appropriate access for other government institutions, and establishing a single identifier clearly have repercussions beyond the business registration proper, affecting registry of claims against movable and real property, enforcement of contracts, and close-out of businesses. Needless to say, although the IT solutions may be ready to be adopted without more development, solving the institutional problems of multiple procedures and registries takes much more time.

Creative approaches can also stimulate improved tax compliance. In 1999, the Dutch Tax Authorities put current and draft tax legislation on the web to enable interested citizens to explore the effects that proposed legislation would have on their individual tax burdens. While the focus of that action was on the development and vetting of new regulations, similar approaches can help small business owners cross over into the formal sector. In the United States, these options have become known as “*TurboTax*®” rules. IT can lead to a transformation of rules from text to such popular software packages as the tax preparation software TurboTax.

Technological opportunities are advancing at a rapid pace. For example, researchers at Stanford University have developed a new approach to tailor existing regulations aimed at the control of hazardous waste to the particular business at hand.<sup>9</sup> Rather

<sup>9</sup> Shawn Kerrigan, Charles Heenan, Haoyi Wang, Kincho H. Law, and Gio Wiederhold, *Regulatory Information Management Compliance Assistance* (National Conference on Digital Government Research, Boston, Massachusetts, May 18–21, 2003).

than offering an infinite sequence of hyperlinks to provide information to the business concerned, this approach uses various types of annotation and regulation-specific metadata (searchable definitions used to locate information) to structure the presentation of the regulation according to the needs of the particular business. These regulation-specific metadata are then used to define logic sentences to represent the rules that must be followed for a business to comply with the regulations, again tailored to the particular situation.

Yet the Stanford approach goes beyond presenting existing regulations in an understandable form as they apply to a particular business. It also detects conflicts between the user's answers and the regulations; in effect, it performs a compliance check online, and records these compliance checks for businesses.

### Introducing Legal and Regulatory Knowledge Systems

The work on building regulatory knowledge systems draws on and is complemented by efforts to equip the judiciary with similar tools to accelerate adjudication and conflict resolution. The substantial body of work on building knowledge-based systems for legal applications dates back to the late 1980s and early 1990s.<sup>10</sup> Since then, advances in IT have produced a panoply of theoretical and applied solutions.

Gordon<sup>11</sup> defines legal knowledge systems as programs that include the “use of all possible sources of legal knowledge, especially original, authoritative

legal texts, such as legislation and case law, in addition to the commentary or opinion of legal experts, and ... all ways of modeling legal knowledge using computers, such as case-based reasoning methods or so-called neural networks, in addition to rule-based technology.” Such legal knowledge systems can play a major part in judicial reform. In many countries, ministries of justice and the courts are compiling electronic collections of legislation and case law. Efforts are under way to add significant judicial decisions to such databases, including in countries (such as Morocco) with a Napoleonic code. Adding software needed for data mining, analysis, and decision assistance will deepen the impact of these efforts.

### Conclusions

The examples cited here illustrate the role of IT in moving from e-government through e-rulemaking to e-governance. The advances in software technology, groupware, parsing, XML framework, metadata use, and related efforts are ultimately value-neutral, yet they can lead to more efficient regulations, greater transparency in rulemaking, lower costs and risks to businesses, and increased compliance. Although most developing countries lag in terms of their communications infrastructure, creative approaches—often driven by commercial considerations (such as microbanking in India)—can address these gaps today, or prepare countries for tomorrow's solutions.

The potential for IT in supporting regulatory reform is vast. The main obstacles are institutional—how to promote consensus on procedures

<sup>10</sup> See P. Wahlgren, *Automation of Legal Reasoning* (Kluwer Law and Taxation Publishers, 1992); and J. Zeleznikow and D. Hunter, *Building Intelligent Legal Information Systems: Representation and Reasoning in Law* (Kluwer Law and Taxation Publishers, 1994).

<sup>11</sup> Gordon 2005.



needed for a uniform and consistent application. The lure of improving administrative procedures and encouraging greater compliance is strong but not necessarily sufficient. Those familiar with different cultural environments often have tales of decade-long debates about introducing a single business identifier, for example. IT may be the lure, but it cannot substitute for political will to overcome institutional inertia.

Finally, automation does have some drawbacks: sometimes it is useful to have administrative discretion. A shift to rule-based applications can turn into a straitjacket for regulators. A recent paper on compliance issues for community banks under new banking regulations in the United States observed: “Morphing the [bank] examination process into the systemic reliability of ‘rule-based’ regulation ... can be counterproductive.”<sup>12</sup> Dealing with these institutional and administrative oversight issues remains a concern, even as software support to the development and implementation of regulations proceeds. ♦

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<sup>12</sup> Christopher C. Gallagher, *Community Banking's New Regulatory Burden: The SarbOx Syndrome* (Gallagher, Callahan & Gartrell, 2004).

# PATHS TO REGULATORY REFORM: MOLDOVA, UKRAINE, AND VIETNAM

*Moldova: Denis Gallagher; Ukraine: Patrick Rader; and  
Vietnam: David Ray, Edmund Malesky, and Linda Nemeč*

The growing emphasis on getting the microeconomic conditions right for enterprise development and economic growth favors pragmatic approaches. What works in a given environment? How far can creative approaches applying the existing legal and regulatory framework reduce transaction costs for businesses? What are the best ways to slash through the administrative procedures that undermine an economy's competitiveness in the global marketplace?

There is no universal “cookbook” to stimulate and support regulatory reform for economic growth. Successful initiatives combine elements of:

- *Advocacy*: What are the linkages between the transaction costs imposed by unnecessary administrative procedures and economic competitiveness?
- *Strategic management*: Where are the immediate targets for reform and what tasks are better tackled through long-term institutional strengthening?
- *Incentives for building and maintaining momentum*: How do we accelerate the reform process?
- *Participation*: How do we build a constituency for the process?
- *Building an identity*: What best symbolizes the focus of our efforts—one-stop shops, the regulatory guillotine, the Provincial Competitiveness Index, or other initiatives?

How these elements are combined depends on the political, economic, and cultural environment of the subject country. But in all cases, the main driver must be a tight focus on economic growth.

## Levels of Regulatory Reform

Many investment climate assessments and benchmarking exercises, such as the World Bank's *Doing*

*Business* series or the World Economic Forum's *Global Competitiveness Report*, focus on the national level, where laws and institutions determine the overall framework for business activities. Many regulatory reform initiatives therefore focus at this level. DAI's experience in Moldova illustrates this type of “top-down” approach to regulatory reform.

Yet even in countries with the most centralized economic governance, administrators at different levels have great latitude in performing their functions and imposing administrative costs on private enterprise. Skilful exploitation of these “gray” areas for proactive management can alleviate the regulatory burden and improve competitiveness, even without changes in the overall legal and regulatory framework.

Moreover, flexibility at different levels of the framework charged with applying existing laws and regulations provides an opportunity to experiment, to try new approaches within the current framework. Pursuing reform through the lower levels in this way can build a constituency for farther-reaching regulatory (and legal) change, and may add to the knowledge of how businesses will react to regulatory innovation.

In promoting business-friendly regulatory reform in Ukraine, DAI focused on the interplay between bottom-up and top-down approaches, principally in provincial (oblast) administrations because they were trying out new options and seeking to exploit administrative flexibility to streamline procedures and reduce transaction costs. Success at the oblast level in turn helped build a constituency for nationwide regulatory reform, and local administrations then played a key role in implementing new approaches to regulatory reform.

In Vietnam, the USAID-funded Viet Nam Competitiveness Initiative and the Vietnam Chamber of Commerce and Industry took an experimental approach targeting provincial administrations as prime movers of regulatory and administrative change. A benchmarking exercise—the Provincial Competitiveness Index—provided both a baseline assessment and a “yardstick” to measure competitiveness and spur competition among provinces seeking to improve their business climates. It is too early to gauge the full impact of this exercise, but initial reactions are encouraging.

### Strategic Direction and Tactical Opportunism

The main lesson to be drawn from our recent experience in these three settings is that a combination of firm strategic direction—a commitment to promote economic growth and competitiveness—with tactical flexibility and opportunism can move mountains. Yet the ultimate criterion for evaluating regulatory reform is the response of the business community, both domestic and foreign, and its performance in the global marketplace. As Darren Welch’s article on regulatory impact analysis in this issue shows, our knowledge of these things remains inadequate.

## Moldova: Top-down works ... if the stakeholders agree

*Denis Gallagher*

“The issue here is that without these reforms, without the creation of new workplaces, without the creation of new modes of production, this country will come to a standstill in four years”—

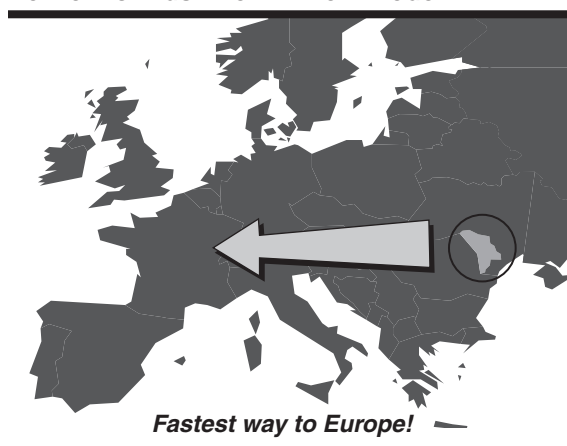
*President Vladimir Voronin of Moldova,*

*Interview with Komsomolskaya Pravda, October 2005*

Moldova declared its independence in 1991 as the Soviet Union disintegrated.<sup>1</sup> For Moldova’s economy, the collapse of the command-and-control market architecture—the rules, standards, and incentives that govern economic transactions—still presents a major challenge. The country has been slow in building its legal and regulatory framework and the institutions to enable its enterprise sector to respond effectively to opportunities and demands in traditional and new markets. The slow pace of reform has undermined Moldova’s competitiveness.

Moldova’s leaders recognize the extent of the challenge they face. The above comment from President

### MOLDOVA’S REGULATORY REFORM LOGO



<sup>1</sup> Moldova is effectively the combination of Bessarabia and Transnistria, incorporated into the Soviet Union as the Moldavian Soviet Socialist Republic. Transnistria claims independence, although that claim is not internationally recognized.

Voronin, made just six months after he won a sweeping election victory based heavily on promises of regulatory reform, underscores the hard-edged approach of the new government and declares a political commitment to overcome the legacy of microeconomic obstacles through accelerated regulatory reform.

On the macroeconomic front, pro-market positions are already in place: Moldova is a full member of the World Trade Organization, party to numerous international agreements, and an eager aspirant to European Union (EU) membership, busily working within the Moldova-EU Action Plan. With at least one-third of its economically active population of 4 million people currently working in the EU—legally or otherwise—Moldova has no realistic choice other than to accelerate regulatory reform to foster a low-cost and low-risk climate in which investors can create wealth and jobs. And in focusing on regulatory reform, the government has tied its fortunes closely to its European aspirations (as exemplified in its regulatory reform logo).

### The Opportunity

In the autumn of 2003, Moldova sought USAID's help in defining actions that would translate political will into strategy and produce short-term results to sustain the momentum of reform. Managed by DAI, USAID's Support to Micro, Small, and Medium Enterprise Development Project (BIZPRO)—which covers Ukraine, Moldova, and Belarus—had begun to add regulatory reform to its various activities supporting enterprise development. Responding to the request from the Moldovan authorities, BIZPRO adapted its approach to the economic setting, joining forces with a World Bank-sponsored effort that brought in Jacobs & Associates, whose espousal of the “regulatory guillotine” had captured the imagination of Moldovan reformers. Seeing national-level initiatives as the main engines of regulatory reform, the government

duly adopted the regulatory guillotine to drive systemic reform in Moldova.

### The Tools<sup>2</sup>

A key document laying out the guillotine approach to accelerated regulatory reform was an April 2004 white paper authored by the chief of reform operations (and then Vice Minister of Economy) and the BIZPRO manager of policy development and regulatory reform, a gifted Moldovan legal scholar. This white paper crystallized the Moldovan regulatory reform initiative in 948 words (in English), establishing the policy framework for Moldova's subsequent reform legislation.

The government created a national working group (NWG), half of whose members were non-civil service representatives who would give stakeholders an anchor in the reform process. BIZPRO provided most of the technical resources for the NWG secretariat, and during the summer and autumn of 2004, this body served as the technical forum for developing the “Law on Reviewing and Streamlining the Normative Regulatory Framework for Business Activity” (Guillotine Law)—overwhelmingly approved by the Moldovan Parliament in December of that year.

#### THE REGULATORY GUILLOTINE

The guillotine rapidly reviews regulations and eliminates those no longer needed without lengthy and costly legal action on each. Clear, decisive, and fast, it generates a comprehensive regulatory registry, as follows:

- The government instructs all agencies to establish lists of their regulations.
- As the lists are prepared (in consultation with the private sector), unnecessary, outdated, and illegal rules are identified and excluded.
- A central list consolidates the ministries' lists. Any regulation not on the list by a fixed deadline is cancelled without further legal action (the guillotine drops).

For more information on the guillotine, see Jacobs & Associates' website, [regulatoryreform.com](http://regulatoryreform.com).

<sup>2</sup> For further details and a step-by-step sequencing of the guillotine process in Moldova, see the government's “aide-mémoire” on [www.bizreforma.md](http://www.bizreforma.md) or [www.bizpro.md](http://www.bizpro.md). These portals include texts of relevant laws.

A major step in the regulatory reform process, the Guillotine Law's demands for institutional engagement and structural change are having far-reaching effects. The law elevates the private sector's status as a leader of reform through a mandatory 50-percent membership on the State Commission (the former Inter-Ministerial Commission) and the NWG. It also stipulates that Commission and NWG sessions must be open to the public and reported widely in the press and on the internet. Finally, it mandates the formulation of an entirely new law defining the principles of regulating business and entrepreneurial activities in Moldova; this law is ready for adoption by the Moldovan Parliament in spring 2006.

#### THE 2005 GUILLOTINE IN MOLDOVA

##### 1,130 Regulations Reviewed

486 included in the Registry  
211 cut  
141 amended  
292 found to be outside the scope of the law

##### 400 Permits (Fee-Based) Reviewed

128 remaining  
47 incurring fees

Of course, the devil remains in the details of implementation, and it is fair to say that the art of utilizing the guillotine lies in igniting the imagination and seizing the opportunity to usher in a new legal definition of the rights and responsibilities of the Moldovan public and private sectors, based on Organisation for Economic Co-operation and Development (OECD) principles and European market norms.

#### Lessons Learned

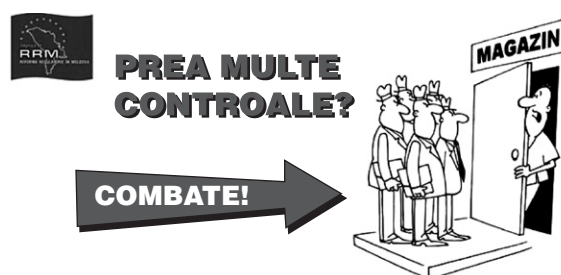
Some observers have characterized Moldova's "quiet revolution" in reform as potentially as important as anything that has happened in this regard in the

former Soviet Union. The Moldovan experience yields valuable lessons for similar efforts elsewhere.

*Leadership:* Bold yet pragmatic leadership is essential. The direction, path, and pace of regulatory reform must be decided by national leaders willing and able to take action. The pace of reform depends on the ability of mid-level public and private Moldovan managers to persevere. The ability of technical assistance to respond flexibly to these opportunities is essential to sustain the momentum.

*Inclusiveness:* Moldova's regulatory reform process has been open to all public-sector, private-sector, and civil society leaders who wish to participate. In particular, the support of business stakeholders is critical to sustain the boldness of reform leaders—there is no substitute for the active participation of private-sector institutions.

*Openness:* In Moldova, an education and advocacy campaign promoted reforms that make a real difference in the attitudes and behaviors of regulators and the regulated. Through DAI, USAID supported a government campaign using TV spots, roadside billboards, and thousands of posters and flash cards to empower civil society to "Join In" and "Fight Back" against anti-competitive regulations.



**În Hîncești: SUNĂ PAIP (269) 2 38 40**



[www.bizreforma.md](http://www.bizreforma.md)

Regulatory reform billboards funded by USAID chide over-regulation and its tendency to promote corruption

## Ukraine's regulatory reform: Top-down or bottom-up?<sup>3</sup>

Patrick Rader

In 2005, Ukraine launched a regulatory reform initiative reminiscent of the far-reaching reforms undertaken by Mexico and Korea.<sup>4</sup> Observers noted the magical aspect of local and national governments coming together to eliminate regulations seemingly designed to maximize inefficiency and corruption. However, pulling back the curtain on this historic event reveals not a wizard, but rather years of consensus-building effort.

### Act Locally

From the mid-1990s on, various presidential decrees and Cabinet of Ministers' resolutions had sought to streamline administrative procedures. Ukraine even created a state institution to advocate for a better business environment on behalf of entrepreneurs. But a few years ago, those attempts at national reform faded as political will faltered.

Fortunately, Ukraine's legal and regulatory environment gives oblast and municipal governments considerable autonomy in setting administrative rules.<sup>5</sup> So with reform at the national level stymied, local administrations launched their own initiatives, with assistance from the USAID-funded BIZPRO project, implemented by DAI. Initially, reform efforts at the local level focused on simplifying business registration. BIZPRO helped three oblast capitals establish one-stop shops for registration and expanded the methodology to 32 other municipali-

ties; their success encouraged many more localities to open their own one-stop shops.<sup>6</sup>

Success with the one-stop shops led local administrations to pursue other opportunities for reform in the context of the national regulatory framework. Eight oblasts sought to address regulatory reform more systematically. With BIZPRO assistance, they created working groups—or competitiveness partnerships—to review, draft, and modify local regulations. The groups included representatives of the private sector, officials from the oblast and municipal government, and local representatives of national agencies including the State Committee for Regulatory Policy and Entrepreneurship (SCRPE). In each of the eight oblasts, BIZPRO hired and trained four Ukrainian consultants on OECD best practices for regulatory reform. Working with competitively selected local organizations, the consultants advised on legal and economic issues and trained working group members in regulatory impact analysis (RIA), regulatory impact evaluation, and other ways to implement regulatory policy.

The working groups drafted regulations to address barriers to business development and vetted them in discussions with affected parties and broader public hearings with the business community. Once a regulation was adopted, its effect was monitored using qualitative and quantitative indicators identified by the working group, including the cost of compliance and the level of related corruption. These impact evaluations were made public and used by local authorities to determine if the regulation achieved its aim or required amendment.

<sup>3</sup> This discussion minimizes technical details to allow readers to follow the rhythm of Ukraine's regulatory reform process. Detailed descriptions can be found on BIZPRO Ukraine's website, [www.bizpro.org.ua](http://www.bizpro.org.ua).

<sup>4</sup> Jacobs & Associates, *Effective and Sustainable Regulatory Reform: The Regulatory Guillotine in Three Transition and Developing Countries* (January 2006).

<sup>5</sup> With a population of more than 47 million, Ukraine is divided into 24 oblasts, plus the Autonomous Republic of Crimea and two cities with special status, Kyiv and Sevastopol.

<sup>6</sup> For a summary of key lessons, see Volodymyr Buryy, Zachary Morford, and Paige Snider, *Business Start-Ups & One-Stop Shops: Principles for Success from Ukraine and Abroad* (2002).



## Expand Nationally

As the BIZPRO localities gained experience in this approach, they disseminated their results and methodology throughout Ukraine via regional roundtables, and the media began to cover “the movement,” stimulating a growing awareness that helped create a critical mass of regulatory reform proponents countrywide. In October 2002, three parliamentary committees requested BIZPRO network assistance in re-drafting the dormant draft Law of Ukraine “On the Principles of State Regulatory Policy in the Sphere of Economic Activity”—the Regulatory Policy Law (RPL). In September 2003, 385 of 428 deputies voted to adopt the RPL, which became operational in March 2004. This comprehensive framework for regulatory policy ensured systemic regulatory reform at all levels of government and was built around three mandates:

- RIA of regulations being drafted by all levels of government;
- Public discussion of all draft regulations, allowing businesses and nongovernmental organizations to participate in the decision-making process; and
- Regulatory impact evaluation of adopted regulations, based on measurable indicators. All ministries, agencies, and local government bodies that impose regulations are required to periodically assess the efficiency of these regulations and to amend or repeal them if they are ineffective.

The law also stipulates that all information on regulatory activities (plans, results of analysis, efficiency evaluations, and so on) should be openly available to businesses and the general public. Effective checks and balances prevent governments from avoiding required analyses and public discussions and promote the implementation of sound regulatory policy.

## Implement Locally

After the adoption of the RPL, and with the assistance of the Association of Ukrainian Cities, BIZPRO surveyed all 176 municipalities of oblast significance<sup>7</sup> to determine which were interested in receiving hands-on training in implementing the RPL. More than 50 municipalities were selected for training—all were required to share costs, and all had at least 100 small and medium-sized enterprises employing 10 or more people each.

At this point, the effort focused on the permit system—long identified as a major regulatory barrier and an area where municipalities have regulatory authority. BIZPRO helped the cities establish one-stop shops for issuing permits, which cut the cost and time for obtaining permits and reduced opportunities for corruption. For instance, businesses in Kupiansk can now obtain a permit in a quarter of the time it previously took them, and businesses in Chuguev can obtain a permit for 20 percent of the former cost. Moreover, the frequency with which permit seekers in Kupiansk encountered corruption fell from 50 percent to 6 percent.

Local experience of this kind guided SCRPE in drafting the Law on Permits System, adopted by Parliament in September 2005. For the first time, the law defines a permit and stipulates the mechanism for performing permitting duties, including the one-stop shop principle for permit-issuance. The improvement in the business environment should be marked when the law is fully implemented as required by September 2006.

## Introducing the Guillotine

Ukraine’s “Orange Revolution” created an environment for accelerating the pace of regulatory reform. The time was ripe for a radical instrument that could quickly reform the regulatory environment

<sup>7</sup> A municipality of “oblast significance” is one that has been determined to be economically important by the national government.

so crippling to Ukrainian firms' global competitiveness. The guillotine approach to regulatory reform seemed appropriate. Because applying the "classic guillotine" would require amending the RPL, SCRPE instead adapted the basic notion to develop a "quick deregulation" approach.

The strategy to implement this approach followed the same pattern as before: build support for reforms at the local level to guide subsequent national reforms. Local initiatives would encourage the national government to "drop the guillotine"—to reform as quickly as the regions did. High public expectations following the Orange Revolution created the right environment. Between March and May of 2005, seven oblasts and their capital cities began to implement quick deregulation. In May and June 2005, President Yushchenko signed Decree No. 779, "On Liberalization of Entrepreneurial Activity and State Support for Entrepreneurship," and Decree No. 901, "On Measures to Ensure Implementation of State Regulatory Policy," which promulgated quick deregulation at the national level and among remaining oblast authorities.

A working group of public- and private-sector representatives reviewed 9,340 regulations: 5,184 (55.5 percent) were inconsistent with the RPL and therefore were repealed or amended. In addition, the working group deemed 66 presidential decrees inconsistent with Ukraine's new regulatory policy framework. Of some 5,100 local regulations, 1,753 (34.3 percent) were repealed or amended.

### Top-Down or Bottom-Up?

Ukraine's experience offers a striking illustration of a pragmatic, and sometimes opportunistic, approach to promoting regulatory reform to enhance competitiveness. When political will for reform at the national level faltered, local administrations took it on. Their demonstrable achievements stimulated action at the national level, which in turn created new opportunities locally. Ongoing reforms are now aimed at expanding systemic reforms and consolidating others.

BIZPRO's assistance techniques are based on the legal and regulatory authority of national and local governments and the ability to move between the two to take advantage of political will and create momentum. As to the question of top-down or bottom-up, it seems that success in Ukraine—like a system of interlocking gears—required both.

## Vietnam: Stimulating business climate competition among provinces

*David Ray, Edmund Malesky, and Linda Nemeč*

In Vietnam, as elsewhere, administrative costs—even within a common regulatory framework—vary greatly across regions, affecting regional economic growth prospects accordingly. The regulatory and administrative performance of Vietnamese provincial officials determines how easy or difficult it is to do business in their regions, promoting or retarding enterprise development. At the national level, private enterprise growth has exploded, largely in response to supportive conditions shaped by the Enterprise Law of 2000. Since then (as of late 2005), some 136,400 private companies have registered, six times the number expected on the basis of registration patterns over the 1991 to 2000 period. Yet this surge has been geographically concentrated in a handful of provinces. Eleven of Vietnam's 64 provinces account for more than 60 percent of growth in the active private sector and 70 percent of private-sector investment and revenue.

Economic growth is, of course, rarely spread evenly across a country. Structural endowments such as proximity to markets, access to natural resources, human resource development, and the level of infrastructure services shape the pattern of regional economic performance. Yet differences in business transaction costs—in the administrative and regulatory burden facing private enterprise—also affect investment and growth. Focusing on economic governance issues, rather than overall development measures, draws attention to what provincial officials can do in the short and medium terms to

improve their respective business environments and thereby boost growth: while it may take many years to develop physical infrastructure or increase education levels, it may only take months or perhaps even weeks to streamline and rationalize business registration and licensing procedures, or to improve investor access to information regarding land planning, or to integrate the local business community into the planning and policy process.

### Rating Business Environments at the Provincial Level

Encouraging provincial officials to take these reform steps depends on both capacity and incentives. While much of the capacity may already exist, incentives are lacking since there is no yardstick to measure how well a province is doing with respect to its business climate. Without such a yardstick, it is hard to tell which approaches to reform work best. In implementing USAID's Viet Nam Competitiveness Initiative (VNCI), DAI and The Asia Foundation took up the challenge to develop such a yardstick and show regional officials that a better regulatory framework and business climate would improve their constituents' economic welfare.

First, though, we needed a better understanding of the critical elements that shape economic performance at the provincial level. Our basic approach to defining the business environment in terms of selected indicators was similar to that used for international benchmarking exercises such as the World Economic Forum's *Global Competitiveness Report*: isolate those elements of the business climate that help explain differences in economic performance, and demonstrate that gains at the provincial level are possible if weaknesses are addressed or strengths exploited. In many ways, the results of such a benchmarking exercise are more reliable within a particular country than in cross-country comparisons because less of the variation can be attributed to cultural and related factors. Moreover, in Vietnam, a subnational benchmarking effort can take advantage of detailed data on economic performance at the provincial level.

For this provincial benchmarking study, VNCI—under Asia Foundation leadership and working closely with the Vietnam Chamber of Commerce and Industry—developed a Provincial Competitiveness Index. The PCI measures how elements of the business climate under the control of regional officials can affect key measures of economic performance and growth. To compare provinces on an equal basis, the index controls for the effects of structural endowments and conditions, such as market size, human and physical capital stocks, infrastructure, and location.

Overall, the national benchmarking effort using the PCI suggested that good economic governance can improve private-sector performance in provinces, regardless of initial endowments. In pragmatic terms, the exercise also stimulates healthy competition among Vietnam's provinces to improve their respective business climates.

### Constructing the PCI

The PCI combines “soft” and “hard” data. For the former, a survey of private enterprises ascertained their perceptions of local business environments. These soft data were then combined with credible and comparable data from official and other sources regarding local conditions, weighted according to their importance for economic development. The final measure was standardized to rank provinces on a 100-point scale. The overall PCI in fact is composed of nine subindices that quantify variations in performance across Vietnam's provinces, beyond the effects of structural endowments:

- *Entry costs*: The time it takes firms to register, acquire land, and receive necessary licenses to start a business.
- *Access to land*: The effective price of land in the provinces, the quality of industrial zone policies, and whether firms possess official land use rights certificates and can access enough land for business expansion.
- *Transparency and access to information*: Whether firms have access to planning and legal documents necessary to run their businesses, whether the documents are equitably available, whether

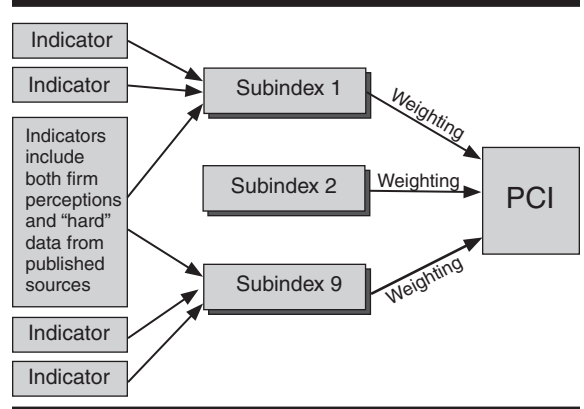
new policies and laws are communicated to firms and predictably implemented, and the business utility of the provincial web page.

- *Time costs and regulatory compliance:* How much time firms waste on bureaucratic compliance, and how often and for how long firms must shut down their operations for inspections by local regulatory agencies.
- *Informal charges:* How much firms pay in informal charges and how big an obstacle those extra fees pose for their business operations.
- *Implementation of policies and consistent application across provincial subagencies:* A measure of the coordination between central and provincial governments.
- *State sector favoritism:* A measure of the bias of provincial governments toward state-owned enterprises (SOEs) in terms of incentives, policies, and access to capital.
- *Proactivity of provincial leadership:* A measure of the creativity and effectiveness of provincial leaders in implementing central policy and designing their own initiatives for private-sector development.
- *Private-sector development policies:* A measure of provincial policies for private-sector trade promotion, provision of regulatory information to firms, business partner matchmaking, and capacity training to improve the quality of labor.

The research team estimated each subindex by combining business perceptions and “hard” data into a composite measure. These subindices were then aggregated into the overall PCI using a weighting procedure wherein some subindices are judged more important in shaping economic performance than others. The team used econometric analysis to explore how each subindex affects investment, profitability, and firm registrations, and used the average of the econometric impact measures as the weight. Figure 1 illustrates the creation of subindices and their aggregation into the overall PCI.

In performing its econometric analysis to derive the weights for the final PCI, the team was able to demonstrate the “instrumental” character of business

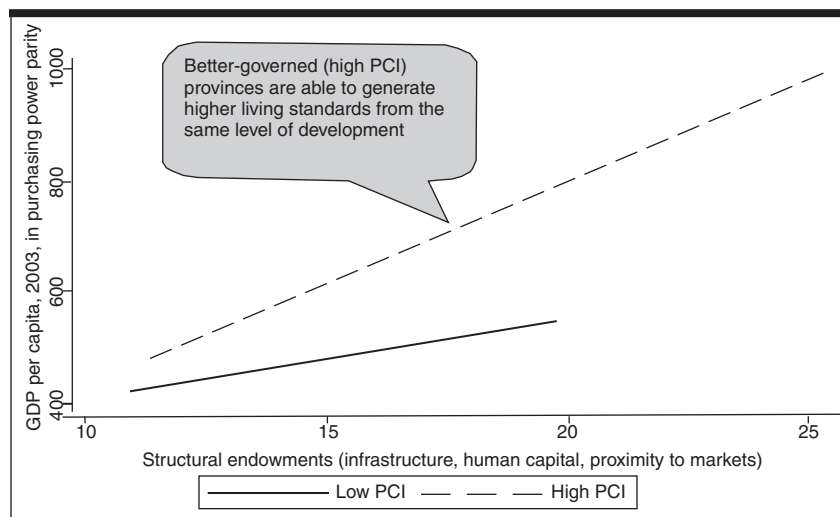
**FIGURE 1: CONSTRUCTING THE PCI**



climate indicators. While better structural conditions, such as more extensive road systems or higher education levels, always improve regional economic welfare, these benefits are most pronounced in provinces with above-average PCI scores. Figure 2 illustrates this finding: it shows that better-governed provinces—that is, those with high PCI scores; in this case the 21 top-ranked provinces—generate higher living standards from the same structural conditions.

The purpose of the PCI is to stimulate reform efforts by identifying best practices in each subindex category and informing provincial authorities of their strengths and weaknesses with respect to the business climate. To structure the policy discussion, VNCI used the PCI to establish five groups of provinces, as shown in Figure 3. Recognizing that the rankings would be controversial, the project team paid particular attention to involving local economic research institutes and well-respected economists to develop the technical approach and check the data.

PCI rankings were presented publicly, generating extensive TV, newspaper, and radio coverage. The results were surprising to many. For example, Ho Chi Minh City, expected to be near the top of the rankings, found itself in the middle. For several weeks the project operated the equivalent of a hotline service as provincial economic leaders called in to ask why they received their ranking and

**FIGURE 2: THE EFFECTS OF GOVERNANCE ON WELFARE**

- The provincial government set up a business information website: <http://www.angiang.gov.vn>.
- A hotline has been established to receive business complaints and the telephone numbers of provincial leaders are publicized in local newspapers and on local radio.
- Business regulation is being streamlined and simplified and a manual of simple guidelines on the registration process provided.

what they needed to do to raise it—exactly what the project wanted.

VNCI provided detailed diagnostics to administrators and the business community in each province, including the results of the survey and the impact that poor performance in certain areas was having on investment, firm profitability, and private-sector growth. Summary charts like the one shown in Figure 4 for An Giang Province graphically demonstrated how a particular province compared to the median for the nine indicators.

An Giang was one of the first provinces to hold a diagnostic workshop, attended by 130 representatives of provincial government agencies and the business community. Speaker after speaker urged participants to “accept the diagnosis” and formulate ways of improving the business environment. Increasingly, participants directed their questions to each other and not to the PCI team: as intended, the PCI was acting as a catalyst for change. Subsequently, An Giang has undertaken the following measures:

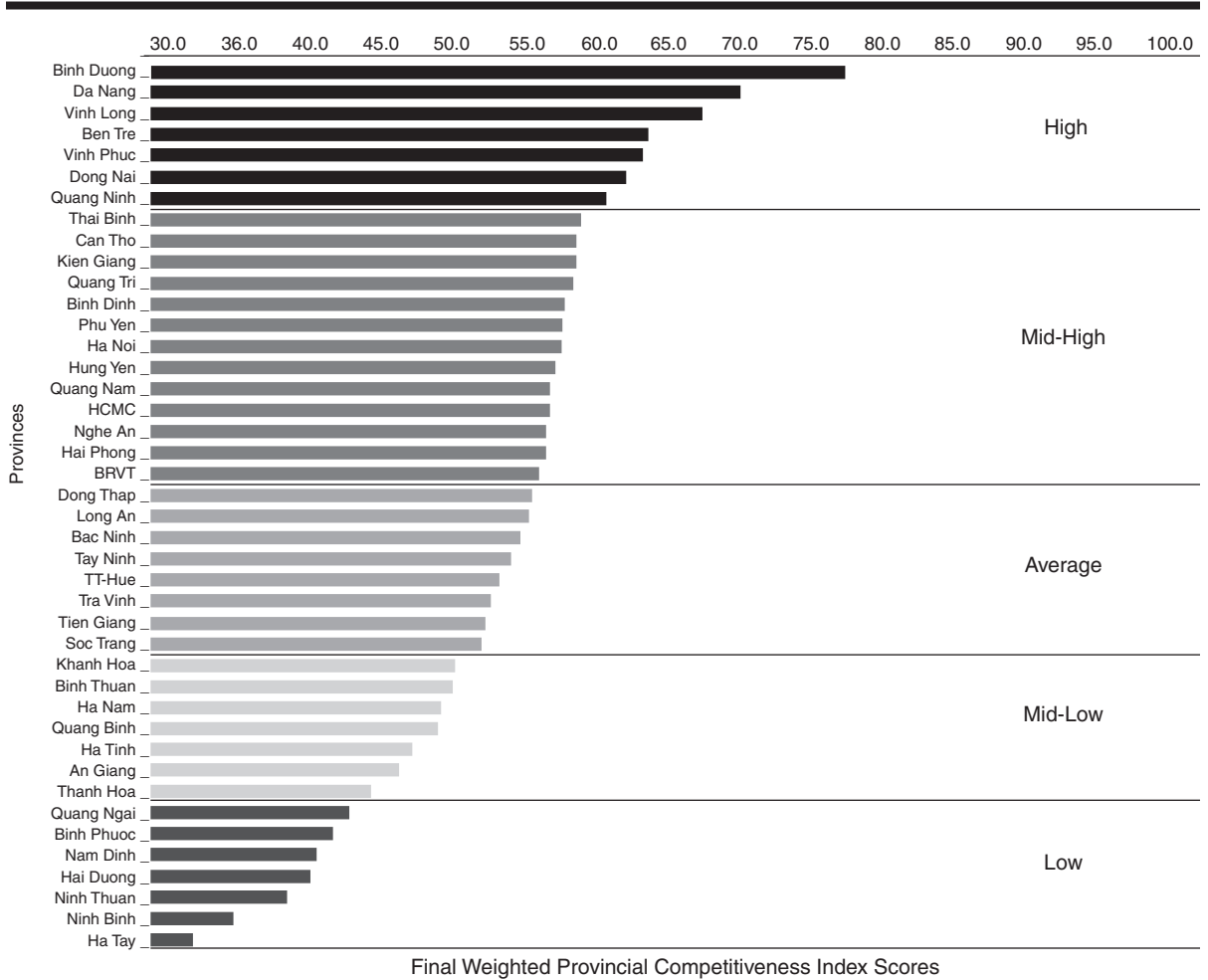
- A valuation process is under way to reduce the number of provincial SOEs.

Following a similar diagnostic in Tien Giang province, government officials plan to take the following steps:

- To improve its transparency score, the province will upgrade its website to better share information on business regulations, procedures, and policies.
- To improve its entry costs score, the province is developing a one-stop shop to facilitate business registration.
- To improve its private-sector development policy score, the province is reviewing its investment regulations and policies.

Ha Tay province—which came in at the bottom of the PCI scores—took swift and decisive actions based on its ranking and diagnostics:

- The Chairman of Ha Tay’s People’s Committee now holds weekly meetings with local business leaders.
- Telephone hotlines and a dedicated mailbox have been set up in the key provincial government office.
- New rules have been promulgated requiring that all investment-related information be made public.
- Regular biannual meetings with investors have been scheduled.

**FIGURE 3: PROVINCES GROUPED BY PCI PERFORMANCE**

Ha Tay also plans to implement a one-door policy for investors, to organize an investment promotion conference, and—most importantly—to implement an ongoing regulatory review process.

### Guiding Assistance Efforts

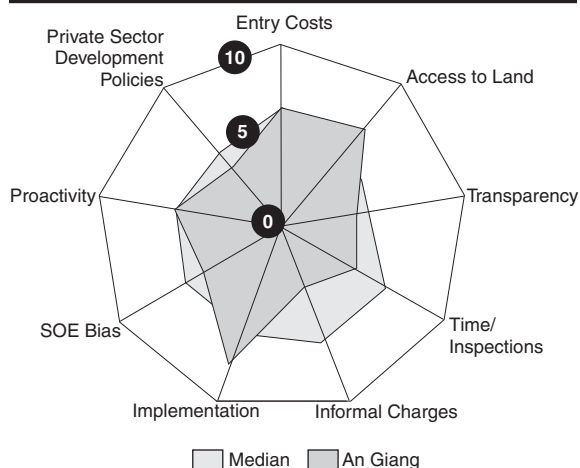
Various technical assistance efforts have focused on improving the business climate in Vietnam and its provinces. Donors focusing on these issues include the Danish International Development Agency (Danida), the International Finance Corporation-Mekong Project Development Facility (IFC-MPDF), the German Technical Cooperation Agency (GTZ), the Netherlands Development

Organization (SNV), and the EU. The PCI tapped into a donor-wide need to provide a baseline measure of the regulatory framework for each province. Its framework will guide capacity-building efforts related to regulatory reform and improving the business environment. Following recent successes in advancing important business-related laws at the national level, attention is increasingly focused on implementing similar laws at the provincial level.

Donors are using PCI data to benchmark the governance performance of target provinces and to identify elements of the provincial business environment requiring the most attention:



**FIGURE 4: COMPARING ONE PROVINCE (AN GIANG) WITH THE MEDIAN PERFORMANCE**



- Danida's Business Sector Program Support project will use the PCI in its monitoring and evaluation framework, noting that the interest of provincial authorities in improving their ranking and the rigorous work that went into the index make it the indicator of choice.
- IFC-MPDF has worked closely with VNCCI on PCI diagnostic workshops designed to engage the Provincial People's Committee in identifying areas where MPDF can direct assistance.
- GTZ is working with VNCCI to hold joint diagnostic workshops and will use the PCI to help provinces identify aspects of the business environment requiring the greatest improvement.
- VNCCI plans similar joint diagnostic workshops with the EU Private Sector Support Project and SNV in their respective focus provinces.

### Preliminary Lessons

The PCI was designed to take advantage of inter-province rivalry and the substantial independence provincial officials have in influencing the micro-business environment. For countries with weak regional systems of government, such an approach may not be appropriate. For newly decentralized governments, such an index and especially its diagnostics can help provide direction.

Establishing the PCI's credibility was critical, and VNCCI did that by working cooperatively with one of the most respected business organizations, the Vietnam Chamber of Commerce and Industry, and by engaging Vietnamese economic research institutions and reformers in constructing the index. Notably little time has been spent questioning or arguing the PCI's results.

The Vietnamese media played an important role in publicizing results, offering constructive criticism on omissions in indicators, and following up on policy differences between provinces with differing scores. It is now commonplace for reports about a province to mention its PCI ranking as a yardstick of performance. The media is playing a watchdog role, carefully studying how provincial business environments vary, where firms have been injured by particular provincial activities, and where other provinces have successfully improved the business environment.

The PCI's ultimate goal is to help government officials make a direct link between the business environment they shape and the success of the private sector. Although initial responses by provin-

"... we have always admitted that our investment environment is not yet attractive. When compared to other peers in the region, Ha Tay falls far behind them in terms of both the volume and the quality of investment even though we enjoy more favorable structural conditions. However, it was not until after the release of the PCI by the Vietnam Chamber of Commerce and Industry-VNCCI [in] which Ha Tay was ranked 42/42 on competitiveness, that we started to think hard about our weaknesses. We had been well aware that our investment environment remained weak, yet, none of us had realized it was that bad.

"Another significant impact is that after the release, the media has run numerous articles and discussions about our performance, which has challenged the values and beliefs of our officials, Party members and people. We then realized that we should take it as an opportunity to reassess ourselves more seriously and harshly in order to make good our shortcomings and work out appropriate policies to remove market entry barriers, and to improve transparency and proactivity."

Ha Van Hien, Ha Tay's Party Secretary  
*Vietnam Economic Times*, No. 142: "Ha Tay to Improve Its Local Investment Environment" (July 19, 2003).

cial officials focused on specific problems identified by the PCI research, there is also a broader acceptance of the need to change attitudes about the role of government and the private sector throughout relevant agencies. If provincial officials focus only on a few technical changes, they will have little beneficial effect on the business environment; for example, one-door policies often accomplish little more than establishing “one more door” for businesses. But in Ha Tay, the positive reaction to the PCI and the public embrace of its findings clearly

articulate the intention to change rules and behavior from the top level. While implementing reforms can always be problematic at lower levels of government, the formal, regular, and public reviews initiated since the PCI went public provide new mechanisms to oversee the implementation of desired reforms. These mechanisms do not guarantee that all necessary changes will be successfully implemented, but they do suggest that leaders will not be surprised when the next round of the PCI rankings are announced. ♦

# THE JUDICIAL SIDE OF REGULATORY REFORM<sup>1</sup>

by Rémy N. Kormos

Conventional wisdom holds that the “easy” part of regulatory reform in developing and transitional countries is drafting new laws and regulations, while the “hard” part is ensuring that government institutions implement and enforce those laws and the decisions arising from them. In reality, there are no easy parts, and the reform process must integrate legal reform (such as drafting new bankruptcy laws), institutional reform (such as establishing specialized commercial courts), and institutional and stakeholder support (such as strengthening professional and business associations and civil society).

Economic development theorists increasingly link democracy and the rule of law to economic growth, and judicial reform has emerged as a core element in building the institutional foundations of a market economy. Even if our theoretical understanding of the impact of judicial reform remains incomplete, it is clear that effective justice sector institutions are critical to resolving commercial disputes, implementing regulatory frameworks, and enforcing judgments and legal instruments. Multilateral development banks, such as the World Bank, have historically linked judicial reform projects to economic development goals.<sup>2</sup> It is now commonplace for donor-funded technical assistance targeting economic growth to include reforms such as ensuring the execution of judgments or strengthening case management in commercial courts. A considerable body of rule-of-law experience and literature relating to reform of institutions such as courts is directly or indirectly applicable to regulatory and commercial law reform.

Besides the traditional role of dispute adjudication, judicial sector institutions play a significant role in regulating commercial and economic activity. Specialized bankruptcy courts, administrative tribunals, and property and pledge registries, for example, often function alongside regulatory agencies in regulatory or administrative functions. The judiciary is also involved in enforcing judgments. This paper briefly summarizes the key lessons of reform with respect to these three functions and concludes by reviewing the crosscutting lessons of judicial reform.

## The Commercial Dispute Resolution Function

The primary function of the courts is, of course, to adjudicate disputes. In many instances, specialized commercial jurisdictions—rather than general jurisdiction courts—deal with disputes involving certain categories of parties, such as merchants, or with commercial disputes above a certain threshold value. The state almost never has a monopoly on dispute adjudication, and many commercial disputes are resolved through traditional or informal dispute resolution methods, or through formal alternative dispute resolution (ADR) methods such as mediation or arbitration.

Countries around the world have periodically undertaken judicial reform, driven by perceived shortcomings in the courts’ adjudication of disputes. Donors, including multilateral development banks, have provided technical assistance and often direction to this reform. Since the early 1980s, building

<sup>1</sup> I would like to acknowledge the guidance of DPK Consulting co-founders and principals William E. Davis and Robert W. Page, Jr., both former court administrators in the United States and experts in the rule of law and governance in the developing world.

<sup>2</sup> Richard Messick, “Judicial Reform and Economic Development,” *The World Bank Research Observer*, Vol. 14, No. 1 (The International Bank for Reconstruction and Development, February 1999).

on lessons learned from earlier failures,<sup>3</sup> reformers have developed a basic theoretical and programming framework around five imperatives<sup>4</sup>:

*Adopt efficiency, independence, and accessibility as guiding principles*<sup>5</sup>

These three principles define a theoretical framework that is useful in designing, implementing, and evaluating reform of judicial institutions. Reforms targeting efficiency address areas such as case management, seeking to reduce delays or improve financial management. Courts, including commercial courts, must be sufficiently independent from political and external forces to render impartial judgments; at the same time, the courts and the reform process will typically remain accountable to executive branch institutions, and ministries of justice tend to play a central role in the reform process in many countries. Courts must also be accessible to users, both geographically and economically. For example, high jurisdictional limits (in terms of the sum under dispute) may shut out small businesses.

*Address “macro-administrative change”*

Judicial reform should address shortcomings in the overall administration of a court system, including personnel, budget, procurement, and information systems. Linn Hammergren, an expert in this area, has referred to this process as macro-administrative change, in contrast to court administration reform that focuses on improved court functioning. Where macro-administrative reforms target civil or commercial courts, it is important for the reform process to include the applicable supervisory institutions, such as the national administrative office for the courts, the supreme court, or the executive branch ministry of justice.<sup>6</sup> The selection, evaluation, and

discipline of judges and other court personnel is another key area often included in judicial reform initiatives.

Macro-administrative change requires the support and participation of leaders in the commercial courts and supervisory institutions, both of which are essential players in sustaining the necessary political will to implement reform. Such support should not, however, come at the expense of other stakeholders or of end users. Indeed, planning organizational change requires clearly identifying the needs and expectations of all stakeholders. Another important element of institutional reform at the macro level is fostering the creation of an open organizational culture. Justice sector institutions in particular tend to be inward-looking and resistant to increased transparency.

*Streamline court administration*

Court administration reform seeks to improve the functioning of local and appellate courts, typically by streamlining case processing, reducing delay, implementing automation, and improving court facilities and administrative, financial, and information systems. Such reform initiatives usually start with or include pilot courts—models that can then be rolled out nationally. Commercial court administration reform typically differs from civil and criminal court reform in the need for specialized subject matter expertise in areas such as accounting or intellectual property. Commercial courts also tend to have smaller caseloads and backlogs than their criminal and civil counterparts. While court administration reforms tend to be technical in nature, they are almost always a prerequisite to improving dispute adjudication and to broader court reform.

<sup>3</sup> Richard Bilder and Brian Z. Tamanaha, “The Lessons of Law and Development,” *American Journal of International Law* (April 1995).

<sup>4</sup> Thomas Carothers, “The Rule of Law Revival,” *Foreign Affairs*, Vol. 77, No. 2 (1998).

<sup>5</sup> William Prillaman, *The Judiciary and Democratic Decay in Latin America* (Westport, Connecticut: Praeger, 2000).

<sup>6</sup> Linn Hammergren, *Institutional Strengthening and Justice Reform* (U.S. Agency for International Development, 1998).

### *Institutionalize training and legal education*

Commercial court reform usually includes a specialized training component for judges, court personnel, and judicial trainees. In addition to commercial law topics, courses in non-legal areas such as accounting and economics should generally be included to address gaps in judicial understanding of business transactions and to prepare judicial personnel for new laws and practices. Training should be linked to improved performance and should be geared to help participants understand wider reforms and institutional changes. Unfortunately, judicial and commercial law reform projects rarely seek to improve the formal education required of law students and judicial trainees because such reforms require sustained government, university, and donor support. Over the long term, legal education reform is at least as important as judicial training.<sup>7</sup>

### *Promote the development of alternative dispute resolution*

Reforms designed to improve dispute adjudication and reduce case backlogs will often incorporate support to develop ADR techniques. Examples of ADR include formal commercial arbitration tribunals established by business associations, court-annexed mediation, and local, traditional dispute resolution systems. ADR development requires legal reform, institution building, and buy-in from stakeholders. To be successful, ADR requires that the business community and legal professions see its benefits and detect no threat to their own professions.

## **The Administrative and Regulatory Functions**

In both civil and common law countries, justice sector institutions—such as commercial courts, administrative law tribunals, and court-administered company or pledge registries—often play a role in regulating business and economic activities. They share these functions with executive branch institu-

tions such as administrative or regulatory agencies and ministries. Examples of such functions include regulating company formation or registration, corporate governance, and the bankruptcy process; regulating aspects of financial services and trade; and registering and protecting property rights. More broadly, in many countries the legal system becomes the “regulator of last resort” because regulatory agencies lack expertise, capacity, or enforcement powers, and resulting disputes must be resolved by the judiciary. For example, in countries lacking an effective system to oppose trademark registration, challenges to the registration of protected trademarks tend to be addressed in court.

### *Transfer of administrative and regulatory activities out of the courts*

Commercial courts in many civil law jurisdictions have traditionally been responsible for company registries that govern the formation of legal entities and the recording of company minutes or decisions, as well as for registries such as pledge or property registries. These registry functions typically consume significant court resources, and a common goal of commercial court reform is to transfer those functions out of the courts. Court leadership often resists such transfer because the registry functions provide significant revenues from fees (and in certain cases from corrupt practices), but registry tasks detract from the judiciary’s fundamental mission. Another example of this type of reform is to locate and strengthen trademark opposition in the responsible administrative agency, so that any trademark opposition takes place during the registration process rather than through litigation.

### *Specialized commercial courts and administrative tribunals*

As economies grow, business transactions become more complex and regulatory systems more sophisticated. This growth often requires commercial or

<sup>7</sup> Mark Dietrich, “Three Foundations of the Rule of Law: Education, Advocacy and Judicial Reform,” *Law in Transition* (European Bank for Reconstruction and Development, London, U.K., Autumn 2002). Available at <http://www.ebrd.com>.

other specialized courts to provide niche expertise that general jurisdiction courts may not have. Likewise, the business community may require the establishment of courts with smaller backlogs. Specialized tribunals may also emerge from government administrative agencies that regulate economic activities, provide services, protect resources, and enforce laws. In such cases, the specialized tribunals are created to impartially handle disputes between individuals or businesses and the state agency.

The creation of new courts or administrative tribunals is a major undertaking, requiring significant planning and allocation of resources.<sup>8</sup> Among other considerations, reformers should:

- Clearly define the court's subject matter—which will usually be complex and evolving—and ensure that the court is likely to adjudicate a volume of disputes sufficient to justify its existence;
- Ensure that the specialized jurisdiction has complete authority in the field and no overlap with other courts (to limit forum shopping and turf battles); and
- Establish appropriate organizational hierarchies (for example, decide whether the court is at the appellate or lower-court level).

### *Legal transplantation and “missing” institutions*

Where legal reforms involve transplanting foreign legal models, special care is needed to ensure that transplanted laws do not assume the existence of institutions or legal concepts absent in the receiving country. For example, the late 1990s and early 2000s saw a series of reforms in Bulgaria's bank-

ruptcy regime modeled partially on U.S. bankruptcy procedures. The new framework required bankruptcy trustees to take on a major role in both liquidation and reorganization. However, when the first legal reforms were implemented, there was no institutional or legal framework for bankruptcy trustees—indeed, the profession did not exist and there was no system to regulate or train trustees. As a result, implementation of the reforms was delayed and the business community's perception of them was tarnished.

### **The Enforcement Function**

Legal frameworks and implementing institutions to enforce commercial law judgments and legal instruments are weak links in the legal systems of many, if not most, developing and transitional economies.<sup>9</sup> In many countries, an alarming percentage of court decisions are never enforced, significantly undermining confidence in the legal system and regulatory regime. Fair and effective enforcement is essential to the proper functioning of a legal system and the healthy development of a market economy. If a country's law and its judicial decisions are not adequately enforced, even the most effective judicial reforms will fail, and local and international investors will be reluctant to invest there.

Before we examine approaches to enforcement reform, it is useful to remind ourselves of the variations in legal models and in institutions responsible for enforcement. Using the methodology developed by Henderson and Kahn,<sup>10</sup> these enforcement models can be broken out into four basic categories:

<sup>8</sup> American Bar Association, *Central European and Eurasian Law Initiative*, Concept Paper on Specialized Courts (1996). Available at <http://www.abanet.org/ceeli/publications>.

<sup>9</sup> World Bank, *Doing Business in 2005: Removing Obstacles to Growth*. This study tracks key business regulatory statistics, including the time, procedures, and costs required to enforce a contract in countries around the world. These statistics are based on a hypothetical fact pattern where the creditor or plaintiff is entirely in the right and the losing party does not appeal the decision or use any extralegal means of delaying the process or hiding assets. The statistics do not purport to document what percentage of decisions are actually enforced.

<sup>10</sup> Keith Henderson and Peter Kahn, *Barriers to the Enforcement of Court Judgments and the Rule of Law* (IFES, 2003). I have relied heavily on this paper.



1. Court-controlled enforcement, where “execution” judges control the process;
2. Diffuse enforcement systems, where responsibilities are shared among the creditor, court, and other agents;
3. Public-sector enforcement systems, where civil servants under the executive branch bear primary responsibility; and
4. Private/semi-private specialist enforcement systems, where independent or semi-independent private-sector enforcement agents take the lead in enforcing judgments.

Once a country is considering significant enforcement reforms, the choice of enforcement model is often hotly contested. Donors sometimes champion systems similar to their own, but the choice should be based on appropriateness and merit rather than on political pressure or the “carrot” of technical or financial assistance.

Enforcement reform must accurately evaluate and target the underlying problems in the existing system. Typical shortcomings in developing countries include ineffective or unnecessarily complex and costly court procedures, notification systems, and disciplinary mechanisms. Loopholes in procedures and in the overall legal and financial system may allow debtors to hide assets from the enforcement agent or court. Enforcement agents may not command adequate resources, such as means of transport, or they may be insufficiently paid or motivated to enforce judgments. In many cases, the enforcement system as a whole has simply ceased to function and is bypassed in favor of traditional systems or informal self-help methods, with only elites able to avail themselves of the formal justice system.

#### *Enforcement of judgments: lessons learned*

A few guiding principles for ensuring fair, effective, and transparent enforcement systems can be distilled from past experience and the (limited) literature on this topic:

- *Transparency:* The enforcement process should be transparent, including clear and flexible notification (or service of process), a functioning system for the sale of assets (if necessary for execution), and a sufficient variety of enforcement methods.
- *Enforceable titles:* Legal provisions should provide a clear list of enforceable instruments, reflecting modern financial practices, and the validity of titles should be easily verifiable.
- *Rights and duties of the parties:* Reforms should take a balanced approach, protecting the basic rights of debtors, creditors, and third parties such as co-owners. For example, there should be provisions for reasonable protective measures in certain cases.
- *Authority:* Enforcement agents must have the authority and support to conduct necessary seizures, possibly involving law enforcement agencies. Any reform in this area will generally be politically charged, with interest groups on both sides claiming that the proposed reforms will favor one side.
- *Enforcement agents:* Where enforcement agents other than the parties are involved, regardless of the enforcement model, the rights and duties of the agents must be clearly set out and adequate institutional supervision provided. The selection and discipline process for agents must be effective, and they must have sufficient economic incentive to complete the enforcement process.
- *Access to information:* Creditors or enforcement agents cannot enforce judgments unless there is reliable information available on a debtor’s address and assets. Judicial reformers may need to address shortcomings in other public- and private-sector institutions (such as property and pledge registries, banks, and credit bureaus) before the enforcement system can be put into place. Judicial reform therefore depends in part on financial sector reforms, in particular on reform of lien registry systems.
- *Effective dispute resolution:* Because disputes often arise in the enforcement process, adequate dispute resolution systems are needed.

## Conclusion

Institutional reform targeting justice sector institutions—and other regulatory governmental and nongovernmental institutions—is a slow process. It is critical to link legal reforms with institutional reforms, but judicial reforms take longer and their success or failure is often harder to evaluate than legal reforms, where the passage of a new law or regulation is an easily reportable success story. A few general conclusions—applying equally to reforms addressing the dispute resolution, regulatory and administrative, and enforcement functions—are submitted below:

- Where reforms are supported by bilateral or multilateral technical assistance, special care must be taken to ensure that the assistance supports domestically rooted processes of institutional change and does not artificially reproduce pre-selected results based on foreign models.
- Designing and implementing successful institutional reforms requires understanding the complete ecology of the government institution, including formal, semi-formal, and informal networks and the various constituencies.<sup>11</sup> Tom Carothers writes that many reformers and purveyors of technical assistance tend to treat institutions as machines that run on their own rather than as complex human institutions embedded in their societies.<sup>12</sup> Institutional reform involving commercial courts or other judicial sector institutions must take into account the complex tension between the executive and the judiciary branches at the national level, as well as the interaction of

the constituencies or spheres of interest of judges, court personnel, lawyers, business leaders, and other stakeholders.

- Once the constituencies involved in or affected by a reform initiative are identified and understood, it is essential to avoid “guild”-type reforms that primarily address the needs and interests of particular stakeholders (for example, commercial court judges) and do not sufficiently take into account other stakeholders. All courts and government agencies should first and foremost provide a public service.
- Corruption is often a major factor in planning and implementing commercial court or regulatory reform, since significant economic interests are at stake. Thus, in addition to encouraging a sharper focus on public service, judicial and regulatory reform should be designed from the start to limit corruption and increase transparency. Anti-corruption initiatives are challenging because corruption—from minor administrative corruption to endemic corruption on the grand scale—arises both from institutional attributes and from broader social factors, and it takes different forms in different societies.<sup>13</sup>
- As Richard Messick points out, while the judicial reform process should be preceded by in-depth analysis and research, that analysis should also be continually reviewed during implementation to reflect new research, lessons learned from other countries, the evolution of political will in the country concerned, and the progress of related reforms.<sup>14</sup> ♦

<sup>11</sup> Thomas Heller and Erik Jensen, eds., *Beyond Common Knowledge: Empirical Approaches to the Rule of Law* (Stanford: Stanford University Press, 2003).

<sup>12</sup> Thomas Carothers, *Aiding Democracy Abroad* (Carnegie Endowment for International Peace, 1999).

<sup>13</sup> U.S. Agency for International Development, *A Handbook on Fighting Corruption* (2003). Available at <http://www.usaid.gov>.

<sup>14</sup> Messick (1999).

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