

## 13. South East Europe: opportunities and challenges for improving regulatory quality

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### INTRODUCTION<sup>1</sup>

South East European (SEE) countries,<sup>2</sup> as with other transition and developing countries, are seeking to increase levels of private investment in order to help stimulate and sustain economic growth. The quality of regulation affecting markets and business activity in general is increasingly viewed as a factor of competitiveness that influences the investment decisions of both foreign and domestic investors.

There is a significant body of work that supports the view that excessive regulations have a negative effect on private investment, international trade and growth. Bolaky and Freund (2004), Dollar and Kraay (2002), Rodrik, Subramanian and Trebbi (2004) have shown that economies with stronger institutions and in excessive labor and business regulations are more likely to realize higher rates of growth through international trade. As noted by Djankov et al. (2002), the quality of institutions and excessive regulation can have a significant negative impact on investment and levels of informality on economic transacting. While it is generally recognized that the impact of foreign direct investment (FDI) is influenced by a range of host country characteristics, Busse and Groizard (2006) have shown that governments must 'tackle the institutional setting and regulatory framework' in order to achieve the positive welfare effects of foreign direct investment (FDI) inflows.

The momentum for regulatory reform appears to be increasing in SEE as governments seek to increase the levels of private investment and growth. The OECD Investment Compact report (2004) noted that there is an increasing recognition of the importance of high-quality regulation at the national, regional and local levels in SEE countries.

\* This chapter should not be reported as representing the views of the International Finance Corporation (IFC) and/or the World Bank Group (WBG). The findings and views expressed are those of the author and should not be interpreted as those of the IFC and WBG.

The focus of these countries on possible EU integration, as well as the influence of international financial institutions (IFIs) and donors, have helped to raise these issues in the economic development agenda. Throughout the region, governments have committed to and/or embarked on some element of systemic regulatory reform aimed at improving the quality of regulations affecting business procedures. This is evident in the action plans submitted under the Investment Compact (the South East Europe Compact for Reform, Investment, Integrity and Growth) of the Stability Pact.<sup>3</sup> Bosnia and Herzegovina (BiH) is undertaking a guillotine review of business formalities and inspections regulations in the Republika Srpska; Croatia recently approved the implementation of a national guillotine review of business regulations and has conducted regulatory impact assessment (RIA) reviews of specific pieces of legislation; Bulgaria has instituted RIA on a pilot basis; Macedonia has passed a decree to establish a regulatory review function at the center of government; Moldova has implemented a Regulatory Guillotine<sup>TM4</sup> to review existing normative acts governing entrepreneurial activity and has recently passed a law<sup>5</sup> to institute RIA for new laws and normative acts and a guillotine review of laws; Serbia has established a Regulatory Reform Council and is in the process of institutionalizing RIA; and, Romania has established a regulatory governance unit at the center of government to lead the business environment regulatory reform process. The importance of strong championship for effective regulatory reform is clear, given the experience of the OECD countries. Within SEE, championship at the highest level of government is critical for effective implementation and institutionalization of a regulatory quality agenda. There is some anecdotal evidence to support the view that political support or appreciation for systemic regulatory reform as a factor of competitiveness is emerging. For example, in the recent political campaign in Macedonia, at least one party included regulatory reform and tools such as the guillotine as part of its proposed economic program. A similar 'link' is apparent in the pre-election dialog in BiH's Republika Srpska as well.

This chapter focuses on administrative regulations<sup>6</sup> affecting the start-up and operation of business, recognizing that economic and social regulations are also part of the broad regulatory framework. It provides an overview of regulatory governance in the region and looks at the recent experience of three countries – Bosnia and Herzegovina, Moldova and Serbia – that have embarked on regulatory reforms from different strategic approaches. The goal of this chapter is to examine some of the challenges faced by these countries in strengthening the quality of regulation and governance and to draw lessons of experience for other developing countries.

The chapter sets out to make the following three points:

1. While the countries in SEE may not have explicit regulatory governance systems comparable to those of the OECD countries, they have in place elements of regulatory governance systems that are part of the pre-transition legacy or that have been acquired through the reforms associated with the ongoing political and economic transition.
2. These pre-existing legislative, administrative and judicial arrangements, characterized as 'institutional endowments' by Levy and Spiller (1995), influence the design, implementation and effectiveness of regulatory frameworks in a given country.
3. Since regulatory governance encapsulates a systemic approach to improving the quality of regulation and the effectiveness of government, it is essentially a process that must be adapted to and aligned with the legal and institutional frameworks, capacities and political realities in a given country. This is important in countries with resource limitations and where there may be limited political capital to support an aggressive regulatory reform agenda.

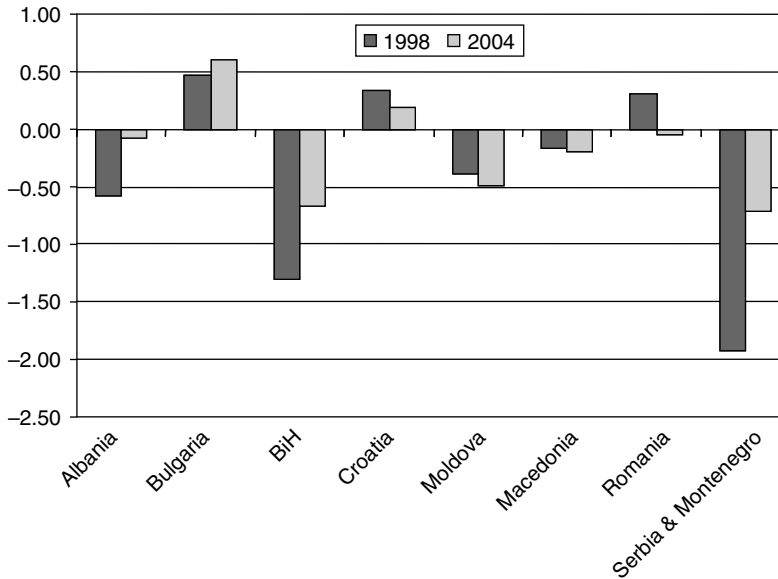
The chapter is organized in three sections. The first provides an overview of regulatory governance in SEE. This discussion draws on the findings of the OECD Regulatory Governance survey (OECD, 2004) and the 2006 Regulatory Governance survey conducted by the University of Manchester's Centre on Regulation and Competition. The second section focuses on the experience of three SEE countries – Bosnia and Herzegovina, Moldova and Serbia. The third section attempts to draw lessons of experience for other developing and transition economies.

## OVERVIEW – REGULATORY GOVERNANCE IN SEE

At the center of the New Public Management (NPM) approach to effective and efficient government in the regulatory state, the concept of regulatory governance moves beyond the narrow objectives of deregulation and slimming the state to emphasize democratic governance factors such as openness, participation, accountability, effectiveness and coherence in the development and implementation of policy. It encompasses the role of government and the interplay of regulatory actors at the legislative, judicial and sub-national levels of the state. This concept is based on two pillars (OECD, 2002):

1. an effective regulatory management system – including the processes and institutions, through which regulations are developed, enforced and adjudicated;

## Regulatory impact assessment



Source: World Bank, Aggregate Governance Indicators 1996–2004.

Figure 13.1 SEE regulatory quality

2. good governance through efficient, transparent and accountable policies and institutions to protect consumers and to achieve sustainable development as well as social and environmental goals.

Within this context, regulatory quality is a defining measure of government effectiveness on the national and sub-national levels. The 2005 OECD *Guiding Principles for Regulatory Quality and Performance* emphasizes the importance of ‘a coherent, whole-of-government approach to create a regulatory environment favorable to the creation and growth of firms, productivity gains, competition, investment and international trade’.

It is recognized that the SEE transition economies have a long way to go given their relatively weak institutions and limited capacities. However, some improvement in regulatory quality is evident (see Figure 13.1) based on the first order reforms (Williamson, 2000),<sup>7</sup> institutional strengthening and administrative simplification associated with the transition to market economies. Moreover, the increased levels of FDI and economic growth for most countries in the region (see Figures 13.2 and 13.3) may be attributed to a range of factors including regulatory quality. According to the World Bank (2002), investment flows are likely to be higher for countries with

South East Europe

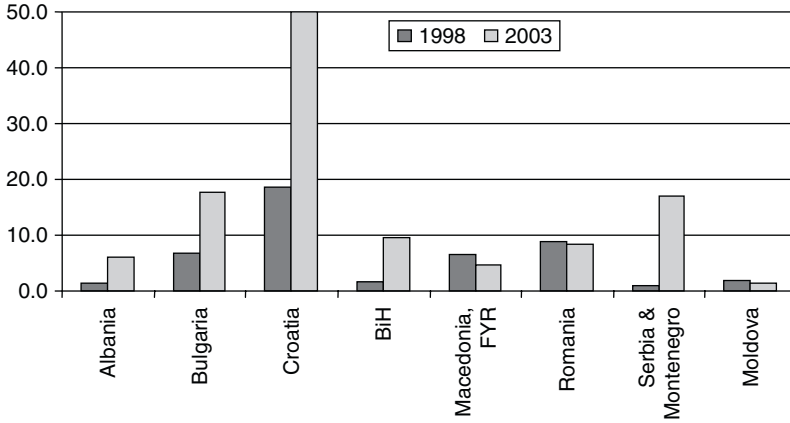


Figure 13.2 SEE per capita FDI inflows (USD '1000)

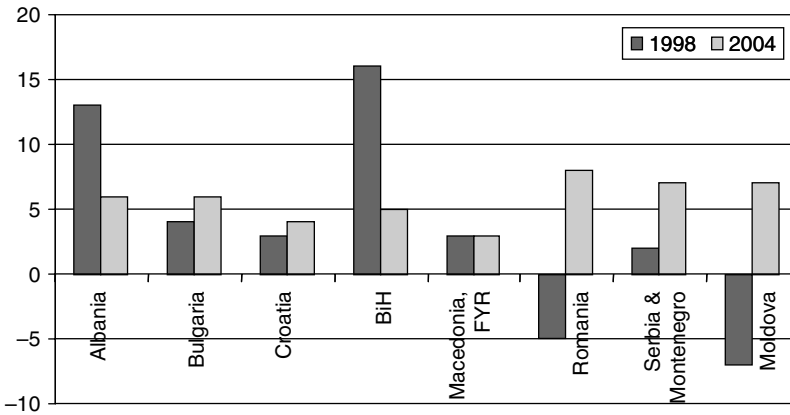


Figure 13.3 SEE annual GDP growth (%)

better domestic investment climates, that is, countries with good governance, sound institutions and property rights. The fundamental challenge faced by the SEE countries is deepening reforms in order to generate sustainable growth.

In 2004, the OECD published a comprehensive review of regulatory governance in SEE (OECD, 2004). Drawing on the experience of OECD countries and the OECD Recommendations on Regulatory Quality, this report identified three mutually reinforcing elements of a regulatory governance framework:

1. An explicit policy for systematically improving the quality of regulation and efficiently employing the regulatory authority of the state. This policy should be adopted at the highest level of government.
2. An established capacity or 'oversight body' for leading and implementing the regulatory governance agenda, preferably at the center of government.
3. A strategy for enforcing and implementing the policy. Various tools are available for implementation, including regulatory impact assessment (RIA) and consultation.

While none of the SEE countries has in place all of the three elements of a regulatory governance framework (as defined above), many have instituted different aspects of these elements, as shown in Table 13.1.<sup>8</sup>

With the exception of Serbia, no country has an explicit, overarching policy for ensuring the quality of regulation. In October 2004, Serbia adopted amendments to the Rules of Operation of the Government requiring regulatory impact assessments for new laws and subordinate regulations and established the Council for Regulatory Reform as a starting point for the development of a regulatory reform strategy. Macedonia, Moldova, and Romania have launched initiatives aimed at introducing systematic, ex ante reviews of laws and regulations. In addition, most countries in the region have undertaken ex post reviews of laws and regulations, building on previous administrative simplification reforms of business start-up and operation procedures (e.g., business registration, licensing and permits, inspections, taxation administration, customs and labor regulations).<sup>9</sup>

As noted by the OECD (2004), a central dimension of good regulatory governance is the existence of systematic and mandatory 'checks and balances' to rule-making powers. All SEE countries have established laws and procedures governing the rule-making process and institutions at the center of government that have the responsibility for reviewing proposed laws (see Table 13.1). In Romania and the former Yugoslav Republics, this responsibility rests with legislative councils or secretariats, while in Albania, Bulgaria and Moldova, the Ministry of Justice carries out this function. The authority of these institutions to challenge and comment on the substance of laws or regulations varies and generally the scope of their review is limited to the form, legal quality, constitutionality and conformity with international treaties.

In all SEE countries, at least one institution has this central review function and most have instituted supplemental budgetary and EU compliance reviews, with varying levels of rigor and formality. Each country requires an assessment of the fiscal impact of proposed laws within the context of broader public administration and fiscal reforms. Increasingly, requirements for monitoring the approximation of draft laws with European Union stand-

ards are being introduced. Bosnia and Herzegovina, Bulgaria, Croatia and Macedonia have instituted measures to promote EU approximation. In addition, assessments for the potential impact on business activity are being introduced on various levels. Moldova's Ministry of Economy is tasked with assessing draft laws for their potential impact on business and the Regulatory Reform Council plays a similar role in Serbia, while public-private councils in Albania and Montenegro have been charged with providing opinions on the potential business impact of draft laws.

In terms of the tools for implementation, the strategies and application vary quite widely across countries in SEE. As shown in Table 13.1, most countries have basic *ex ante* regulatory transparency mechanisms for forward planning of laws, notice and comment periods and active consultation. These mechanisms are generally quite weak, with the notable exceptions being Bulgaria's formal system for forward planning and coordination and Romania's robust consultation mechanism that has been formalized under the Sunshine Law<sup>10</sup> and in which private sector bodies (e.g., the Strategic Alliance of Business Associations, the Chamber of Commerce and Industry of Romania) and the Social Dialogue Commissions play an active role in policy dialogs and in providing comments on major legislation. Throughout the SEE, there is a growing network of business advisory councils, business task forces and working groups associated with administrative simplification and business climate reform initiatives (e.g., Albania, Bosnia and Herzegovina, Croatia, Macedonia), foreign investor councils and chambers (e.g., Croatia, Serbia), competitiveness councils (e.g., Croatia, Macedonia, Serbia) and other private sector organizations that can play a critical role in promoting transparent and vigorous consultation in high-quality fora.

In 2004, the OECD concluded that SEE experience in the application of RIA as a tool for systematically assessing the impact of policies and regulations is relatively modest. Since then, there has been an increased momentum and focus on the *ex ante* and *ex post* application of impact assessment in the region.

In terms of *ex ante* assessments, Serbia is the most advanced in the region, with the introduction of mandatory RIA for legislation proposed by the government. Although the implementation of this requirement has been hampered by limited resources, RIAs are being selectively conducted by the Council for Regulatory Reform (Marušić, Milovanović and Penev, 2006). In the cases of Bulgaria and Moldova,<sup>11</sup> although there are requirements for mandatory RIA for primary and secondary legislation, this tool is not being applied systematically. Croatia has completed pilot RIA exercises and is currently applying the RIA to assess the potential impact of selected draft laws.

There is increasing momentum for the application of *ex post* application of the RIA methodology for guillotine reviews. In 2005, Moldova carried

Table 13.1 Regulatory governance frameworks in SEE countries

	Policy		Oversight Body			Strategy and Tools Indicators*						
	Explicit policy	Legal controls	Budget controls	Other controls	Forward planning	Notice and comments	Active consultation	Better access	Silence is consent	Licenses elimination	RIA	Inspection reform
Albania	No	Ministry of Justice	Ministry of Finance		NA	NA	1	3	1	1	1	
BiH	No	Legislative Secretariat	Economic Secretariat – EU Directorate		2	1	2	2	1	2	3	3
Bulgaria	No	Ministry of Justice – Legislative Council; Council of Ministers Legal Dept.	Ministry of Finance	Ministry of European Affairs Ministry of Economy and Energy	3	1	2	2	3	2	2	2
Croatia	No	Cabinet Office for Legislation	Ministry of Finance	Ministry of European Integration	2	1	2	3	NA	3	2	3
Rep. of Macedonia	No	Legislative Secretariat	Ministry of Finance	Ministry of European Integration	2	2	1	3	1	3	1	2
Moldova	No	Ministry of Justice	Ministry of Finance	Ministry of Economy	2	1	2	2	2	3	2	1

Romania	No	Legislative Council	2	2	4	2	3	2	2
		Ministry of Public Finance and Court of Auditors							
Montenegro	No	Legislative Secretariat	2	2	2	2	2	2	2
Serbia	Yes	Office of Legal Service; PM's Office; Legislative Secretariat	2	1	3	3	NA	3	2
		Council for Economic Regulation Reform							

*Note:* \* Base scale and rating developed by Cesar Cordova-Novion based on responses to the 2004 OECD review and supplementary information. Updated by author in 2006 based on the University of Manchester's 2006 Regulatory Governance survey and supplementary information. Scale of 1 to 5: 5 indicates performance comparable to OECD good practice.

*Source:* OECD (2004); 2006 Regulatory Governance survey, University of Manchester. Centre on Regulation and Competition.

out an extensive guillotine review of close to 1000 normative acts and, in July 2006, passed a law that established a timetable for the revision and assessment of all laws regulating business activity. In similar fashion, the Republika Srpska in Bosnia and Herzegovina is conducting a review of business formalities and inspections procedures and the Government of Croatia has approved plans to launch a similar exercise in September 2006.

## REGULATORY REFORM IN THREE SEE COUNTRIES

### **Bosnia and Herzegovina**

Following the break up of Yugoslavia and the ensuing political and ethnic conflict, Bosnia and Herzegovina (BiH) still faces the costly legacy of the conflict and the combined challenges of post-conflict reconstruction and transition from a centrally planned to a market economy. With the assistance of the international community, BiH has succeeded on a number of fronts. A number of difficult and important institutional reforms have been successfully implemented. BiH has achieved macroeconomic stability and has initiated a range of business environment reforms. However, BiH continues to lag behind its neighbors in the region. Important structural reforms still need to be completed and the administrative procedures associated with market entry, operation and exit need to be further streamlined and simplified. As shown in Figure 13.1, investors still perceive regulatory quality in BiH as relatively poor and the World Bank's 2006 *Doing Business* report ranks BiH as number 87 (of 155 countries) in terms of the ease of doing business.

The complex administrative and decision-making framework, limited technical capacity, and weak policy coordination across the different levels of government further compound the difficulties faced by BiH in the transition process. The government's Medium Term Development Strategy identified a number of reforms that are necessary for sustainable growth including business environment, enterprise and labor market reform.

### **Legal and administrative framework**

The Constitution of BiH provides a framework for a complex governance structure at the state and entity levels. The Constitution spells out the role and responsibilities of the executive, legislative and judicial institutions of the state of BiH vis à vis the responsibilities of the entity of the Federation of Bosnia and Herzegovina (FBiH) and the entity of the Republika Srpska (RS). Responsibility for foreign policy, defense, security, refugees and civil affairs, international relations, trade and taxation rests at the state level.

The Constitution of BiH and the Constitution of FBiH define the responsibilities of the Federation Government and those of the cantons as well as the responsibilities shared by both levels of government. The responsibilities of the cantons include policy for the regulation and funding of public services, local land use and the regulation and promotion of local business. In parallel, the Constitution of the BiH and the Constitution of the RS spell out the responsibilities of the Government of the RS since there are no cantons in this entity. In addition, Brčko has a status separate from the FBiH and RS with governmental authority residing within the district and the BiH institutions (Čaušević, 2006). Responsibility for rule-making rests at each level of government within its specific competencies in accordance with the Rules of Procedure. In addition, the Office of the High Representative (OHR), established under the terms of the Dayton Peace Agreement, has the authority to propose and impose laws in cooperation with the BiH Members of Parliament, Council of Ministers, Presidency and Parliament chambers. This complex structure and allocation of authority at the various levels of government necessarily frames the approach to regulatory governance in BiH.

The Rules of Procedure on all three levels of government include provisions for consultation within government. Draft laws must be supported by justifications addressing the constitutionality, legal basis and budgetary impact of proposed laws and opinions from designated bodies. For example, in the case of FBiH, opinions are required from the Legislative Office, Federal Ministry of Justice and Federal Ministry of Finance in FBiH (Penev, 2006). In the RS and FBiH, the Rules of Procedure provide for public consultations to be conducted at the discretion of the relevant legislative committees. Similar provisions are included at the state level in the Rules of Procedure of the House of Representatives and the House of Peoples. Generally, public consultations are conducted only in the case of critical legislation. When consultations are conducted, they are done on a tripartite basis – engaging labor unions and the chambers of commerce.

There is no explicit policy on regulatory quality in BiH and no body (or bodies) charged with systematically assessing the impact of proposed laws and regulations (Penev, 2006). Since much of the authority for regulating the start-up and operation of business resides at the entity and municipal levels in the RS and at the entity and cantonal levels in FBiH, responsibility for improving regulatory quality for business activity effectively rests at the corresponding levels of government.

### **Administrative simplification**

With the assistance of the donor community, a range of activities related to administrative simplification have been undertaken in BiH, covering

reforms in areas such as business registration, inspections, business licensing, customs and taxation administration. Improvements are evident in the regulatory quality indicator (Figure 13.1). Despite these improvements, it is clear that further work needs to be done. In terms of the overall ease of doing business, BiH is ranked at number 87 of a total of 155 countries.

Two complementary approaches to promoting administrative simplification have been applied in BiH. They are instructive since they underscore the importance of engaging the appropriate levels of government in designing and implementing regulatory reform, securing ownership and credibility among stakeholders, and marshaling resources to support implementation.

Under the first approach, diagnostic analyses, such as the Review of the Legal Framework and Administrative Barriers to Investment (FIAS, 2000), were carried out at three levels of government, addressing the issues relevant at each level of government and making recommendations for harmonizing entity-level laws and regulations, where appropriate. Comprehensive reforms were designed, implemented and institutionalized with technical support provided by international donors, including, for example, the World Bank's comprehensive Business Environment Adjustment Credit project; USAID's programs on taxation reform, bankruptcy and liquidation, inspections and permits; and, UK-DFID's project on business registration streamlining. However, the work of actually implementing change is done at the entity and cantonal levels through various working groups. The outcomes and impact of these reforms varies for a number of reasons including lack of capacity and resistance to change.

Under the second approach, a fast moving 'bulldozer' initiative was launched by the Office of the High Representative (OHR) in 2002. Under the leadership of a committee, which included representatives of the Council of Ministers, OHR, entity governments and the private sector, wide consultations were conducted to target specific aspects of business-related regulations for amendment (World Bank, 2004b). This is very much a bottom-up approach in which safeguards are required to avoid capture or perceptions of capture by special interests. Several iterations of the bulldozer have been conducted and efforts have been made to institutionalize this mechanism.

### **Regulatory reform in the Republika Srpska**

More recently, the Government of the RS initiated several inter-related measures to build on ongoing public sector reform and administrative simplification work and to improve systematically the quality of regulations affecting business activity. In November 2005, the government adopted a policy recommendation for the introduction of regulatory impact assess-

ment (RIA) in reviewing policy proposals and laws. Following a change in political leadership, and the emergence of the new Prime Minister as a strong champion for business environment reform, the government issued a decree to establish a Regulatory Reform Council (chaired by the Prime Minister and including the Ministers of Finance and Economic Relations and Coordination, the President of Municipalities and representatives of the private sector – the Chamber of Commerce and Association of Employers) and launched an ex post review of business formalities (licensing and permits system) and inspection-related controls and measures. The government has committed publicly to reducing significantly business formalities and inspection measures and has garnered extensive support from the business community in this undertaking.

In view of the limited resources and technical capabilities for implementing this guillotine review, a small secretariat was established in the Ministry of Economic Relations and Coordination to support the Regulatory Reform Council and to lead the review process. Although it is not at the center of government, the secretariat effectively reports to the Prime Minister and it works closely with the Legislative Secretariat and other parts of government to facilitate the guillotine review. The staff of the secretariat constitutes a small group of public servants, supplemented by four-person team of consultants – lawyers and economists and international experts.<sup>12</sup> In addition to the coordinating function of the secretariat, the role of the secretariat staff and the consulting team is to review and challenge the submissions of the various ministries of the government, take on board the findings and recommendations of the stakeholder consultations and to make recommendations to the Council for eliminating and streamlining formalities and inspection measures. The registry of 'valid' informalities and inspection measures will be a critical output of the guillotine review. It is expected that this registry will be accessible to the general public through the internet, thereby increasing transparency and access to information on business regulations.

The guillotine review process includes an energetic public relations campaign and an extensive public consultation component. Starting with the launch of the guillotine, the government has undertaken a public relations campaign to explain the objectives and expected outcomes of the exercise and to build broad support for the initiative. As part of a structured public consultation mechanism, sectoral inspection working groups established by the Chamber of Commerce under a related USAID project, play a critical role in reviewing inspection measures and consulting with the private sector to make recommendations for the guillotine. The sessions of these working groups are open to the public and to the press. The sessions have been generally well attended by the business community and often generate

vigorous, open discussions about the clarity, consistency and impact of inspection measures and the administration of inspections. One of the emerging points of discussion relates to the need for a systematic review of the impact of proposed laws and regulations. The business community has recognized that the outcome of the guillotine could be undermined if an ex ante review mechanism is not implemented and is now advocating the introduction of RIA. In addition, the leaders of several municipalities have initiated a discussion on the applicability of the guillotine review at the municipal level.

The guillotine review is still a work in progress and the effective outcome is yet to be seen. However, there is every indication that the process has effectively applied some of the key principles of the regulatory governance framework – increased openness, participation, accountability – in helping to improve the coherence and quality of regulations affecting business operations in the RS. Despite the strong political leadership, a number of challenges have emerged as ministries within government resist efforts to streamline business formalities and promote a change in the command and control culture of the public service. Nevertheless, this initiative provides the nucleus of regulatory policy that can be further developed and applied more broadly. Moreover, there is strong potential for the RS model to be adapted and applied in the rest of BiH.

## **Moldova**

With the break up of the Soviet Union, Moldova faced a number of challenges in the process of the political and economic transition to a democratic, market-oriented economy. Following a period of political instability and slow growth, Moldova has staged an economic turnaround. Since 2000, the economy has grown some 40 percent, with average real growth rates of 7 percent. However, the major source of this growth has been worker remittances. Private domestic investment is relatively low (roughly 17 percent of GDP), the government faces the considerable challenge of generating sustainable growth. Since the government views private investment, both domestic and foreign, as an important engine of sustainable growth, it has focused attention on improving the business environment and the quality of regulations affecting business operations in order to reduce the cost and risk of doing business. The Ministry of Economy champions and is spearheading the ongoing regulatory reform initiative.

### **Legal and administrative framework**

The legal system in Moldova is based on the Soviet and continental legal systems. The Law on Legislative Acts and the Law on Normative Acts

provide the basic framework for the rule-making process. The Ministry of Justice has the responsibility for reviewing draft laws and preparing legal opinions before discussion in the Cabinet of Ministers and to represent the Cabinet in the relevant parliamentary discussions. In principle, draft regulations are subjected to legal, policy coherence and budgetary impact scrutiny. The laws on legislative and normative acts require that the attachment of an informative note with legal and economic analysis to support draft laws and regulations. However, this requirement constitutes a mild scrutiny that is not rigorously enforced. The primary review is legal and focuses on the constitutionality of draft laws. In addition, the Ministry of Finance is responsible for the budget impact review.

There is no explicit, overarching policy on regulatory quality in Moldova although the 2005 EU Action Plan and the 2006 Law on Basic Principles Regulating Entrepreneurial Activity establish key elements of such a policy. As is the case in most SEE countries, Moldova's approach to regulatory governance is rooted in the established institutions and administrative laws and procedures of government. For example, under the rules of the government, there are requirements for consultation with all stakeholders during the law drafting process. However, in practice these requirements are rarely or selectively observed and there is no enforcement. As a result, a draft Law on Full Decision-making Transparency has been prepared to strengthen these requirements. As noted in Table 13.1, Moldova has applied some aspects of the standard regulatory governance tools including forward planning, notice and comments, and consultation. However, clearly there is much room for improving and enforcing the use of these tools in order to improve the quality of regulations and strengthen the rule-making process.

### **Regulatory reform in Moldova**

Starting in 2000, Moldova introduced several regulatory reform initiatives including the passage of legislation for the establishment of a competition agency and administrative simplification programs. The results of these initiatives were mixed and there was considerable resistance to change within the public service and from special interest groups.

In 2004, the World Bank completed a comprehensive assessment of the investment climate in Moldova (World Bank, 2004a). This assessment identified a range of administrative and legal impediments to business activity and stressed that excessive regulations and the risks associated with poor-quality regulations and non-transparent administrative procedures had a significant negative impact on private investment and economic growth in Moldova. Business surveys showed that Moldovan managers spent roughly 19 percent of their time complying with regulatory requirements and the

bureaucracy and businesses spent more than 2 percent of their revenues on bribes and facilitation payments, on average. In addition, it was found that the powers and institutions of the judiciary lacked credibility due to corruption, discretionary authority, political influence over the judiciary and the absence of accountability mechanisms (World Bank, 2004a). This report recommended, among other things, that Moldova develop a strategy and institutional framework for deregulation and introduce RIA of government regulations affecting the investment climate.

With the support of the World Bank and bilateral donors, including USAID, Moldova has taken a number of steps to build on the business environment reforms initiated in 2000 and to develop and implement a strategy for regulatory governance. This strategy has been championed by a reformist Ministry of Economy and Trade. The regulatory reform agenda has apparently gained deeper traction with the re-election of the government in 2005 and the political window for pursuing aggressive reforms.

In 2004, the government adopted the policy Decision on the Reform of State Regulation and Entrepreneurship Activity.<sup>13</sup> This decision provided the legal basis for establishing an inter-ministerial commission, a national working group (NWG), and a secretariat to develop a coherent regulatory policy and framework for implementation. The commission was subsequently transformed into the State Commission for Regulatory Reform. The NWG consists of 32 permanent members and 18 ad hoc members drawn from the public and private sectors.

In 2005, the government launched a guillotine review of subordinate regulations with the Decision on the Registry of Normative Acts and the Registry of Authorizations, Permits and Certificates governing entrepreneurial activity.<sup>14</sup> Under the guillotine review, approximately 1000 normative acts were reviewed: 426 were retained and included in the registry; 285 were targeted for amendment; and 99 were eliminated. In addition, the number of authorizations, certificates and permits governing entrepreneurial activity was significantly reduced and a registry has been established.

In 2005, the government adopted the EU-Moldova Action Plan, which articulated Moldova's commitment to economic reform, approximating of Moldovan legislation with that of the EU and its goal of integrating into the EU. This action plan perhaps comes closest to outlining a national regulatory policy and can be interpreted as a first step in this direction. Box 13.1 outlines the major regulatory and administrative reform elements of the action plan.

In July 2006, the Parliament passed the Law on Basic Principles Regulating Entrepreneurial Activity. This law establishes the legal and institutional framework for the systematic review of existing and proposed laws and regulations affecting business activities. It is based on the principles of

### BOX 13.1 THE EU-MOLDOVA ACTION PLAN

The EU-Moldova Action Plan, signed in February 2005, covers a wide range of issues, including democratization, health standards, legal reform and economics. In the economic area, it includes the following key elements:

*Administrative reform and reform of the judiciary:*

- adopting an ethics code for civil servants, judges and law enforcement bodies;
- implementing a working program for regulatory reform;
- amending laws concerning the independence and impartiality of the judiciary;
- introducing administrative reform of local government.

*Improving the investment climate:*

- screening of national legislation to identify barriers to business establishment and progressively abolishing them;
- taking steps to reduce over-regulation, improve transparency and predictability and reduce further the burden of licensing and inspection regimes;
- setting up a dialogue on regulation, enterprise and industrial policy with foreign investors;
- enhancing the prudential regulatory framework for financial markets and supervision to bring it in line with that in the EU;
- creating a national agency for competition protection, providing it with sufficient budgetary means to carry out its mandate.

*Trade promotion:*

- harmonizing legislation and procedures with EU norms on certification and control of origin of goods in Moldova;
- preparing a plan of steps toward fulfillment of EU requirements on animal health and for the processing of animal products, and for hygiene in food processing.

Source: Moldova Ministry of Foreign Affairs. [www.mfa.md/EN/Action\\_Plan\\_EU\\_Moldova.pdf](http://www.mfa.md/EN/Action_Plan_EU_Moldova.pdf).

predictability, transparency and proportionality and it establishes RIA as one of the primary tools for implementation. This Law provides for a repeat of the guillotine exercise, this time targeting laws affecting business activity.

## SERBIA

Following the armed conflicts of the 1990s, international isolation and deterioration of the rule of law, Serbia emerged from the velvet revolution

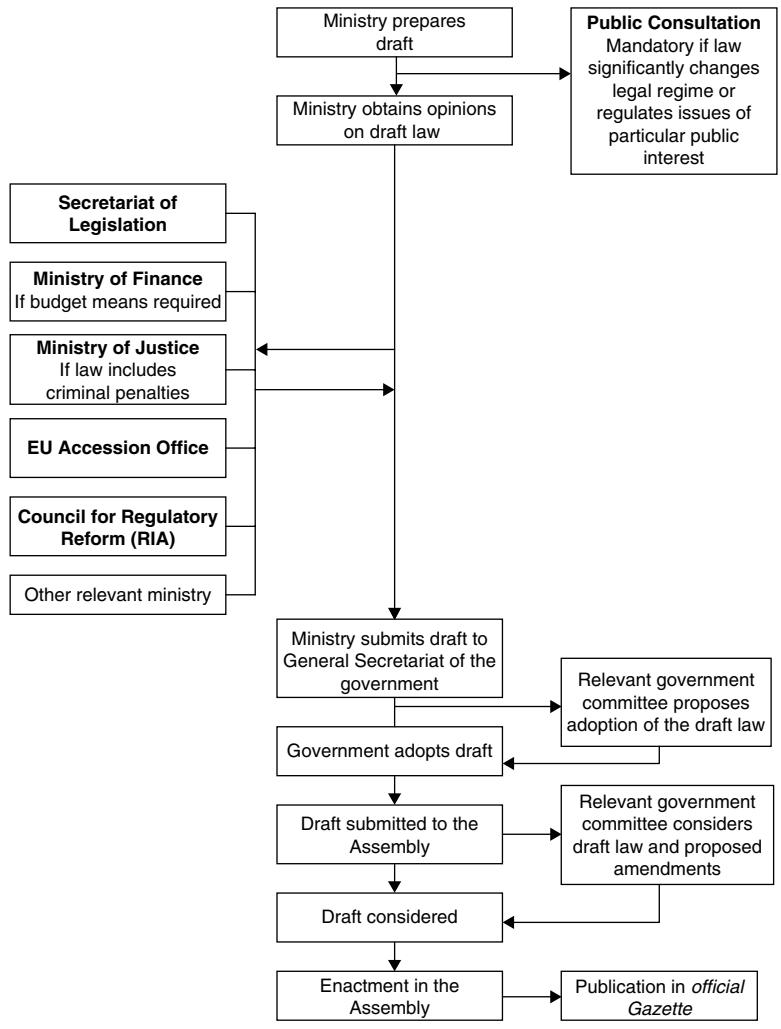
in 2000 and embarked on the second wave of its transformation to a democracy and transition to a market economy. Starting in 2000 and despite a number of subsequent political setbacks, Serbia implemented several major policy steps as part of its transition. These steps, largely consistent with the first generation Washington Consensus reforms, were aimed at stabilizing the economy, integrating Serbia into the global economy and jumpstarting economic growth. Since 2000, Serbia has achieved average annual economic growth rates of roughly 5 percent and 2006 growth rates are now projected at around 7 percent, inflation rates have been reduced from approximately 100 percent in 2000 to 16.5 percent by September 2005, and annual inward FDI flows have risen steadily, peaking at USD1.4 billion in 2003 driven by privatization. In 2005, Serbia was recognized as one of the top reformers by the World Bank's *Doing Business* report. However, as noted by the World Bank's *Investment Climate Assessment* (2004a), the initial reforms focused on stabilizing the economy and putting critical pieces of legislation in place. The government has now embarked on a range of second-generation reforms aimed at triggering sustained growth, including improving the quality of regulations affecting the business environment, and building institutions and capacity for implementation.

#### **Legal and administrative framework**

Serbia's legal system is based on the civil law tradition of the former Yugoslavia, with its foundation on the laws of the former Federal Republic of Yugoslavia except for components superseded by the Constitution. As provided under the Rules of Procedure of the Parliament, the principal actors in the legislative process are the government, Members of Parliament, the Assembly of the Autonomous Province of Vojvodina, and voters constituted in groups of at least 15 000. These actors have the right to propose and amend laws, regulations and general acts. In addition, by government decision, the Council on Regulatory Reform, as part of the government, can make recommendations to ministries for the adoption or amendment of laws, regulations and general acts (Penev and Marušić, 2006).

All draft laws prepared by the government or its constituent bodies are subject essentially to three levels of review before they are presented to the Parliament for adoption. Figure 13.4 provides a summary of the process of enacting laws proposed by the government (Penev and Marušić, 2006).

On the first level, the Rules of Procedure require that draft laws and acts be reviewed for: constitutionality (by the Legislative Secretariat); budget impact (by the Ministry of Finance); consistency with EU regulations (by the European Integration Office); property rights and national obligations (by the Public Attorney's Office); and criminal implications (by the Ministry of Justice). In 2004, the requirement for an RIA was added by a



Source: Penev and Marušić (2006).

Figure 13.4 Serbia: rule-making process for laws proposed by the government

Decision of the Government. The Council for Regulatory Reform is charged with the responsibility for assisting ministries with the preparation of RIAs and for reviewing the assessments for quality. The opinions produced by these reviews are included in the mandatory justification statements, which are appended to drafts for consideration by the government.

The General Secretariat of the government has responsibility for examining the submitted drafts to ensure that the requisite supporting documentation and the draft conform to the requirements.

On the second level, the Committee of the Government with the relevant competence for the law or act presented considers each draft and makes a recommendation to the government for or against adoption. The Legislative Secretariat is charged with reviewing laws or acts proposed by the government for enactment by the Parliament. On the third level, the competent committee of the Assembly reviews the draft proposal before it can be sent to the floor for debate.

The levels of review outlined in the process above provide opportunities for strengthening regulatory governance through the enforcement of compliance with the requirements for regulatory quality and public consultation. However, this is contingent upon a fundamental shift in the culture of regulation based on the old command and control approach. Within the existing structure, it appears that there is considerable scope to circumvent these requirements by expediting the passage of legislation or by following an alternative legislative route outside of the government. In addition, it is worth noting that the Regulatory Reform Council is a temporary body and has not been effectively institutionalized or integrated into the rule-making process.

### **Regulatory reform in Serbia**

As noted in the preceding sections, since 2000 Serbia has undertaken a series of economic and legislative reforms to stabilize the economy and to improve the environment for doing business. The first wave of reforms included administrative simplification measures, such as the amendment of the Company Law to eliminate pre-registration inspections, and policy measures such as tax reform, adoption (2001) and amendment (2003) of a Law on Privatization, promulgation of the Law on Public Procurement in 2002, and the promulgation of leasing, collateral and concessions laws in 2003. A second wave of reforms has been launched with a strong focus on effective implementation and deepening administrative simplification. In 2004, the Enterprise Law was promulgated and the Business Registration Law was amended to harmonize the two laws and facilitate effective implementation. Similarly, the Law on Public Procurement was amended to simplify and streamline further the implementing procedures and to harmonize the law with related legislation.

As with the other SEE countries, Serbia does not have an explicit regulatory policy. However, the Regulatory Reform Council has been assigned the task of preparing a regulatory reform strategy for review and adoption by the government. This strategy is expected to incorporate and make

explicit many of the elements that already exist as part of the rule-making process and in the various procedures and practices within government, thereby increasing the transparency of the legislative process, strengthening the public consultation mechanisms and increasing public access to information. For example, while there is no formal forward planning system for laws and acts, the ministers of the government are requested to submit annual legislative plans for use within government. In the area of public consultation, the Rules of Operation of the Government were amended in 2004 to permit consultation on all laws at the discretion of the proposing entity, except in cases where the proposed laws are intended to change significantly the legal regime in areas of critical public interest. Generally, the need for and extent of public consultation is determined by the proposing entity and the relevant committee of the government (Marušić et al., 2006).

## CONCLUSIONS

Based on the close look at the experiences of BiH, Moldova and Serbia in this chapter, it appears that governments, policy-makers and politicians in the SEE countries increasingly share the view that regulatory quality is a determinant of private investment and growth. Therefore, the focus on improving the quality of regulations affecting the business environment is increasing. The Investment Compact's Ministerial Statement 'Building a New Environment for Private Investment in South East Europe',<sup>15</sup> recognized that 'high quality regulatory governance guided by a comprehensive and strategic policy is essential for strengthening the confidence of private investors in the region'.

In the absence of explicit strategies for regulatory governance, the SEE countries have adopted an opportunistic approach to regulatory quality – building on administrative simplification initiatives and taking advantage of opportunities to conform to international practice with the assistance of international donors, the 'pull' of EU accession, and the need to comply with international membership requirements (e.g., WTO). In general, they have made considerable progress despite the constraints of politics, capacity and resources for implementation.

When considered in the context of the OECD's Recommendations on Regulatory Quality, it is clear that no country in SEE fulfills the three criteria of a regulatory governance framework – explicit policy, oversight body at the center of government and a strategy for implementation. However, as shown in Table 13.1, all of the countries in the region have in place elements of such a framework. Most have implemented some combination of the

regulatory quality tools with varying degrees of sophistication and 'rigor'. As civil law countries with a central administrative law framework, all of these countries, including Moldova and Bulgaria, have institutions at the center of government with some quality control function regarding the review and promulgation of laws, legislative acts and regulations.

The case can be made that these countries have in place the building blocks for regulatory governance frameworks. The challenge is to strengthen and supplement these building blocks where feasible and to introduce new institutions as necessary in order systematically to improve regulatory quality. For example, as shown in the preceding sections, several oversight bodies exist and carry out a review function in the rule-making process in the SEE countries. These include the legislative secretariats, secretariats of the government and government committees such as the Collegium of deputy ministers/state secretaries in Macedonia or Serbia. There is significant potential to strengthen substantially their role in assuring regulatory quality. However, this would require a significant shift in the culture of these bodies and possibly changes in their mandates. In the case of Macedonia, an effort was made to link an ongoing public service reform program with the fiscal review and the regulatory review function under the General Secretariat of the government. This initiative was facilitated by the ongoing change management program within the secretariat to achieve a shift in the organizational focus to a proactive, quality paradigm in organizing the business of the government and ensuring coherence between the proposals submitted for review with the policy goals and strategic priorities of the government.

'Institutional endowments' (Levy and Spiller, 1995) influence in some measure the frameworks for regulatory quality that are being established. BiH provides a good example of this. Because of the complex legal and administrative structure and weak policy coordination mechanisms at the state and entity levels, the policy for regulatory quality is being developed at the sub-national entity level. The Republika Srpska has initiated an ex post review of business formalities and is moving to establish an ex post review of business regulations and an explicit policy on regulatory quality. This is likely to serve as model for the rest of the country. The BiH approach contrasts with that of Serbia as well as Moldova, on the other hand, where the institutional framework for regulatory reform is being set up at the national level consistent with their legal and administrative mechanisms for rule-making.

A similar view can be taken of the strategies for implementing the nascent regulatory quality policies and the deployment of a range of tools including public consultation and RIA. Most countries have employed an evolutionary approach to regulatory reform, starting with administrative

simplification and moving on towards systemic mechanisms, in order to achieve sustained and deeper reforms and better-quality regulation. This evolutionary approach is most likely a function of the political economy as well as capacity and resource limitations. As noted earlier, the momentum for applying the RIA methodology for ex post reviews of regulations through the guillotine is increasing in the region. More than half of the countries in the region have already launched guillotine reviews or are planning to do so. In the case of RS in BiH, the guillotine is considered a first step towards a systematic ex ante review and pressure for the next step is coming from stakeholders in the private sector. Moreover, every country in the region, with the possible exception of Montenegro, has either already piloted the RIA or plans to introduce the RIA over the long term.

Finally, it is worth noting that the broad experience of the SEE countries is similar to that of the OECD countries where the regulatory reform was part of a broader transformation to market-led growth and the regulatory reform agenda was broadened to include the adoption of 'explicit overarching policies, disciplines and tools, tending to be more permanent than episodic in nature' (OECD, 2005). Regulatory reform is being integrated with broader governance principles. For example, Box 13.2 summarizes the sequencing of reforms and institution building in Italy and highlights some of the issues faced during the process.

### **BOX 13.2 SEQUENCING REFORM – FIRST STEPS IN ITALY**

The emergence of a genuine regulatory quality programme in Italy took considerable time. In 1978, the Minister of Public Administration launched a major review of the quality of public administration, including the regulatory management system. Based on his report, a second commission recommended the assessment of 'administrative impact of laws', based on the German Blue Checklist, and the establishment of a central unit to monitor it. In 1986, the President of the Chamber of Deputies issued a circular containing rules and recommendations about language, structure, quotation, modification, and repealing. A 1988 law created basic institutions to improve regulatory management, such as the Department of Legal and Legislative Affairs under the Prime Minister's Office and the de-legislation mechanism.

In the early 1990s, the most important reform of the Italian state since 1860 was launched, including a major review of the constitutional framework through numerous initiatives, policies and programmes, supported by six successive governments. Five major governmental policies stand out concerning the reform of the state's intervention in the economy,

including privatisation, establishing new regulatory regimes and institutions, and simplifying law on a broad scale; the management and control of the public budget and civil service; the simplification of the public administration, procedures and controls; the 'reorganisation' and management of the legal and regulatory system; and the balance between the centre and sub-national governments.

In 1990, an administrative procedure law (Law 241/90) was issued, being the main vehicle for regulatory simplification. The focus was on improving the structure of each procedure by reducing steps in the procedures and mechanisms that reduced the administration's capacity to delay and forbid action. The law complemented simplification with crucial provisions on the rights of citizens and accountability mechanisms. In 1993 a second law (Law 537/93) reformed institutions to simplify procedures, concentrating efforts on reducing duplication of functions among ministries and governmental bodies.

In 1997, under the 'Bassanini laws', the government launched a new phase of regulatory reform, creating a process of continuing improvement and the rebuilding of institutions. The reforms had two goals: to re-balance the powers between the centre and the sub-national governments, and to re-launch the administrative simplification policy based on a permanent approach and a more aggressive reorganisation of regulatory reform. This led to the introduction of more effective regulatory tools, such as consultation mechanisms and RIA.

Source: OECD, 2005.

## NOTES

1. Special thanks are due to Cesar Cordova-Novian for his comments on the paper and collaboration on Table 13.1.
2. Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Montenegro, Romania, Serbia.
3. The Stability Pact was adopted in 1999 by 40 partner countries and organizations to strengthen SEE countries and to support cooperation, sustainable development and peace in the region.
4. © Jacobs and Associates, 2005.
5. Law on Basic Principles Regulating of Entrepreneurial Activity, 11 August, 2006.
6. Administrative regulations are paperwork and administrative formalities through which governments collect information and intervene in individual economic decisions, OECD (1997).
7. Washington Consensus reforms, including fiscal discipline, tax reform, financial liberalization, openness to foreign direct investment, privatization, deregulation and secure property rights.
8. The data presented in this table are drawn from the OECD 2004 survey and the University of Manchester's Centre on Regulation and Competition 2006 Regulatory Governance survey.
9. The World Bank Group's Foreign Investment Advisory Service (FIAS) has conducted administrative barriers reviews in all SEE countries except Moldova. Various other

donors have conducted supplementary diagnostic reviews and have provided implementation assistance in a number of areas.

10. Law on Transparency No. 52/2003.
11. Moldova: Law on Basic Principles Regulating of Entrepreneurial Activity.
12. In addition, the Government of the RS requested technical assistance from the Foreign Investment Advisory Service (FIAS) of the World Bank Group and the United States Agency for International Development (USAID).
13. Government Decision No. 141 of 17 February, 2004.
14. Government Decision No. 920 of 30 August, 2005: Monitorul Oficial # 126-128/1047 of 23 September, 2005; Government Decision No. 1030 of 3 October, 2005: Monitorul Oficial # 132-134 of 7 October, 2005.
15. Signed in Vienna on 9 July, 2004.

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