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**Research Report**

## Institutional frameworks to support regulatory reform in middle-income economies: Lessons from Russia's recent experience

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Lev Freinkman – Andrey Yakovlev

Institutional frameworks to support  
regulatory reform in middle-income  
economies: Lessons from Russia's  
recent experience



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## Institutional frameworks to support regulatory reform in middle-income economies: Lessons from Russia's recent experience<sup>1</sup>

### Abstract

This paper addresses sustainable institutional arrangements to support economy-wide improvements in the investment climate in the context of a middle-income economy. The recent experience of the Agency for Strategic Initiatives (ASI) in Russia provides a valuable example of establishing a new government agency to advance economic deregulation in an environment where the political appetite for reform is limited. In our view, ASI has been the most successful institutional innovation to emerge in Russia since the 2008-09 financial crisis. Rather than engage in the traditional tussle over budget funds and benefits, ASI's mandate has been to organize a strategic dialogue with the private sector and build consensus within the government. We consider ASI's institutional set-up in light of the good practice principles adopted under Russia's "new industrial policy." Our findings suggest other middle-income economies may find ASI's experience applicable when designing institutions to support a deregulation reform agenda. While the crisis in Ukraine has triggered a fundamental shift in Russia's developmental path that is likely to make ASI's deregulation efforts largely irrelevant, the agency's practical experience remains pertinent to the broader discussion of institutional arrangements to promote deregulation.

JEL: L50, P20, O25

Keywords: national development agencies, investment climate, deregulation, medium size business, industrial policy.

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# 1. Introduction

Reduced administrative barriers for business and deregulation of the economy continue to be standard policy priorities of national development programs worldwide. A number of studies of reform programs seek to draw lessons that may be applied in future design of similar interventions. One insight common to this literature is the need to establish a powerful, specialized agency at the center of the government quite early in the reform process (World Bank, 2010). Such agencies are typically tasked with both design and implementation of the national deregulation strategy.

There is also a good reason why so few such agencies are found outside OECD member countries. The need for a reduction in administrative barriers is most acute in environments with weak local institutions and strongly entrenched vested interests. Such institutional environments are usually unsupportive of any strategy for setting up an empowered new agency with a mandate to fight vested interests. Attempts to establish such an agency (e.g. an anti-corruption unit) are likely to result in an entity with highly limited real powers or vulnerable to quick co-option by the prevailing bureaucratic structure. Indeed, in politically fragile situations, this type of institutional innovation may even be counter-productive as it carries the risk of destabilizing the prevailing balance of rent-sharing arrangements associated with the existing regulatory regime, i.e. the logic of Limited Access Order (LAO), (see North et al., 2007).

The conundrum for the policymaker is obvious. On one hand, the launch of deregulation reforms requires a strong institution that owns the reform agenda. On the other, the barriers to creating such an institution can be prohibitively high, especially where the respective reforms are the most needed. One approach to resolving this contradiction is to draw upon the experiences of countries with weak institutions still going through the initial stages of reforming their investment climate. What institutional solutions has this country chosen to launch its reform process? What are the strong and weak features of this particular solution? What is the potential for this to become a sustainable institutional arrangement?

Russia's recent experience may provide valuable insights into the unconventional institutional option of putting in place a government agency in charge of designing regulatory reforms and coordinating the implementation of such reforms. Russia's Agency for Strategic Initiatives (ASI) was established in 2011 and in a limited time proved to be quite effective in advancing an ambitious multi-sector reform program to improve Russia's investment climate. The agency was set up on the basis of specific administrative arrangements and charter, and enjoyed strong political support from the very top of Russia's administration. This made ASI a very special developmental agency with respect to Russia's institutional traditions.

Unfortunately, given the ongoing Ukrainian political crisis and the Russian government's new priorities in reaction to the deterioration in the external economic environment, we hold little hope that the government's earlier efforts to improve the business environment and attract private investment will be sustained. The events in Ukraine have triggered a fundamental shift in Russia's developmental path that is likely to make ASI's programs in support of deregulation, discussed in this paper, largely irrelevant. The subject of this paper, therefore, is mostly of historical interest. Still, we believe the practical experience accumulated by ASI remains highly relevant to the broader discussion of workable institutional solutions to promote deregulation in the context of a middle-income economy.

The structure of the rest of this paper is as follows. In the following section, we briefly summarize the international experience with specialized government agencies responsible for implementing the "cross-cutting" deregulation agenda. We next present an analytical framework (good practice principles) for assessing the quality of core organizational principles (institutional set-up) for establishing such an agency. In section 4, we discuss the post-2009 conditions that

motivated the Russian government to seek improvements in the business climate. Section 5 summarizes the results achieved by ASI from 2011 to 2013. Section 6 compares ASI's set-up against the principles of good practice identified earlier in the paper. The concluding section offers six take-away lessons from the ASI experience for policy planners in middle-income countries.

## 2. Experiences of other national agencies leading government deregulation initiatives

Experiences of establishing and operating national institutions to lead government deregulation initiatives have been well summarized by the World Bank and OECD (World Bank, 2010; OECD, 2010, 2012). These analyses reveal two salient features of successful agencies. First, deregulation is a fully independent government function, distinct from other functions of public administration. Second, it must be implemented in concert by a number of government institutions all sharing the same vision about the path forward. In view of the variety of tasks and a multitude of participants in the deregulation processes, it is expedient to have a specialized government agency responsible for overall progress with regulatory reform. Timely establishment of such an agency on the basis of special national law is also often part of successful reforms to improve the investment climate (Kikeri et al., 2007).

Such specialized agencies are usually created at the heart of the government, either directly under the office of the prime minister or within the structure of the ministries of finance and economy. They are also typically endowed with considerable operational autonomy. Primary functions include preparation of national plans for regulatory reform, regular adjustment of priorities and specific targets within such plans, drafting rules and instructions for government institutions, monitoring the implementation, and providing technical support to line agencies in implementation of their own plans.

These agencies also have a powerful oversight mandate, i.e. administrative resources for organizing effective promotion and monitoring of the pace of reform in the area that fall under jurisdiction of individual line agencies (OECD, 2012). This often includes identification and dissemination of best regulatory reform practices to make sure others know what to do. In other words, such agencies do not promulgate new regulations or makes amendments to existing regulations, but instead organize, coordinate, and provide direction for others.

OECD countries known for the high quality of their governance institutions are most often cited as examples of good practices in establishing and operating a national deregulation agency. Heading the list are the Office of Best Practice Regulation (OBPR) at the Ministry of Finance of Australia, the Better Regulation Unit in Ireland functioning as part of the Prime Minister's Office, and the Regulatory Reform Office in South Korea located within the Prime Minister's Office (OECD, 2010; OBRP, 2012, World Bank, 2010). However, in economies with weak institutions, particularly in the developing world, similar successful examples are rare. Mexico may come closest in this respect (see box below). It is worth noting that it took Mexico over a decade to evolve its current agency, the Federal Commission for Better Regulation (Cofemer).

### **The evolution of institutional deregulation in Mexico**

*Institutional deregulation formally began in 1988 with the president of Mexico's appointment of a "deregulation czar." This czar reported monthly to the president and his economic council of ministers. In principle, every business in Mexico, large or small, had equal access to the czar's office to complain about burdensome rules and regulations. When the office received a complaint, it was obliged to find out why the rule existed, how it interacted with other regulations, and whether it should continue in effect. The office operated under a strict deadline. If it failed to act to maintain, revise, or abolish a disputed rule within forty-five days, the rule was annulled automatically.*

*The first four year's work of the deregulation czar is widely credited with accelerating Mexico's reforms. It provided struggling private businesspeople with a responsive champion at the highest level of government. The factors behind this success included:*

- *unequivocal presidential support;*
- *czar decisions could only be overruled at the highest level of government;*
- *setting of tough penalties for officials who failed to implement the rulings; and*
- *a requirement that quick and visible results were achieved by a deadline.*

*To establish credibility with officials and the public, the czar had to give fair hearings to the powerless and the influential alike, as well as set a consistent record of impartiality.*

*In 1989, the government of Mexico added a small Deregulation Unit (UDE) under the influential Ministry of Trade. The UDE was directly accountable to the minister. In light of UDE achievements and increased demand for reform from businesses, a powerful advisory council was set up in 1995 at the UDE that included well-known private sector representatives. The role of the council included giving advice to the UDE on deregulation priorities and helping it monitor the work of federal agencies in revising regulations. On the whole, the council provided the UDE with political backing and helped it set more ambitious goals.*

*In 2000, UDE was transformed into an autonomous agency, the Federal Commission for Better Regulation (Cofemer), functioning on the basis of special amendments to the Federal Administrative Procedures Law. This transformation has strengthened the independent status of the organization, as well as extended its sphere of responsibility and the scale of its activities.*

Sources: Salas and Kikeri, 2005; World Development Report, 1997, p.73; Kuznetsov, 2002.



In its appraisal of the World Bank's efforts to support investment climate reforms worldwide, the Independent Evaluation Group (IEG) found institutional arrangements for carrying out reforms in the business environment were country-specific and that knowledge about good practices in institutional design or the dynamic process of changing institutions was spotty at best. In other words, institutional designs must be tailored for each country; they cannot simply be transferred from one country to another (World Bank, 2006).

Thus, the institutional solutions to promote deregulation that were successful in Ireland and Australia may not be readily applied to a weaker institutional environment with entrenched vested interests working to preserve existing rent-sharing arrangements. Such interests may even sabotage or block altogether attempts at creating a new powerful agency or government commission to deal with outdated regulations (as a ultimate source of rents). The problem is similar to creation of an anti-corruption government body; institutional deficiencies and weakness of local social capital prevent developing countries most affected by corruption from setting up anti-corruption agencies with teeth.

In Russia, for instance, we have seen frequent criminal violations of ownership rights (raider attacks) backed-up by officers of the country's law enforcement agencies (Firestone, 2010; Gans-Morse, 2012; Yakovlev, 2012). Any significant improvement in the business environment cannot be achieved, therefore, without tackling the broader governance issues related to public oversight and reform of the country's security apparatus, which requires massive political support at the very top of the government.

While there are considerable internal institutional and political economy constraints to launch successful reforms of the business environment in low- and middle-income economies, these local constraints have been addressed in recent years through partial externalization of the problem of administrative barriers. This approach draws on global indicators of the investment climate quality that may provide an "objective" measure of cross-country variation in severity of administrative barriers to doing business. This information is leverage to put pressure on poorly performing governments in order to shift the internal balance of interests in favor of pro-reform groups in individual economies. The World Bank's annually published Doing Business Index is an example of this approach (Doing Business, 2013).<sup>2</sup> Rather than emphasize creating new national institutions to promote the process of deregulation, the reform agency uses indices to benchmark reform outcomes in various practical areas such as business registration, electrical hook-ups, licensing, and paying taxes.

Doing Business (DB) and similar indices have always been controversial. They have been criticized for excessively simplified approaches to measurement of regulatory quality, inadequate reflection of national differences in economic organization (and related differences in regulatory requirements), and lack of opportunities to verify respondent claims. The rankings generated through this approach are often seen as overly formalistic, disconnected from the actual challenges businesses face daily, and prone to manipulation by national governments.

Two former Soviet countries highlight DB drawbacks. Belarus, which is regularly mentioned as an over-achiever in manipulating the DB methodology, climbed the DB rankings from 127<sup>th</sup> place in 2007 to 63<sup>rd</sup> place in 2014. Among the DB components showing marked improvement were *ease of starting a business*, *dealing with construction permits*, and *registering property*. By DB measures, the investment climate in Belarus is significantly better than in China, which ranked

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<sup>2</sup> The Doing Business (DB) Index measures and analyzes regulations that apply to small and medium size local businesses in 185 economies. The report is based on ten indicators and updated annually. These indicators reflect regulations affecting local businesses throughout their lifecycle and capture some idea of obstacles faced in dealing with start-up regulations, court systems, trading across borders, and paying taxes. DB focuses on the *de jure* (formal compliance with the law) aspects of the business environment.

only 96<sup>th</sup> in the *Doing Business 2014* survey). This is particularly remarkable in light of the fact there is no evidence that the overall intensity of state control over Belarus' economy, a fundamental feature of the country's economic system, has declined significantly over the last decade.

Our second example is Georgia, a country that pushed over the past decade for radical deregulation of its economic system and a sharp reduction of state control in the economy. These reform efforts have produced highly ambiguous results that remain the subject of heated debate. On the one hand, some observers emphasize significant positive effects of the reforms, especially in terms of DB measures for *reducing corruption, trade liberalization, streamlining tax administration, and easing barriers for establishing a new business* (World Bank, 2012). Indeed, the World Bank recognized Georgia as the absolute global leader in investment climate improvement over the period of 2005–2010. Some independent researchers, however, believe that Georgia's progress toward deregulation has been much less substantial. They further claim that the formal state regulation and the associated large-scale corruption were to some extent replaced in Georgia by informal and arbitrary interference by senior government officials operating outside the regulatory framework (Timm, 2013). Simultaneously, there has been strengthening of various local monopolies and growth in influence of individual large business owners in the absence of effective regulation. Not surprisingly, the World Economic Forum (WEF) ranks Georgia quite low in its global rankings for protection of property rights (131<sup>st</sup>) and development of competitive markets (127<sup>th</sup>). Corruption in the country has adapted, taking on new, subtle forms and concentrating at the level of the economic and political elite (Papava, 2013). Such subtle forms of investment climate distortion are difficult to measure using DB indicators.

In the end, the critics of the DB methodology became too vocal to be ignored, especially as they were backed up by the governments of several major developing countries, including China and India. India's Ministry of Finance, for example, complained that the DB methodology is insufficiently robust and reflects very narrow set of issues.<sup>3</sup>

In response to this criticism, the President of the World Bank appointed an independent panel of experts to conduct a review of the Doing Business methodology. In their assessment, "Independent Panel Review of the Doing Business Report (World Bank, 2013), the panel recommends adjustments to the DB methodology and advises against future publication of a consolidated (aggregate) ranking of countries. It further warns that the DB report is not a reliable guide in designing broad government strategies for improving the investment climate.

The panel's conclusions, at least in our view, provide additional rationale for analysis of actual practices in regulatory reforms, particularly the ways governments structure reform strategies and select institutional arrangements to support strategy implementation.

### 3. Analytical framework: Characteristics of a sustainable deregulation regime

Proponents of modern industrial policy (Rodrik, 2004, 2007; Sabel, 2006) assert that efficient industrial policy has little to do with direct state financial support to the private sector. Good policy focuses instead on ensuring strategic cooperation between public and private sector entities for the purpose of joint identification of significant barriers to economic development and joint elaboration of measures to reduce these barriers. An important characteristic of contemporary industrial policy is its horizontal nature. The emphasis is on coordination of interests and actions among equal

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<sup>3</sup> Narayan Lakshman. India disputes World Bank business ranking methodology. *The Hindu*, March 22, 2013

partners (as opposed to relations of subordination in “vertically” organized management hierarchies).

Pragmatic rules and mechanisms for interaction between participants are needed to encourage collective learning of representatives of the public and private sectors, i.e. learning to learn. A general list of principles for establishing public-private partnership mechanisms for addressing core industrial policy challenges are presented in Table 1.

**Table 1.** General principles for establishing public-private partnership mechanisms to support industrial policy objectives

<b>Principle</b>	<b>Characteristic</b>
Top-level political backing	The presence of a political leader ready to invest personal political capital in implementing program objectives creates added incentive for participants to invest their own resources in the process.
Informational openness (transparency)	High level of openness on interaction mechanisms, especially with respect to the resources used by program participants, program goals, and benefits they expect to receive as a result of their involvement.
Agency with enforcement powers	Existence of a government agency with a mandate to monitor and enforce decisions jointly adopted by several agencies.
Internal competition	Encouraging competition among individual project groups seeking to promote their own solutions within the program framework, while at the same time ready to share their experiences and expertise with other groups.
Transparency of participation	Existence of clear criteria for selection of the program participants and specific tasks they are expected to carry out as part of the joint effort.
Coherent monitoring framework	Existence of a coherent set of benchmarks for monitoring the participants' progress.
Encouraging pilot programs	Active use of local pilot programs and experiments as part of the collective learning process. Use of pilot programs also for mid-course adjustments, identification of the best practices, and scale-ups.
Efficient communication	Establishing efficient and open communication channels among participants, including special platforms for discussion and coordination of implementation efforts.
PR support	Intensive information support of the program aimed at forming “expectations of improvement”

Sources: Based on Rodrik, 2004, 2007; Sabel, 2006.

The characteristics of frameworks for improving the investment climate in low- and middle-income countries, including Russia, share many similarities with the tasks addressed under “new industrial policy” paradigm. Such similarities reflect the fact that administrative barriers are among the biggest constraints to economic growth in these settings. Establishing an efficient and sustainable mechanism for interaction between the government and business community along the lines presented in Table 1 is required to overcome this kind of constraints.

We suggest the listed principles deserve consideration in creating a guiding framework to assess actual institutional arrangements used by various governments to support implementation of their deregulation strategies.

## 4. Motivating factors for improving the investment climate in post-crisis Russia

The 2008–2009 financial crisis resulted in considerable adjustments to Russian government policies. The top political leadership recognized that sustainable economic growth was impossible without improvements in the investment climate, which, in turn, required better policy engagement with the business community. In the wake of the crisis, the government initiated “second generation” policy reforms aimed at lowering administrative barriers and advancing economic deregulation.<sup>4</sup>

The first signs that the government was committed to a new policy direction came as an amendment to the Criminal and Criminal Procedure Codes in 2009 preventing illegal criminal persecution of businessmen and the launch of the Regulatory Impact Assessment (RIA) mechanism in 2010. The new RIA procedures envisaged an obligatory public deliberation with representatives of the business community of all new draft economic regulations with the aim of reducing the business costs of new initiatives (Karapetov et al., 2012).

Two factors strengthened the impact of these policies in 2011–2012. First, the slowdown in Russia’s economic growth after the global financial crisis added to pressures to move ahead with deregulation. Second, the approach of parliamentary and presidential elections influenced the economic policy discussion. To expand the social base of the ruling coalition, Russia’s top political elite began to push for establishment of new organizations to integrate the interests of broader social groups and incorporate representatives of these groups into its decision-making processes. One product of this was the Agency for Strategic Initiatives (ASI).

Mass-scale protests after Russia’s parliamentary elections in late 2011, and the risk that the business community might side with the protesters, led to further extension of the policy agenda. Measures included adoption of a “National Business Initiative for Improvement of Investment Climate,” expansion in the sphere of application of RIA procedures, and establishment of an ombudsman for entrepreneurs’ rights. These innovations were introduced during Vladimir Putin’s presidential campaign during January-February 2012. Another initiative in this policy area has been the “Open Government” initiative launched in autumn 2011 by then-president Dmitry Medvedev. The Open Government project declared the goals of enhancing transparency in the work of executive authorities, improving interaction between the government and civil society, and raising the efficiency of public administration through such interaction (<http://open.gov.ru>)

The initiatives called for a more intense dialogue between the government and medium-sized businesses. Medium-sized businesses were singled out because they suffer considerably from the poor investment climate and are potentially important engines of economic growth (Vinkov et al., 2008; Yakovlev et al., 2010; Yasin et al., 2013).

The government’s embrace of business issues coincided with the changes inside the business community. Against a background of increased uncertainty and declining profitability, high costs of doing business in Russia started to be perceived as a major constraint that could be tackled only through the collective action of entrepreneurs. This caused a noticeable boost in activity of the leading business associations, above all, *Delovaya Rossiya* (Business Russia), which represents the

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<sup>4</sup> The first generation of such reforms in the early 2000s is usually associated with the elaboration and implementation of the Russian Development Strategy up to 2010 (commonly known as the “Gref Program”). During that period, the government implemented a radical tax reform that provided business with incentives to bring them out of the shadows and enhanced revenue performance (Batkibekov et al., 2003; Jones Luong & Weinthal, 2004). The government also attempted to reduce administrative barriers to the business development, including scaling down licensing requirements and simplifying the process of registering a business (Auzan and Kryuchkova, 2001; CEFIR, 2005).

interests of successful mid-sized companies in Russia. Collective action of Russian entrepreneurs led to the creation in 2011 of the Centre of Public Procedures “Business against Corruption” (CPP “BAC”, <http://www.nocorruption.biz/>).

Based on its initial track record, ASI appears to be the most successful of these institutional innovations to facilitating government-business interaction. What distinguishes ASI from other second-generation initiatives are its use of a project-management approach with clear objectives and direct access of its executives to government leaders.

## 5. ASI activities and outcomes over the 2011–2013 period

ASI was established in the summer of 2011 after a series of meetings between president Putin and entrepreneurs. These meetings highlighted the substantial barriers to implementation of business initiatives and the low enthusiasm within the government bureaucracy for removing such barriers. ASI was initially created to help young representatives of medium-sized business enter the policy arena. It was to become a tool of government interaction with a politically promising section of the population with interests and agendas that differed significantly from those of Russia's large enterprises and lobbying organizations that had their roots in the privatization deals of the 1990s. ASI's support for individual business projects aimed at lowering administrative barriers to project implementation rather than at preferential access to cheap financing for project sponsors.

ASI's mission emphasizes strategic dialogue with the private sector and the coordination of interests within the public sector. Unlike other development institutions such as Vnesheconombank (VEB, Bank for Development and Economic Affairs) or the Rusnano Corporation (nanotech promoter), ASI does not get involved in allocation of budget funds or lobby for special investor treatment.

ASI is an autonomous non-profit organization, established by the federal government. President Putin heads the ASI Supervisory Board. Under its charter, ASI goals include:

- Promotion of projects sponsored by fast growing medium-sized businesses and projects in the social sphere;
- Increasing the representation of new leaders from medium-sized business and the social sector;
- Improving Russia's business climate; and
- Dissemination of best business practices.

ASI was provided with considerable public resources for pursuing these goals, which enabled it to recruit qualified experts with business experience. Its professional staffing level exceeds 100 at the moment. International consulting firms, including Boston Consulting Group, have been involved in ASI projects.

ASI from the start has sought to promote specific projects put forth by individual entrepreneurs. Even today, most of ASI's daily activities and resources go to supporting projects.

The ASI 2013 Annual Report (2014) shows businesses submitted 538 project proposals to the agency. Of those, the ASI Expert Board selected 53 projects to receive ASI support. ASI provides three types of support to projects: *administrative* (overcoming administrative barriers through coordination with specific line agencies), *methodological* (access to additional professional expertise), and *informational* (PR support).

In approximately 10 percent of selected projects, ASI encounters situations where the problems faced by the particular business are emblematic for a much broader swath of potential

investment projects. Such cases are categorized as “systemic” and brought to the Supervisory Board for discussion. If political support for policy changes is found, the board can move ahead with specific senior-level administrative decisions and task assignments for relevant government agencies.

Starting in 2012, ASI assumed a new mission that refocused a considerable portion of its efforts on implementation of the “100 Steps” Program to improve the economy-wide business climate and elevate Russia’s position in the World Bank’s Doing Business rankings from 120<sup>th</sup> place to 20<sup>th</sup> place by 2018. Within the 100 Steps context, ASI, in collaboration with Russia’s leading business associations, launched the National Business Initiative and developed roadmaps to removing major administrative barriers in dealing with construction permits, obtaining electricity connections, improving customs administration, etc. Once the ASI Supervisory Board adopts a particular policy roadmap and the government approves it, the roadmap becomes effective and the involved line agencies are expected to follow or implement it.<sup>5</sup> By the beginning of 2014, the Russian government had approved eleven roadmaps (<https://инвестклимат.рф/nei/>).

Use of a roadmap tool in policy development was novel for Russia. Drawing upon the experience of the Malaysian Deregulation Commission in application of the roadmap tool (Tan, 2013), ASI identified roadmap priorities and specific targets through intensive consultation process with the business community. Several thousand business people engaged in consultations through crowdsourcing. ASI also involved about 40 federal ministries and agencies in the development of roadmaps and implementation of its other core initiatives (ASI, 2013).

The emphasis on production of various roadmaps, each comprising the set of specific reform targets that are made quite familiar to business groups, distinguishes ASI’s approach from other entities created in Russia since the start of the first wave of reforms in 2000, including the decisions regarding rationalization of government control and supervisory activities. Three innovations of ASI largely explain this difference:

*Enhanced monitoring of implementation.* All ASI roadmaps include sets of interim indicators and targets to allow effective assessment of implementation of the agreed reform programs.

*Feedback from the business community.* The roadmaps provide for active business participation (through both sectoral and regional working groups established by the ASI) in program monitoring. Russia has traditionally limited the involvement of business to the program development stage (e.g. in the work of the governmental Commission for Administrative Reform in 2009–2010). The monitoring function has always been reserved to government officials.

*Political support at the top.* ASI has gained added leverage over other government agencies through the support of influential presidential aide Andrey Belousov, one of ASI’s original sponsors. Belousov assists ASI on a daily basis in advancing the implementation of agreed roadmap decisions.

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<sup>5</sup> Close scrutiny of ASI’s activities suggests that even ready access to the top political leadership is not enough to fully overcome bureaucratic inertia. Under current regulations, even if the ASI Supervisory Board approves a policy roadmap, it is the relevant line agency that presents the finalized roadmap document to the government for adoption. This gives the line agency considerable influence over content and pace of document advancement. For example, ASI’s tax administration reform roadmap proposal was accepted in November 2012 (see <http://www.asi.ru/upload/iblock/99d/pres-asi14-11-2012.pdf>), but inter-agency finalization and clearance took another year. The relevant government resolution was passed in February 2014.



ASI has also implemented a pilot regional project. The Operational Standard is a set of monitoring indicators for regional executive authorities of the Russian Federation. The project seeks to mainstream activities that support improvement in the investment climate at the regional level. Delovaya Rossiya prepared the initial draft of the Operational Standard with a view to highlighting the best regional practices in promoting and interacting with private investors. In September 2012, Operational Standard indicators were adopted under a presidential decree as an integral part of the broader evaluation system for Russia's regional governors.<sup>6</sup> In May 2014, president Putin introduced a national rating that uses the same evaluation principles and ranks the investment environment for Russian regions. He declared the rating system “a tool for real change.”<sup>7</sup>

The first interim results of roadmap implementation were summed up at the end of 2013 at the meeting of the Economic Council under the Russian President.<sup>8</sup> Indeed, over the first two years of program, Russia improved its standing in the global Doing Business rankings, moving from 120<sup>th</sup> to the 92<sup>nd</sup> place in the overall rankings.

One reason why ASI has succeeded in making headway in addressing problems that have earlier confounded line agencies is that the innovation activities of federal ministries (including the Ministry of Economic Development that holds a formal mandate for improvements of the business climate) are restricted by the existing (formal and informal) rules of inter-agency coordination. Under these rules, inter-agency policy issues can only be discussed officially at the level of department director or deputy minister.

Launching the process of approvals in such a coordination model has been quite difficult and unattractive to middle-rank officials. Moreover, the need to coordinate approvals arises typically either by a direct order from the senior leadership or when a particular middle-rank official is personally interested in promoting a solution to the problem in question. Thus, the interests of certain companies lobbying for resolution of a particular policy matter often enter into the picture. Within this administrative context and incentive structure, a reform agenda related to improvements in the investment climate has been traditionally left on the fringe of activity of government agencies – a benign business climate is a public good that benefits everyone. Free-riders by definition have little interest in bearing political or administrative costs associated with such a public good. Indeed, no rational business organization or government agency alone can be expected to devote a significant share of its resources in promoting broad-based investment climate reforms while others get the benefits for free.

Moreover, compared to many economic policy issues, the improvement of the investment climate is a complex task with no guaranteed political outcome. The individual agency thus has little motivation for making a serious push in this direction. Bureaucratic transaction costs represent an extra barrier for reform, further undermining the possibilities for meaningful policy dialogue across government.

ASI is not formally embedded into Russia's bureaucratic hierarchy like line government agencies. However, owing to its direct access to the president, the agency enjoys fairly high administrative status. ASI representatives can directly communicate with officials responsible for specific policy matters, bypassing bureaucratic subordination.<sup>9</sup> As ASI has no administrative powers or regulatory functions of its own, it lacks its own agency-specific interests with respect to

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<sup>6</sup> RF Presidential Decree No. 1276 of September 10, 2012.

<sup>7</sup> Kathrin Hille. “Putin backs moves to improve Russia's investment climate.” *Financial Times*, May 29, 2014

<sup>8</sup> <http://www.kremlin.ru/news/19785> (in Russian), preview of discussion <http://eng.kremlin.ru/accreditation/6365>

<sup>9</sup> It was mentioned in one interview that it is quite common for working meetings at ASI to have a “mixed” participation level – a deputy minister from one agency and a department head or a chief expert from another ministry. This is highly unusual for Russia's bureaucratic traditions.

the proposed reform options. This provides ASI with the opportunity to play the role of independent broker in agency interactions.

The parallel development of roadmaps and regional standards constitute a sort of comprehensive deregulation approach, implemented simultaneously at the federal and regional levels. Notably, the shift in ASI focus from the project agency to coordinator of national efforts to improve the investment climate is reminiscent of the role evolutions seen in the highly successful national development agencies such as IDA in Ireland and CINDE in Costa Rica (Monge-González and Tacsir, 2014). Though intense dialogue with investors (particularly, large foreign investors), these agencies formulate requirements for improvements in the national legal and regulatory framework, as well as in other key characteristics of investment climate (e.g. quality of infrastructure and adequacy of labor skills in key sectors). They also organize monitoring of the government programs tasked with implementing changes. Such agencies become leading players in national industrial policy by directly addressing what Rodrik calls the “coordination problem” in removing the bottlenecks in emerging industrial value chains (Rodrik, 2004).

## 6. Assessment of the ASI model against recommended principles of good practice

We consider ASI’s current business model to be largely in line with the recommended principles of good practice. This is evidenced in the following aspects of ASI operations:

*Well-structured and effective dialogue with the private sector.* This was established first through building a productive relationship with the independent non-profit organization *Delovaya Rossiya* (Business Russia) and then all of Russia’s leading business associations.

*Rational organizational set-up.* ASI was formed as an autonomous agency with a powerful Supervisory Board made up of representatives of business, non-government sectors, and political leaders. The board tracks implementation of its decisions and imposes penalties on agencies that fail to comply with the agreed action plans.

*Senior managers have direct access to the president and other senior government officials.*  
*Mandate to conduct reforms at both federal and regional levels.*

*Specifically formulated objectives and clearly defined monitoring system.* Roadmaps contain lists of specific targets for lowering administrative barriers to business. These targets are quantifiable and can be verified with private-sector stakeholders.

*New system for evaluating the performance of federal executive authorities.* ASI has developed a system based on monitoring key performance indicators (KPIs).

*New system for evaluating performance of regional governors in business climate improvement.*

*Advanced PR capabilities.* ASI works with the media in dissemination of regulatory reform stories to enhance the public’s confidence in government policies that support entrepreneurship and business climate improvement. For example, ASI arranges regular conferences with the newspaper *Vedomosti*.



*Personnel profile unlike other Russian government agencies.* The core staff consists of young professionals, fluent in project management techniques, and hired predominantly from the private sector.

Certain aspects of ASI's current set-up remain inconsistent with the principles of good business practice, however.

*No statutory powers.* ASI lacks exercisable powers in the area of business deregulation beyond “developing proposals for improvement.” ASI's power thus comes from a cloaking of apparent authority from its political sponsor, rather than any codified powers.

*Principal objectives and mandate not enshrined in law.* Russia still lacks a law on improving the investment climate, so ASI operates on governmental order. Moreover, Russia has no legal provision for a regular compulsory audit of its regulatory regime that might serve as a framework for ASI's efforts at lowering administrative barriers.

*Transparency? Not so much.* ASI is quite open in disclosing the scope of its activities and implementation results. Yet, while ASI has a respectable track record of intense consultation with the business community, Russian business are still quite wary of government intentions and actual commitment to long-term improvement of the investment climate. They recall their own previous negative experiences and on-going inconsistencies in government policy, and point out that the availability of information on the sources and levels of ASI funding remain quite limited.

*Implementation of a reform monitoring system remains incomplete.* There is still no publicly accessible reporting system to track the agencies' progress in reaching their core KPIs. There is also no system of penalties for those who obviously sabotage the deregulation process. Such a system of monitoring/reporting should have been developed outside ASI (at the level of either the central government apparatus or the presidential administration) and operated under direct presidential control.

*Skill development of governmental staff.* ASI has sponsored many training events for public officials within the framework of its core “Young Professionals” program. However, ASI still has no clear mandate to support systematic professional skill development at particular agencies or in specific regions. ASI is unable to influence the composition of managerial teams at government agencies or see that staff who have embraced “best managerial practices” get promoted in regional governments. We can cite several instances when experts employed by regional ASI expert groups were promoted to posts in regional administrations, but such experiences are rare.

*Motivating ASI managers.* To the external observer, the incentive structure of ASI senior managers remains unclear and potentially could limit the effectiveness of their work. At the moment, ASI project administrators have no assurances of administrative recognition of their efforts or career opportunities opening up with excellent performance. The lack of explicit career trajectories for ASI managers risks their gradual “re-blending” back into the rest of government bureaucracy with whom they maintain daily contacts (and on whom the implementation of ASI projects largely depends).

The threatened long-term survival of ASI achievements reflects three specific vulnerabilities.

First, in the absence of formal administrative powers *ASI's capacity to influence the operations of line agencies depend primarily on its access to president Putin*. Of course, other influential administrative players also have direct access to the president. Therefore, ASI, which can operate successfully only through close cooperation with other agencies, naturally tends to avoid unnecessary tensions in relations with other influential organizations and individual officials. This generates the risk of ASI's gradual co-opting by the existing bureaucratic system.

Second, there is a risk that the *regulatory changes advanced by ASI may prove insufficient to drive change at the deeper levels of government agency conduct* of daily business and staff attitudes. Russia has yet to adopt a model where government inspectors (i.e. lower-level officials in regulatory agencies) act as business development partners and advisers to the private sector on matters of compliance with public policy requirements (Coolidge, 2006). Changing routine behavior and the prevailing motivation at lower level of bureaucracy remains one of the most complicated tasks of reform, especially in countries with deep-rooted bureaucratic traditions. One answer might be to employ a system of horizontal (cross-agency) rotation of government staff. Priority in eligibility for rotation would go to agencies that demonstrate objective improvements in the business climate through their efforts.

Third, there are *persisting risks of fragmentation and parallelism within the framework of the government's overall program for investment climate improvement*. Institutional bureaucratic competition across several new government initiatives has intensified during the past couple of years. This applies, above all, to competition between the Open Government project and ASI.<sup>10</sup> In addition, the RIA department at the Ministry of Economic Development and the Office of Commissioner for Entrepreneurs' Rights also play important roles in the government's policy of deregulation. From the point of view of traditional approaches to government organization, this enhances the risk of spreading thin already limited resources (human and political), thus complicating the identification of priorities.<sup>11</sup>

Such parallelism carries with it the possible loss of strategic focus on key weaknesses in the investment climate. Multiple organizations with overlapping mandates allow each to avoid dealing with the most complicated and politically sensitive problems (e.g. strengthening public oversight of the judiciary and law enforcement). This may lead to a reform scenario under which considerable progress in certain areas fails to generate system-wide improvements in the business environment and major bottlenecks remains intact. Thus, the purpose of business climate improvement is defeated: business sentiments stay the same and there is no overall increase in investment inflows. There is a serious risk of "activity imitation," whereby agencies appear to be doing something by regularly deciding on programs or actions, but in fact make decisions without reviewing the outcomes or results of their previous actions or established programs.<sup>12</sup>

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<sup>10</sup> The Open Government program is charged with arranging public hearings on proposed laws and regulations. This is also part of ASI's mandate with respect to changes in business regulation.

<sup>11</sup> There may also be positive consequences from bureaucratic competition, especially in Russia, where other mechanisms of social and political competition are weak or rudimentary.

<sup>12</sup> This sort of bureaucratic churn has become familiar during the past ten years in Russia with respect to industrial policy development. Preparation of new government programs and strategies has increasingly become "process oriented," i.e. going through the motions, rather than focused on tangible policy outcomes (Simachev, Kuznetsov, 2014).

## 7. Six lessons from ASI's experience applicable to middle-income countries

The Russian government's response to the Ukraine crisis has shifted Russia's long-term developmental path. This choice, made without regard to the full economic consequences, abandons earlier policy objectives of investment climate improvement and investment promotion as tendencies that frustrate Russia's path to modernity continue to arise in the post-Soviet era (Malle, 2009).

While this paper may merely be a footnote to modern Russian economic history, we believe some broader lessons of institutional design could be learned from ASI's experiences that are applicable in the broader reform context of middle-income countries.

The immediate lesson, we think, relates to the reasons for the limited traction of ASI efforts and its failure to secure a real change in perceptions of Russia's business climate. Above all, this failure relates to the inconsistency of signals from the top level of government (Yakovlev, 2014). The core limitation of Russia's policies regarding the investment climate in 2010–2013 was not due to specific features of organization and functioning of ASI and other institutions supporting reforms, but was rooted in the remaining fundamental weaknesses of the government's economic strategy. On the one hand, the very fact of creation of ASI and other deregulation institutions was a manifestation of the national leadership's concern over the state of the country's investment climate. On the other hand, the government regularly adopted incoherent decisions that derailed efforts to improve the investment climate. The dramatic payroll tax hike in 2013, for example, led to widespread closure of small businesses. Another example relates to the Federal Investigative Committee's opening of legal proceedings against experts who had conducted, on behalf of the Human Rights Council under the president, an independent assessment of the second criminal case against the owners of the Yukos oil company. In May 2013, the activities of the Investigative Committee caused Sergei Guriev, a leading Russian economist, to emigrate from Russia.

This inconsistency reflects the reality that different groups within Russia's ruling elite continue to pursue highly disparate interests. Government policies to improve the investment climate in favor of medium-sized business also risked infringing on the interests of politicians connected to the national security and law-enforcement bureaucracy (*siloviki*). This led to internal inconsistencies in the policy course, and resulted in no increased business confidence in the government's policy.

***Lesson 1: An effective implementation agency cannot bring about a major change if there are major deficiencies in the policy framework.***

A successful institutional set-up is no substitute for a policy failure. The task of improving the investment climate has to become a genuine priority for the government at-large and the policy framework must become more coherent in this respect. There needs to be better coordination and prioritization of activities of various government agencies dealing with regulatory reforms. Recent experience of ASI in Russia also provides several lessons with respect to institutional arrangements and sequencing of reforms that may be relevant to the circumstances of other middle-income countries.

***Lesson 2: An ASI-type institutional solution can work well at the start of reforms in a political environment with strong vested interests and poorly organized pro-reform groups.***

In this situation, the ASI-type strategy of building a broad and strong coalition with pro-reform business groups seems promising. ASI focused first on relatively narrow sector-level improvements, without attempting more difficult issues such as protection of property rights and large-scale corruption. The plan was always to broaden reform coverage as political support for reforms was consolidated.

***Lesson 3: Get broad-based political support.***

ASI represents an example of an institutional set-up for launching broader deregulation reforms with full recognition of local political opportunities and constraints. ASI political support comes from pro-reform business groups, political leaders at the very top of the government, and individual government officials across the administration. Political backing has allowed ASI to build partnerships across the federal government and engage with reform-minded regional administrations.

***Lesson 4: Roadmaps provide direction at all levels.***

The roadmap tool proved to be quite effective in mobilizing grass-root support for reforms, structuring the medium term sector-level reform programs around core objectives, and providing a promising format for monitoring.

***Lesson 5: Performance indicators work.***

ASI's experience shows how a well-organized process of stakeholder consultation with business groups can lead to adoption of relevant standard objectives. Even rather general monitoring frameworks based on e.g. the World Bank's Doing Business indicators can be used to generate a meaningful country-specific national reform program to reduce administrative barriers for business. In Russia, business associations representing medium-sized businesses have a longer-term interest in investment climate improvement and have accumulated sufficient capabilities to contribute to the reform process. Thus, ASI's experience has been a story of successful mobilization of middle-size business in support of regulatory policy reforms through challenging officials to meet objective benchmarks.

***Lesson 6: Be prepared for loss of reform effectiveness.***

ASI's experience suggests that the risk that institutional features will gradually lose effectiveness should be considered before the reform is launched. Solutions include the use of explicit, time-specific reform targets; incorporation of business groups in the process of reform monitoring; and building a regional reform rating to encourage cross-regional competition and peer pressure.

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