



Broad Reform of the Business Environment: Drivers of Success in Three Transition Countries and Lessons for South Asia[©]

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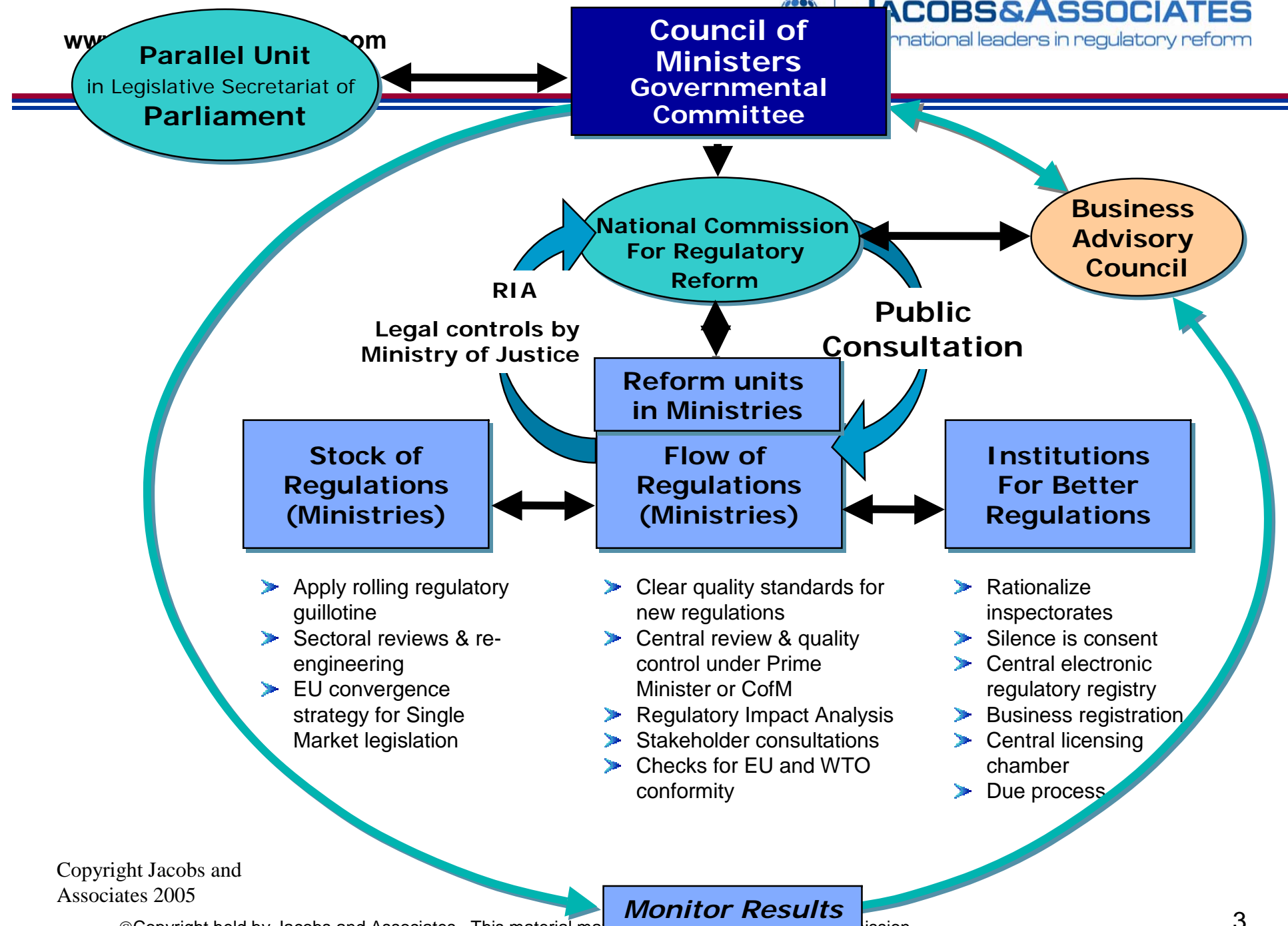
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Four main regulatory reform tasks

- Picture the regulatory system as a swimming pool
- To create a healthy, clean pool for businesses you must:
 - ◆ **Clean** the water in the pool (the regulatory stock)
 - ◆ **Filter** new water coming into the pool (the regulatory flow)



- **Maintain** the pool infrastructure (institutions)
- **Ensure that someone is responsible** for keeping the pool clean (regulatory quality control)





Key questions for reformers

1. What strategy for broad-scale regulatory reform maximizes the chances of genuine and durable success in environments resistant to reform?
2. How can a reform strategy be designed to make best use of the opportunities provided by the drivers of change?
3. How can experiences in other countries explain slow progress in reforms in South Asia, and be used to design reforms that will speed up and broaden reforms in the region?



Poverty reduction targets require faster and broader business environment reforms

- National development and poverty reduction strategies depend on speeding up and broadening reforms to improve the business environment.
- Sustained higher levels of growth at 6-9% p.a. require lasting and fundamental improvements in private sector performance.



Most business environment reforms are marginal and short-term

- Legal and regulatory environments in South Asia are among the world's **highest-cost** and **highest-risk** for businesses. FDI lagging far behind as % of GDP.
- None of the countries in South Asia are addressing the systemic, governance, and institutional problems that increase regulatory costs and risks
- Broad-based reforms are needed, but are very difficult to carry out and sustain over the whole public administration and across years.



Far-reaching and rapid business environment reform is possible, producing large gains

- Hungary moved in ten years from a planned economy to a market-led economy that was more private sector-based than Western Europe.
- South Korea succeeded in eliminating 50% of its regulations in less than a year through a national program of reform.
- Mexico reversed 70 years of intervention and economic controls by revising over 90% of its national legislation in five years to open up and transform its economy.



What are drivers of change?

*Forces that expand
the opportunity for reform
within the political economy of the country.*



Main drivers of change for enabling environment reforms

1. Globalization or competitiveness
2. Crisis
3. Political leadership
4. Unfolding reform
5. Technocratic forces
6. Changes in civil society
7. External pressure



Reform unfolded through a changing mix of drivers, like dancers in a waltz

- These three countries did not show a linear cause-and-effect scenario in which a single driver of change created and defined the success of reform.
- “Crisis” did not create reform, nor did political leadership or a “champion” of reform.
- The three countries used a changing mix of drivers through an unfolding sequence of events



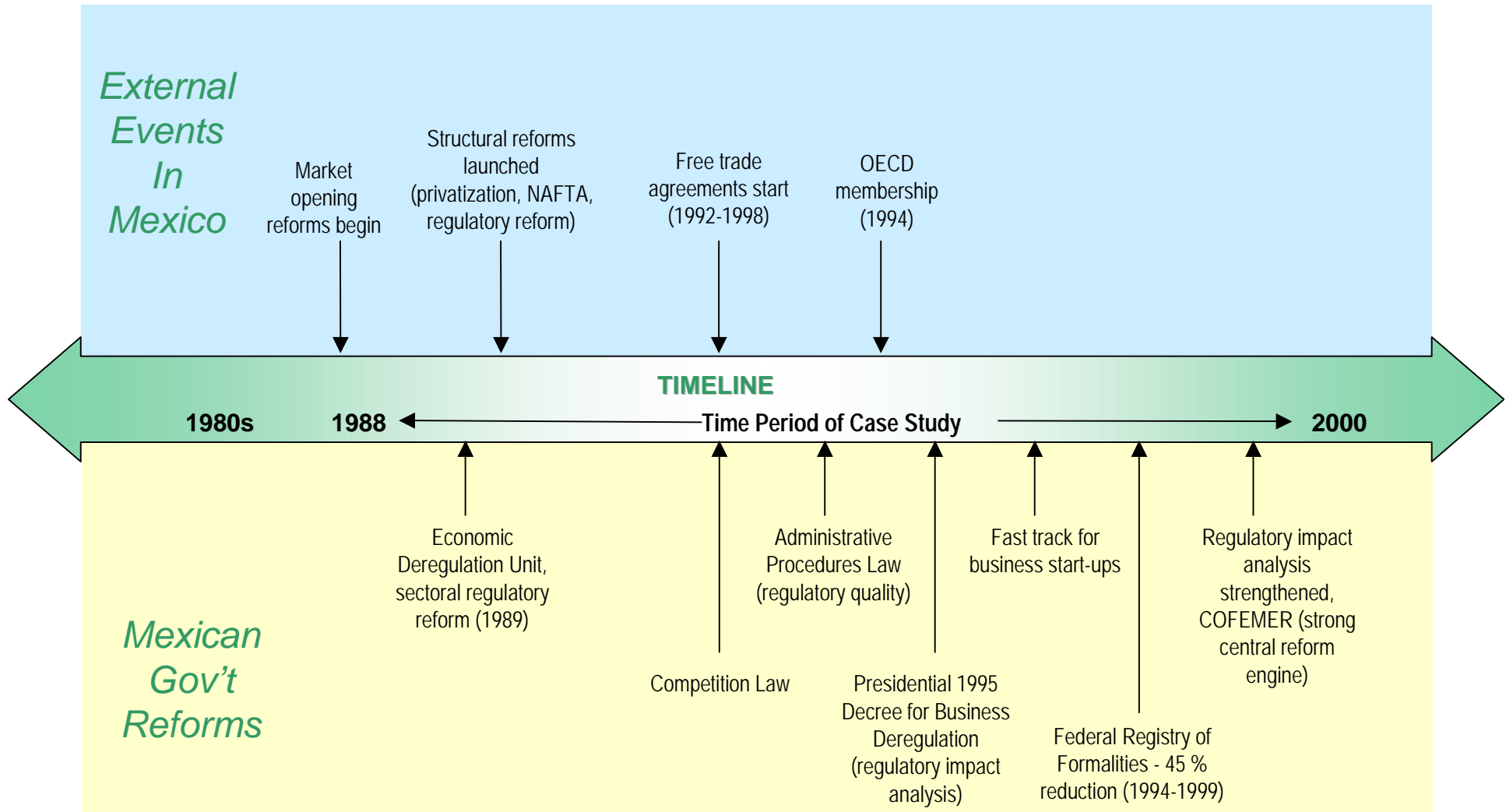
The sequence of drivers in broad reform (1)

- Crisis OR a sense of impending crisis OR external obligations were important to begin the market reforms
- BUT...Crisis generated the first wave of market reforms ONLY when politicians set reform agendas outside of traditional insider-interest processes. Reform-minded groups at the center were empowered to define much more radical and bold reform agendas.
- The first wave of bold reforms created a momentum of continuing reform: New pressures and new allies whose advantage lay in further reform. Some reforms increased the costs of non-reform. Consensus-building important.
- Market reforms were sustained ONLY when they were institutionalized into machinery of government (building new technocrats), and constituencies for change were mobilized and included in policy processes.



The sequence of drivers in broad reform (2)

- Crisis, Competitiveness fears, and External pressures
 - Political leadership respond with broad goals
 - Technocrats empowered to set bold reform strategies that challenge insiders
 - Bold reforms create momentum for new reforms
 - New allies emerge in civil society
 - Reforms are embedded in technocratic and stakeholder institutions in governments
 - Donors and external forces continue to push





Turning drivers into results: Critical success factors to design and sustain broad reforms

1. Diagnosing and exploiting the drivers of reform in each country
2. Setting the reform agenda that turn drivers into market reform strategies
3. Designing reforms to match development needs: bold reforms aimed at real change
4. Implementing reforms across the public sector
5. Sustaining reforms against resistance and habit, such as through monitoring and institution-building

Success factors are inter-related; successful governments invest simultaneously in strategies such as active management of reform program, public-private dialogue, and results monitoring.



Drivers of reform and factors of success are weak in South Asia

- No South Asian country has carried out broad-based reforms similar in scale or longevity to the three cases. Drivers of reform are not sufficient to create lasting change.
- None of the critical success factors identified in the three case studies are well developed in the region.
 - ◆ Strategies of reform are short-term, non-institutionalized, and poorly financed.
 - ◆ Institutions dedicated to reform are almost nonexistent.



Why are drivers of reform not working in South Asia?

- **Competitiveness:** Strong competitiveness pressures for trade and investment, but governments react with narrow reforms that benefit vocal, large investors.
- **Crisis.** No obvious economic crisis. Political leadership is unable to create social consensus for market reform, due to lack of organization of groups most harmed by lack of reform (enormous informal sectors)
- **Political leadership.** Reforms are usually initiated top-down from strong Prime Ministers or Finance Ministers but are not institutionalized and lack social agreement on market reforms
- **Evolving reforms.** Lack of strategic planning has meant that reform drivers are not linked or sequenced in South Asia. Opening of borders was not followed by changes to regulatory structures and labor markets. Pressures caused by market opening are contained through very limited reforms such as special economic zones.
- **Technocracy:** Independent technocratic institutions such as competition regimes that have supported reforms in other countries are weak in South Asia.
- **Civil society:** Consumer and stakeholder participation is weak in reform in the region.
- **External pressures:** South Asia has no strong movement for a regional free trade zone. Its countries do not belong to international reform-minded institutions. Donors have done much to drive enabling environment reforms, but donors are limited.



Future reform and growth in South Asia: What are the most important drivers?

- Competitiveness drivers, but ONLY if they are linked by political leaders to consensus on broad market reform agendas
- Civil society drivers, specifically, the growing class of entrepreneurs that are export oriented
- External drivers (mostly donors).



Conclusions for South Asia

- South Asia is unlikely to succeed with broad reform unless these governments:
 - ◆ exploit and develop multiple drivers of reform that are stronger, better linked, and aimed at breaking the capture of policies by status quo interests
 - ◆ Develop sustainable implementation strategies based on the factors of success



Launching and sustaining reform: implications for donors

- Donors have done much to drive enabling environment reforms across the region, but the limitations of donors in driving broad, durable reforms are clear: donors are usually time-limited, risk-adverse, and unable to challenge the accepted limitations of the political class.
- Donors could be more effective in using their resources and influence through coordinated and careful design of reforms based on exploitation of reform drivers and the factors of success.



Implementing reform: priorities for donor investment

- Strategize a multi-year reform program based on identified drivers of change
- Develop explicit regulatory and administrative reform policies – with clear goals -- in each country that aim at changing overall costs and risks. Don't waste years and energy by starting small or modestly without a strategy.
- Build capacities at the center of governments to organize, coordinate, implement and oversee multi-year, cross-ministerial reforms
- Support reforms to institutions, skills, and incentives in the public sector to reflect the needs of a market-led development strategy rather than a state-led strategy
- Create public private capacities for analysis and monitoring of regulatory and policy impacts on market development to guide a reform program.