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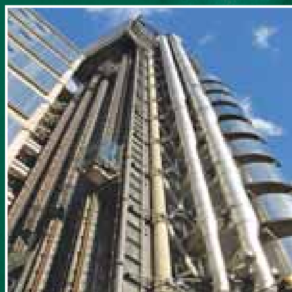
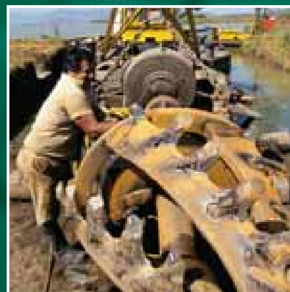
LESSONS FOR REFORMERS: HOW TO LAUNCH, IMPLEMENT, AND SUSTAIN REGULATORY REFORM

AN ANALYSIS OF SIX CASE STUDIES IN DEVELOPING AND HIGH-INCOME COUNTRIES





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AN ANALYSIS OF SIX CASE STUDIES IN DEVELOPING AND HIGH-INCOME COUNTRIES:

Hungary
Republic of Korea
Mexico
Australia
Italy
The United Kingdom

June 2009

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EXECUTIVE SUMMARY

Governments around the world are basing their economic development and poverty reduction strategies on efforts to expedite and expand reforms that improve their countries' business environments. Reforms of the "enabling environment" have become the norm in developing countries seeking higher, sustainable growth. The enormous inefficiencies constraining growth must be addressed mainly at the microeconomic level, such as through broad legal and regulatory reforms.

Yet broad reforms are difficult to implement and sustain. Successful reform requires overcoming vested interests in the public and private sectors, fears of change, and the complexities and uncertainties of change in dynamic economic and social environments.

In recent years, considerable knowledge has been accumulated on implementing successful regulatory reforms in developing countries, including a body of research based on the experiences of the World Bank Group's Doing Business and FIAS programs. The case-study evidence documents the factors leading to good reforms and the results of these reforms.

This paper focuses on core aspects of the political economy of reform, drawing on case studies of three economies transitioning to stronger business environments (Hungary, the Republic of Korea, and Mexico) and three countries with well-developed business environments (Australia, Italy, and the United Kingdom). The purpose is threefold: first, to identify so-called drivers of reform among successfully reforming countries; second, to explore how a reform strategy can make optimal use of the opportunities provided by the drivers of change; and third; to suggest how these lessons can be proactively used by other reformers to design and guide reforms.

The case study findings suggest that, regardless of the content of reform, success is influenced by an evolving mix of seven drivers of change: i) globalization or competitiveness; ii) crisis; iii) political leadership; iv) unfolding reform synergies; v) technocrats; vi) changes in civil society, and vii) external pressure. *(See Box 1 for a short description of the drivers, and Table 1 at the end of the Executive Summary for an outline of how they played out in the subject cases.)*

BOX 1

What Are the Drivers of Change?

Drivers of change are forces within a country's political economy that expand opportunities for reform. The seven main drivers of change are:

- *Globalization or competitiveness.* As capital and corporations move more freely across national boundaries, governments are forced to engage in regulatory competition.
- *Crisis.* Crisis, or a sense of impending crisis, can be important at the start of reforms and can provide an opportunity to stimulate action.
- *Political leadership.* Whatever the other drivers, political leadership is the yeast that makes them rise. Opportunities for reform are maximized when crisis leads to political shakeup.
- *Unfolding reform synergies.* Market-oriented reforms in one area can increase pressures for reform in other areas—and even change the political economy so that voices for reform emerge.
- *Technocrats.* Reform can be driven by technocrats—that is, politicians and senior civil servants with training in economics or other fields who develop rational policies to lead the country forward.
- *Changes in civil society.* Reform is not a task only for governments, even in countries with weak civil societies. Other stakeholders, such as firms and workers, can help build and sustain support for reform.
- *External pressure.* External commitments and pressures are often essential to reform, even in developed countries. External obligations allow reform-minded governments to shift responsibility—and hence the political costs of reform.

The paper then asks how a reform strategy can make optimal use of the opportunities provided by the drivers of change. The case studies suggest that few factors are truly exogenous. With proper sequencing, governments can do a lot to create conditions for change.

The case studies also suggest that reformers can influence the direction and pace of change by mobilizing and exploiting drivers of it. Rather than a cause-and-effect scenario in which a single driver—such as a crisis—creates and defines the success of a body of reforms, what happens is an unfolding series of events in which various drivers become more and less important in defining phases of the reform process. For example, by itself crisis does not create reform, nor does political leadership. Although reformers often applaud crisis, it is a risky approach to reform if it is not quickly supported by other drivers. Moreover, reforms launched on the back of a crisis are difficult to sustain, and there is no guarantee that leaders will make the right decisions in the face of crisis. The case studies provide little support for the "champion" model of reform.[1]

The studies show a similar pattern in how drivers of change were sequenced:

- *Step 1.* A crisis, or a sense of impending crisis, or pressures from external obligations were important at the start of reforms. These drivers redefined the political economy of launching change, weakened defenders of the status quo, and emboldened reformers inside government.
- *Step 2.* The first wave of reforms came only when politicians set reform agendas without regard for traditional insider interests. Agendas were imported from other countries, or politicians permitted reform-minded technocrats to define the specific goals and content of reforms—sometimes in a "stealth" mode that caught opponents off-guard.

1 The "champion" model of reform uses a single strong reformer to achieve sustainable results.

- *Step 3.* The first wave of bold reforms increased momentum for further change by creating new pressures and allies, and new institutions were built that gave technocrats more power and influence. Reforms were embedded in international agreements, limiting backtracking. And some reforms increased the costs of not reforming. For example, opening markets led to deeper domestic reforms as domestic businesses faced external competition.

- *Step 4.* Reforms became sustainable only when they were institutionalized into the machinery of government and constituencies for change were mobilized and included in policy processes. Reforms were more successful when governments built wider networks of reform-minded institutions throughout the public administration.

How these steps unfold defines the reform path. Strategically exploiting successive drivers of change appears crucial to achieving sustainable reform. This does not suggest that the reform path can be controlled or even anticipated, since much that happens is beyond reformers' control. But it does suggest that better understanding of the drivers of change and their sequencing can increase the chances of broad, successful change.

This paper concludes with a series of recommendations on how these lessons can be applied proactively in the design and management of reforms. Among the most important:

- Use a crisis (if available) to stimulate reform, but sustain reform by locking in political leadership and bipartisan political support through formal agreements, legislation, international agreements, and new institutions.

- Success factors seem to be interrelated—more successful governments seem to invest simultaneously in strategies such as managing the reform program, ongoing public-private dialogue, and results monitoring. All these factors do not have to be highly developed for reform to succeed. Weakness in one area may be compensated for in another area.

- Active management and support of the reform process are essential, primarily through dedicated, day-to-day leadership in the public administration. Governments that strengthened capacities for promoting, monitoring, encouraging, and assisting reforms across the entire administration seemed to do a better job of implementing them.

- Implementation is stronger when there is continuous learning. It is important to benchmark based on good practices in similar countries and to assess, pilot, innovate, and learn from past experiences. Monitoring and evaluation at all levels of implementation should be a priority in order to capture a complete record of past experience to improve upon.

- Aim for systemic change, but use one-off reforms to build momentum. One-off and visible projects can contribute to systemic change. Early results help build credibility and momentum, and success breeds success

- Put transparency at the heart of the process and reform contents. Transparency is not only a tool for strengthening reform drivers, it is also crucial in reducing regulatory risks—one of the main goals of reform. Strict adherence to principles of transparency and accountability is vital to market confidence in a modern regulatory state. Reforms should include developing new transparency habits across the public administration. New technologies such as electronic registries can also support openness, and at lower cost.

These case studies primarily focus on reform dynamics, rather than the technical aspects of the applied regulatory reform tools, procedures, and techniques. Knowledge about the relevance and adaptability of these tools, however, is as critical for successful reform as the reform dynamics described in this paper. For further guidance on regulatory governance tools and their application for

transitional and developing economies, please consult www.fias.net for activities under the Better Regulation for Growth (BRG) program. The BRG program focuses on synthesizing, reviewing and adapting regulatory governance tools such as Regulatory Impact Analysis, tools to review the regulatory stock, regulatory reform institutions, and indicators for regulatory quality.

TABLE 1

Drivers of Regulatory Reform in Hungary, Mexico, and the Republic of Korea

Driver	Hungary	Korea, Rep. of	Mexico
Globalization or competitiveness	Reform was triggered by the need to create a market-based economy and join the European Union.	To increase foreign direct investment, reforms had to remove explicit investment barriers and excessive regulations.	In the 1980s competition for international capital and investment was growing, and leaders saw the benefits of liberalizing trade for assembly plants exporting primarily to the U.S. market.
Crisis	An unprecedented change in political regime and collapse of the economy created new elites and growing expectations for real change.	The 1997 crisis produced the most painful economic contraction in OECD history: 1998 was the first year since 1979 in which Korea had negative growth.	In the 1980s a collapse in oil prices and default on massive external debt, followed by five years of economic stagnation, triggered privatization, trade liberalization, and regulatory reform.
Political leadership	Successive prime ministers actively backed reforms to secure democracy, the rule of law, open markets, and eventually EU membership.	The president elected in 1997 supported reforms. The National Assembly provided support by enacting legislation needed to implement them.	The president and a small group of advisers initiated extensive reforms using a top-down approach based on traditional command and control mechanisms. The resulting backlash slowed reforms.
Unfolding reform synergies	So many reforms were launched in such a short period that reform could be slowed, but not stopped—without disaster.	Initial top-down reforms produced impressive results, but lack of incentives for regulatory reform within the government slowed further reforms after a few years.	Market-opening reforms increased stakeholder pressures for economic liberalization, which increased public sector capacity for good regulation.
Technocrats	The strongly independent, professionally staffed Hungarian Competition Office played a vigorous role in privatization.	The Regulatory Reform Committee—staffed partly with academics, supported by civil servants, and co-chaired by the prime minister—is responsible for examining new and existing regulations and maintaining regulatory quality.	In 2000 an agency was created in the Ministry of Economy to impose quality and transparency on the public sector, and highly trained technocrats (economists) had legal authority and political backing to drive reforms
Changes in civil society	Reform was legally based, with active involvement by Parliament and extensive consultation with stakeholders such as businesses, trade unions, and disadvantaged social groups.	Political support for reform was built on a popular campaign to eliminate corruption, which coincided with an upsurge of NGOs focused on the issue. In the 1990s NGOs grew very quickly: by 2000 there were up to 8,000, providing a new force for political change.	Early reforms were not transparent, which limited reformers' ability to gain support from private stakeholders. Later, as political support wavered, special private bodies were created to oversee the reforms and provide sustained support.
External pressure	Close relationships between government officials and outside think tanks and international organizations helped reforms through inflows of new ideas, shared experiences, and funding.	OECD membership brought new demands for openness and good regulatory practices. In 1997 the government, in cooperation with the IMF, began deregulating the financial sector.	Mexico's close relationship with the United States—cultivated through NAFTA—helped it recover quickly from the 1995 liquidity crisis.

Note: This table itemizes the drivers of reform in the three developing countries only.

1. THE SEARCH FOR EFFECTIVE REFORM

Governments everywhere are basing their economic development and poverty reduction strategies on efforts to expedite and expand reforms that improve their countries' business environments. Such broad reforms can be difficult to implement and maintain across the entire public administration and over several years.

What strategy for broad regulatory reform maximizes the chances for genuine, enduring success in environments hostile to reform? And how can a reform strategy best use the opportunities provided by drivers of change? This paper provides a qualitative assessment that links exogenous factors with the choices available to each government. It concludes that very little is truly exogenous, and that success involves changing what can be changed and using what cannot to best advantage.

Successful development depends on making the right changes quickly, and achieving better outcomes than have been achieved through previous approaches. Achieving sustained higher growth requires fundamental improvements in private sector performance. In countries with legacies of instability, rent-seeking behaviors, excessive government intervention, and weak public and market institutions, better private sector performance demands better performance by the public sector as well—particularly in how the public sector relates to the private one through its legal and regulatory functions. Reforming these functions is part of the body of reforms sometimes referred to in discussions of the "enabling environment" for private sector performance.

This paper does not review why reforming the enabling environment is important. The role of such reforms in stimulating economic performance through productivity growth has been widely analyzed. It is sufficient to note that, just as regulatory reform became the norm for microeconomic policy in the 1990s in Organisation of Economic Co-operation and Development (OECD) countries, reforms of the enabling environment have become the norm in the 2000s in developing countries seeking higher, sustainable growth. The enormous inefficiencies holding back growth must be

addressed mostly with microeconomic rather than macroeconomic policy.

The obstacles to successful reform are equally familiar. To succeed, reform must overcome vested interests in the public and private sectors, fears of change, and the complexities and uncertainties of change in dynamic economic and social environments. For three reasons, transforming how the public sector conducts its regulatory and administrative functions is extremely difficult:

- First, it is a far-reaching agenda, requiring governments to make the transition from state- to market-led growth. Transformation of the public sector goes beyond changing policies and legal mechanisms, because the role and style of regulation in society are deeply embedded in traditions, capacities, interests, and the distribution of power. Making extensive change to the regulatory function stretches from legal instruments to government institutions, processes, and capacities—and even further, to the rule of law and changing relationships between the state, markets, and society. Because the culture of governance is relatively path-determined, reforms can often be reversed or ignored.

- Second, existing incentives strongly favor the status quo. Interest groups inside and outside the public sector have organized it for their benefit. Reform often encounters massive resistance, both passive and organized, that delays implementation or undermines its results.

- Third, capacities and strategies for change are often insufficient. Even if a government decides to move forward, weak political leadership, poor coordination, fragmented policy jurisdictions, low skill levels, and limited accountability—within the larger context of a weak rule of law—conspire to make successful reform extremely difficult. As a result, reformers often tackle the easiest or most isolated issues, with marginal and unsustainable results.

For these reasons many attempts at reform have been disappointing. Results have usually failed to match expectations, leaving reformers exhausted and disillusioned. Reformers often underestimate or are intimidated by the scale of problems, and isolated, one-off reforms usually do not produce lasting benefits for the private sector.

Those who believe that public sectors in developing countries are slow to act have never considered the regulatory function. In 2005, Kenya's government estimated that there were up to 600 business licensing requirements. In 2006, it became clear that businesses actually suffer from more than 1,300 licensing and other fees imposed by 178 state bodies. Moldova's reformers originally estimated that its 67 inspectorates had created 300–500 regulations for businesses; the actual number was more than 1,100, many illegal and never published.[2] Reforms aimed at achieving single processes and rules will never catch up with the capacities and incentives of governments to create regulations and controls. The issue is systemic in nature.

The challenge is to find ways swift ways of changing the complex system of instruments and behaviors, enabling the economic growth needed to achieve the ambitious poverty reductions promised and sought in many countries. There are always lags between market and legal changes, but the lags need to be shortened so that legal systems catch up with market needs.

Governments that have managed to effect meaningful reforms have reaped the benefits. Countries that have succeeded in managing broad reform programs over several years—even over several administrations—have shown the fastest changes and greatest gains in economic development. In just 10 years, Hungary moved

2 Scott and Astrakhan (2006).

from having planned to market-led economies, with larger roles for the private sector than in most Western European countries. This transition required massive deregulation and re-regulation, complete rebuilding of the countries' institutional frameworks, and the creation of strong transparency and accountability measures. The success of these efforts—including Hungary and Poland's rapid achievement of membership in the OECD and European Union—was due to the adoption of strategic and systemic approaches for building regulatory policies, tools, and institutions, backed by external pressures and political flexibility.

But success is not limited to the extraordinary transformations in Eastern Europe. Korea eliminated half of its regulations in less than a year through a national reform program, while Mexico reversed 70 years of economic controls by revising more than 90 percent of its national legislation in about six years, opening and transforming its economy. Results from Kenya's licensing reform suggest that similar processes can be initiated in less developed countries.[3] But highly developed countries can also summon the energy and support to embark on major new directions.

The question is, how? How can genuine, lasting success be achieved in a governing environment resistant or hostile to change? Can general lessons be learned from the countries discussed above? This paper analyzes the political economy and institutional mechanisms of successful reforms to help governments implement good practices based on international experiences—not only in Hungary, Korea, and Mexico, but also in Australia, Italy, and the United Kingdom. It focuses on how governments can speed up and broaden reforms to improve the business environment by building capacity to plan, organize, implement, and sustain a government-wide, multi-year reform strategy. The paper also assesses the relationship between the design of reforms and the constraints posed by a country's political economy.

3 Jacobs, Ladegaard, Musau (2007).

2. DEFINING AND MEASURING EFFECTIVE REFORM

Before identifying lessons of reforms to improve the business environment, it is essential to first define and then measure what is meant by effective reform.

Defining Effective Reform

Viewed as a whole, the business environment goes far beyond the impacts of regulatory and administrative practices, and includes a range of issues such as infrastructure, natural resource endowments, political risk, and macroeconomic stability. But regulatory and administrative issues require their own policy agenda, so the discussion here is limited to them.

How should success in improving the regulatory and administrative environment for business be defined? The most advanced countries working on regulatory reform have taken a broad social welfare approach to measuring regulatory improvements. This approach uses various techniques to assess the net social gain from the government's regulatory function. No country has developed a way of making such assessments on a national scale, but a few countries are slowly improving their understanding of how regulatory systems change over time in delivering net benefits.

A measure of success, then, would be a steady increase over time in net social benefits from all regulatory and administrative practices. But this measure goes beyond the impacts of regulatory and administrative practices on business, and includes the wider societal benefits of regulation. As a practical matter, it is not necessary to take such a wide scope to measure success for the business environment. And methodologically, it is impossible to adopt a net benefit approach at this time. Over time though, reformers must increasingly balance regulatory costs and benefits, since improvements in regulatory benefits—such as higher health, safety, and environmental standards—are crucial even in countries with terrible business environments.

Instead, a measure of success in improving the business environment could focus on the specific impacts that the regulatory and administrative environment have on business decisions.

These impacts can be divided into two categories: costs and risks.

Regulatory costs for businesses fall into three categories:

- *Operating or transaction costs.* Sometimes called administrative costs, these include costs imposed by paperwork, formalities, corruption, and operating procedures such as information disclosure. Such costs usually last for the life of the company, so their net present value tends to be high. These costs also have a fairly high fixed component, and are particularly hard on small and medium-size enterprises. Unless they can be passed on to consumers, these costs reduce profitability.
- *Capital costs.* Capital costs usually refer to the costs of buying new equipment and land. Though often high upfront, they fall over time as new equipment characteristics are built into equipment design and investment planning. In the early years of a business, capital costs can distort basic decisions such as on the trade-off between labor and capital. Regulations imposing capital costs diminish investment in productive activities and so reduce firm innovation and productivity.
- *Reductions in the value of business assets by eliminating opportunities for higher returns.* Regulators can impose such costs by allowing monopolies or imposing other barriers to market entry, slowing innovation, reducing business flexibility (say, in labor decisions), or forcing businesses to spend resources on strategic behavior. These lost opportunities force investment decisions into lower-return activities.

Regulatory risks—that the rules of the game will change or be understood only once an investment is sunk—reduce the amount, return, and social value of business investments. Investments will fall because their projected returns decrease. The more uncertain and risky the legal and administrative environment for economic activity, the more likely it is that aggressive rent seeking and short-term profit taking will replace longer-term investment. This is the main reason it is difficult to attract infrastructure investments in uncertain regulatory environments.

When regulatory and administrative impacts on the investment environment are discussed, it is usually specifically in terms of how regulatory costs and risks affect businesses themselves. The assumption is that as regulatory costs and risks rise for a company, its projected return on investment declines. That is not always the case, because some regulatory costs—such as consumer protection—may produce higher gains than losses for companies. But if governance is poor and public services are of low quality, this relationship is indeed almost always inverse.

Thus a reasonable definition of success for reform of the enabling environment, and the one used in this paper, is: reform that increases private returns on investment by reducing net regulatory risks, costs, or both. The word “net” is critical here. Investors make aggregated decisions about returns on investment. All regulatory costs and risks must be combined to obtain an accurate view of future returns. This is an enormous undertaking in countries that are highly over-regulated because few reforms will, in isolation, significantly change returns on investment.

Prior to the 2005–07 licensing reform in Nairobi, Kenya, for example, a taxi driver was required to have 12 permits to drive from the city center to the airport. Investors in a taxi service had to consider the cumulative effects of all 12, plus any new ones that might be added in the future. Business environment reforms that eliminate six low-cost permits can be negated by the addition of one high-cost permit or by enforcement changes in the other six. Thus, to genuinely change the business environment by increasing projected returns on investment, it is necessary to have a comprehensive view of

regulatory costs and risks facing the businesses of interest. Reform boosts business activity only if net benefits are achieved.

This definition of success has important implications for the reform strategy, as discussed later in this paper. Efforts to change net costs and risks lead to strategies that are systemic, longer-term, top-down, and institutionalized. Efforts to change selected costs and risks, by contrast, tend to be shorter-term, bottom-up, and limited in scope.

Another possible measure of success in reforming the business environment is the extent to which economic gains are passed from businesses to consumers. Business environment reforms that increase competition are not always beneficial to business profitability. In fact, increased competition—particularly after a period of high protection—often results in more business turbulence and restructuring. In such cases, good reforms might lower returns on investment in those activities. Here success could be measured in terms of sustained increases in consumer welfare, not returns on investment. But the distributional issues of business environment reforms are not necessarily a primary concern in countries where the top priority is increasing overall economic growth. When setting priorities for business environment reforms, it might be preferable to focus on reforms that produce the highest gains in household income, instead of returns on investment. That would be a reasonable adjustment of the definition of success.

Measuring Effective Reform

How should the success of business environment reforms be measured? This is a key question, because often the measurement technology de facto defines what is meant by success. Unfortunately, the ways of measuring the net effects of regulatory costs and risks are not always reliable.

In the past few years, a flood of business environment indicators and assessments has produced a wide range of possible inputs into a good business environment. These assessments typically assert that certain indicators are correlated with economic performance. The implication is that a country that seeks to improve its performance based on these indicators will improve its business environment, encouraging investment and growth.

Some of these indicators take a bottom-up approach, selecting regulatory and administrative issues considered high priorities and developing quantified measures of regulatory costs and, increasingly, risks. The World Bank's influential annual *Doing Business* report is one of several projects that uses such indicators:

> "The data offer a wealth of detail on the specific regulations and institutions that enhance or hinder business activity, the biggest bottlenecks causing bureaucratic delay, and the cost of complying with regulations. Governments can identify, after reviewing their country's *Doing Business* indicators, where they lag behind and what to reform"(www.doingbusiness.org).

Here success means moving up the indicators' rankings on the things being measured. Some datasets generate synthetic indicators of the "overall business environment" by aggregating large numbers of indicators of specific problems. Performance on these meta-level synthetic indicators is increasingly seen as a proxy for real changes in the business environment.

Taking this approach, this paper measures reform success as steady and sustained improvement, objective or relative, in individual indicators—or, preferably, in broad, synthetic indicators of inputs to the business environment. Some of these indicators, such as those used in the *Doing Business* project, have been extremely successful in attracting political attention to the problems of the business environment and in drawing reform resources to the problems being measured. In many countries business registration is likely much

more efficient and transparent today than it was five years ago as a direct result of the *Doing Business* database. The same may be true for other procedures measured by this and similar databases. Such indicators would seem to have an important place in any monitoring program.

Yet as a means of designing a national reform strategy for the business environment, this approach does not seem intuitively satisfying. Indeed, none of the case studies summarized in this paper took such an approach. Because these indicators are based on individual inputs, they risk undue attention to a few trees in the forest rather than the health of the entire forest. This method is also limited by the indicators chosen, which in turn are limited by the measuring methods used for each indicator. Synthetic indicators are based on some implicit weighting scheme that may or may not correspond to the actual importance of each indicator. Most important, these indicators do not measure net changes. Changes in the business environment outside the scope of the indicators are simply ignored—and in the vast, complex, continually changing regulatory and administrative environments of every country, this limitation seems significant.

Another approach is to collect general perceptions of the business environment using interviews with business people and investors. Most indicator databases collect specific information on regulations, government administration, and other perceptions immediately relevant to regulatory costs and risks. This is the approach taken by the World Bank's World Business Environment Survey (covering 10,000 firms in 80 countries), A.T. Kearney's Foreign Direct Investment Confidence Index, and Transparency International's Corruption Perceptions Index.

This kind of indicator seems to better capture net effects, because they aggregate the perceptions of businesses on the costs and risks they face. Such perceptions drive business decisions. Strangely, almost none of these surveys actually ask whether anticipated return on investment is increasing or decreasing. The problem with using such indicators as a measure of success for a reform program is that business perceptions are notoriously difficult to compare over time and across countries, they change for many reasons besides actual regulatory risks and costs, and they often suffer from a lag of uncertain length between reforms and changes in perception. Moreover, such measures are often viewed with suspicion by government officials, and so may not have the credibility needed to underpin reforms. It would be difficult to use these indicators as a measure of success for a national reform program, though they could be used to validate information from other sources.

Another aggregated approach to measuring success in business environment reform programs is to avoid using proxies and instead monitor revealed preferences—that is, actual business decisions. This approach would require a monitoring exercise aimed at sectors or activities affected by reforms, and developing indicators of changes in business profitability, investment, hiring, expansion, and other measures of revealed business confidence. These indicators can be measured in real time, but have the weakness of aggregating factors beyond the regulatory and administrative environment. Accordingly, they will probably measure only the most significant impacts of reforms that are visible through the noise.

None of the reform programs in the case studies summarized in this paper was followed up with this kind of detailed monitoring. Instead, the results of the reforms were embedded in larger macroeconomic results, such as national investment flows.

The approach used to measure the success of reforms is likely to drive their content and strategy. If the focus is on reducing net costs and risks, then aggregate measures are needed relevant to broad, systemic reforms. But such measures are not yet sufficiently developed for widespread application. This gap between the goals of reform and monitoring techniques merits attention.

3. SUMMARY OF REFORMS IN SIX COUNTRIES

The case studies summarized in this paper cover middle- and high-income countries that have successfully conducted broad reform programs. Some of the findings may not be directly applicable to low-income countries, but the overall lessons—linking reform strategies with reform drivers—seem transferable, with care, to countries with weak reform institutions and environments that are hostile to reform.

This chapter does not provide detailed summaries of the case studies, which are available separately.[4] Rather, brief descriptions of reforms in each country are followed in Chapter 4 by analyses of the drivers of reform and in Chapter 5 by the criteria deemed critical to success across the six countries. Table 2 provides a timeline of significant reform events in the six countries. It illustrates a point made repeatedly in this assessment: that broad, sustainable reforms did not occur rapidly, evolved over time (sometimes unpredictably), and unfolded through a series of steps that required the efforts of many actors. Success was determined by how these actors and steps were linked together in a momentum for reform.

4 See www.fias.net

Hungary

By 2001, after more than 10 years of determined reforms, Hungary had largely completed its historic social, political, and economic transition. One indicator of the scale of this change is that, by the end of 1998, the private sector generated 85 percent of gross domestic product (one of the highest shares in the OECD), up from 16 percent in 1989. The transition involved both new regulation and deregulation, and a conceptual as well as a technical transformation.

Starting in 1989, successive administrations eliminated large swathes of laws and other regulations designed for a centrally planned economy. In addition, every year Parliament passed more than a hundred laws, the government adopted twice as many decrees, and ministries promulgated many hundreds of orders. From government procurement laws to property rights, bankruptcy, and business startup rules, many of the regulations and

TABLE 2

Regulatory Reform Timeline in Six Countries

	Hungary	Korea, Rep. of	Mexico	Australia	Italy	United Kingdom
Pre-1980				**1960s and 1970s** Anxieties develop over a long-term decline in economic performance.		**1979** Conservative Party comes to power determined to reverse economic decline.
1980	**Late 1980s** Deteriorating macroeconomics and growing corruption. **1987–88** "Reform communists" take power and support market economy. **1989** Political upheaval leads to institutional and legal reforms. **1989–90** First guillotine review (driven by the prime minister).	**1980s** Economy becomes too large and complex for government-led development.	**1980–86** Economic crisis leads to stagnant economy and cumbersome bureaucracy. **1988** Salinas government pushes for rapid economic reform. **1989** High-level Economic Deregulation Unit created.	**1980s** Public backs substantial federal reform program.	**1980s and early 1990s** Soaring public deficit and corruption scandal prepare way for reforms.	**1980s** Focus on privatization; European Union (EU) Single Market spurs reforms. **1988** Next Steps initiative transfers public service delivery from ministries to tightly managed agencies.
1990	**1990–94** Reforms slow as bureaucratic support solidifies; key laws passed; macroeconomic problems continue. **1994–98** Second guillotine review (driven by legislature).	**1992** New regulatory reform laws and institutions have little impact due to poor staffing and ministerial resistance to change. **1992–96** Regulatory reform committees established under president have little clout and are not part of bureaucracy.	**1991–94** NAFTA requires structural reforms and key privatizations. **1994** When currency collapses, businesses demand reform.	**1994** Success of earlier reforms leads to adoption of National Competition Policy (NCP). **1994–95** State governments initially resist because NCP seen as federal power and money grab.	**1990** First administrative procedure and antitrust laws enacted.	

(*Continued*)

TABLE 2 (*Continued*)

	Hungary	Korea, Rep. of	Mexico	Australia	Italy	United Kingdom
1995	1998–2002 Reforms slow; privatization continues.	1997 Asian financial crisis shifts politics and leads to key Basic Act on Administrative Reforms. 1998 Influential Regulation Reform Committee created with civilian and government members. 1998–99 President orders 50% reduction in number of regulations 1998–2002 Regulation Reform Committee limits number of new regulations and helps interministerial coordination.	1995 Presidential decree requires regulatory impact analysis. 1995–99 Guillotine review eliminates 45% of business red tape. 1997–2000 Congress and Judiciary block reform initiatives.	1995 Federal and state competition entities created to oversee reforms; financial incentives bring states onboard. 1995–99 Stakeholders see urban areas as benefiting more than rural areas.	1996–2001 "Bassanini reforms"—single minister promotes a series of broad regulatory reforms to better position Italy in EU; key support comes from three successive prime ministers and general public. 1999 Central Regulation Simplification Unit established; regulatory impact analysis only on an experimental basis.	1997 Labor Party comes into power and reenergizes reforms. 1997 Better Regulation Task. Force formed to give voice to stakeholders. 1999 Central regulatory quality office created and regulatory reform official placed in each ministry. Regulatory impact analysis white paper published.
2000	2003 New government reenergizes market-oriented reforms. 2004 Hungary joins EU.		2000 Although Cofemer established as strong central agency, public backlash against reforms continues.	2000 Modest changes to NCP include better interpretation of "public interest test." 2004 Plans made for second wave of reform.	2000 Government allowed to use decrees to bypass parliamentary bottlenecks in getting regulatory reform tools. 2001 Ministerial and bureaucratic resistance to reforms increases; support among stakeholders wanes.	2000–03 Series of legislation enacted to improve business environment and competitiveness.

institutions needed for the smooth operation of markets were established and secured.

Important lessons from Hungary include the value of consistent reforms over several years (though this aspect should not be exaggerated, since the country's reform process was turbulent and not always coherent) and of accompanying market liberalization with governance reform. Hungary's reforms also show that institutions

play a crucial role in economic performance and good governance.

Republic of Korea

During 1993–2002 Korea's growth slowed, the performance of its *chaebol* (huge conglomerates) contributed to the massive financial crisis of 1997, and the country joined the OECD, forcing it to open its markets. In response to these challenges, an ambitious regulatory, financial, and structural reform program was launched in the late 1990s to make the economy more competitive and restore the foundations for sustainable growth.

The program worked, boosting the confidence of investors both domestic and foreign. The reforms moved Korea from a highly interventionist, authoritarian model of economic development to a market-oriented, open model based on consumer choice, democracy, and the rule of law. The changes made to Korea's public sector are among the most far-reaching reforms of regulation ever undertaken in an OECD country.

Mexico

Mexico made regulatory reform a central element in its transformation from an inward-looking economy to an open, market-based one. The rapid pace, broad scope, and considerable depth of Mexico's regulatory reforms exceed those of most longtime OECD countries, and are comparable to those of the emerging market economies in Eastern Europe that recently joined the OECD.

By 1998 virtually all price controls had been eliminated. A deregulation program adopted in 1995 attacked myriad forms of government intervention in economic activity and promoted better regulatory techniques throughout the public administration (including at state and municipal levels). These efforts were supported by others aimed at modernizing the Mexican state. Domestic reforms were boosted and underpinned by new international commitments as Mexico joined the General Agreement on Tariffs and Trade (GATT), Asia-Pacific Economic Cooperation (APEC) consortium, and OECD, and signed the North American Free Trade Agreement (NAFTA) as well as other free trade agreements with Latin American countries.

High-Income Countries

A single case study was conducted of three high-income countries—Australia, Italy, and the United Kingdom—that are representative of successful, broad, multi-year reform programs resulting in much stronger business and investment environments. Though the focus of reforms varied by country, the processes faced similar challenges: conceptualizing, organizing, marketing, implementing, and sustaining major regulatory reforms despite institutional weaknesses, incentive problems, and resistance from public and private interests. While the ways that reforms were enacted were tailored to each country, this paper draws general lessons about institutions, externalities, capacities, and organization of reform energies that sustained change in the face of vested interests.

Australia

In 1994 the heads of Australia's federal, state, and territory governments adopted a national competition policy. The policy sought to accelerate and broaden microeconomic reform to achieve higher, sustainable economic and employment growth. A unique feature of the policy is that it was designed as an integrated strategy that would apply consistent competition principles across an extremely wide range of policy areas and multiple levels of government. It aimed to embed a presumption in all regulatory processes that competition would not be restricted, and imposed strict public benefit tests to limit such restrictions. A key goal was to ensure the existence of a single open market for goods and services across

Australia. The National Competition Policy (NCP), which was implemented over six years, represented a long-term policy commitment, building on long-term microeconomic reforms that began in the 1980s.

Italy

Starting later than many countries, Italy devoted the 1990s to catching up with leading OECD countries on economic and governance reforms. The scope, speed, and consistency of structural reforms over multiple administrations were remarkable. Regulatory reform was only one of many changes in Italy in the 1990s, but it was an essential one. After the macroeconomic stabilization program of the early 1990s, regulatory reform helped attack many of the underlying structural problems in the economy and the public administration.

The confluence of multiple political and economic challenges—domestic and foreign—was in some ways shock therapy for Italy. Rigidities and practices accumulated over decades were reassessed, and many abandoned. Growing awareness of the excessive role that the state played in economic life led to policy and institutional changes. As the political landscape was redrawn, aspects of the centralized state were dismantled and many statist economic policies were replaced with more transparent, pro-competition policies.

United Kingdom

Since the early 1980s regulatory reform has been a key part of successive U.K. administrations' ambitious structural reform programs, intended to strengthen competition and private sector vitality. Four features of recent regulatory reforms in the United Kingdom are particularly relevant. First, an extensive program of privatization, deregulation, and targeted re-regulation was conducted. Second, deregulation occurred at the same time as extensive re-regulation through the creation of numerous new regulatory bodies. Third, reducing regulatory burdens on small businesses was a central feature of the program. Fourth, public sector reforms sought to ensure that public services were of high quality, effective, and homogeneous.

4. DRIVERS OF CHANGE: THEORY AND EXPERIENCES

Opportunities for genuine reform come rarely—often only when crises and external pressures make clear the costs of inaction and change the balance of power that previously protected the status quo. In most countries where donors are active, the dynamic of change is controlled by public choice and captured state interests.

Such interests almost always run contrary to the role of the state as envisioned in business environment reforms. In most developing countries, improving the business environment requires that governments unwind extensive state involvement in the economy, discourage entrenched rent seeking behavior, build new regulatory and administrative capacities, and create market-based regulatory regimes and institutions that support investment, innovation, and vigorous competition. How can drivers of change work against drivers of the status quo?

A greater understanding of the dynamics of change is emerging primarily as a result of decades of study in fields such as political science and new institutional economics. These efforts recognize that sustained changes in economic policy can be understood only in the context of wider changes, particularly in the stock of knowledge and institutions—such as market institutions changed by globalization and political institutions changed by upheaval.

This macro perspective drives some advocates of new institutional economics to pessimism because of the difficulty of bringing about broad change. But it should not obscure the fact that reformers can influence the direction and pace of change. This perspective emphasizes the roles of drivers of change, defined here as forces that expand opportunities for reform within the political economy of a country. This chapter reviews the seven main drivers of change

identified in the academic and development literature:

- Globalization or competitiveness
- Crisis
- Political leadership
- Unfolding reform synergies
- Technocrats
- Changes in civil society
- External pressure

These drivers are assessed for their relevance in each of the six case studies discussed here (Table 3). The studies show that, rather than a cause-and-effect scenario in which a driver of change creates and defines the success of a body of reforms, what happens is an unfolding series of events in which various drivers rise and fall—becoming more and less important in driving reforms. If this conclusion is correct, strategic exploitation of drivers of change is key to sustainable reform.

Globalization or Competitiveness

As capital and corporations move more freely across national boundaries, governments are forced to engage in regulatory competition. To retain current investments and attract new ones, they must lower the costs of doing business in their countries (Vogel and Kagan 2004, 3). Thus, globalization drives regulatory reforms intended to reduce the costs or risks of investment and increase expected returns on investment.

The globalization or competitiveness driver is often supported by the use of comparative indicators of performance that are intended to carry two messages. First, to the extent that such indicators can be correlated with economic performance, rankings on the indicators are proxies for relative performance. Improvement in the indicators is supposed to improve economic performance. Second, a country targeted for reform is usually described as falling behind peer countries. This message is intended to convey a sense of urgency to the government in pushing ahead with reforms in order to catch up—that is, capture its fair share of global wealth.

The competitiveness driver of reform is familiar to donors, who often rely on it to persuade political elites that the costs of not reforming will be higher than the costs of reform. In this case the costs of the status quo are seen as rising, reducing the cost of change.

Competitiveness was important in all the case studies. In every country reforms were an explicit response to fears of falling behind, losing national markets, and seeing rising imports. These fears were especially strong in countries trying to integrate with markets where competition was keener (Mexico with North America; Hungary, Italy, and the United Kingdom with Europe). These fears were also strong in countries dropping barriers to foreign trade and investment, exposing domestic businesses to new international competitors (Australia, Korea).

Concerns about competitiveness can lead to damaging policy reforms, such as protection and government intervention. But such concerns can also lead to market-oriented reforms. Decisions to respond with market-oriented reforms in the six countries were due to other drivers, such as strong external pressures to open markets and consensus that growth depended on private sector performance. Indeed, regulatory reforms were widely seen as a way to deal with competitiveness concerns. The first round of regulatory reforms in Korea cut by more than half the number of industries subject to strong entry barriers, while continued efforts to drive down regulatory costs pulled Korea up on the World Economic Forum's *Global Competitiveness Report* from 48 of 53 countries in 1997 to 26 of 75 in 2002.

The nature of regulatory competition in global markets has been the source of much debate in the developed world. Some feel that regulatory competition has led to a "race to the bottom" in which environmental and labor standards are undermined by companies seeking to become more competitive. Other groups, supported by most academic studies, believe that regulatory competition tends to increase efficiency and quality rather than laxity—and that higher economic growth generally leads to higher protection through improved regulation (Drezner 2000). For that reason the competitiveness driver must be carefully deployed, to avoid the impression that competitiveness is strictly about expanding deregulation and reducing burdens on businesses.

The globalization driver has the potential to drive a broad reform program. But often, because its starting point is the interests of large investors, it leads to a narrow focus on their needs. This is the inherent contradiction of the globalization driver: competitiveness is a far-reaching concept, yet reforms related to competitiveness often focus on the needs of large, export-oriented investors.

Crisis

"A crisis is a terrible thing to waste," wrote Thomas Friedman (2005). Many theories of reform start with the idea of a galvanizing event—some kind of crisis that upsets the balance of power that has preserved the status quo. This approach has much appeal because it seems to be one of the few realistic ways of loosening the grasp of powerful interests that have captured the state apparatus.

The six subject countries in the case studies present a mixed picture of the importance of crisis in reform. Three (Hungary, Korea, Mexico) sought reform while recovering from painful economic and political crises. All three used the crisis to launch reforms whose consequences were probably not well understood outside the reform elite. The other three countries (Australia, Italy, United Kingdom) did not face alarming short-term crises, but were beset by a sense that crisis was looming unless real change was made. In these countries, competitiveness fears substituted for a real crisis.

Reformers may applaud the opportunities afforded by crisis, but crisis is a high-risk approach to achieving reforms. Italy, and to some extent, Korea, show that reforms launched on the back of a crisis can be difficult to sustain. There is also no assurance that leaders will make the right decisions in the face of a crisis, rather than making things even worse. Mexico went through a long series of peso crises in which policy reforms followed no coherent strategy—before finally arriving at the sustained market-oriented reforms of the 1990s.

Political Leadership

Even when a crisis becomes apparent, lack of political leadership can result in little or no action. There is little question that whatever the other drivers, political leadership is the yeast that makes them rise. Political leadership is at its most fearless just after elections, when promises of reform and the forbearance of the electorate are at their height. When crisis leads to political shakeup, opportunities for reform are maximized. But by then, the costs of reform can be much higher.

Public choice theory assumes that courageous political leadership will not occur because politicians will always maximize their well-being by splitting up the economic pie in a way that ensures their re-election. But even under the public-choice paradigm, predatory states sometimes create a situation where radical reform is a self-interested strategy. In such cases "political leadership" simply means a political elite skilled enough to recognize that its advantage lies in reform. This type of skilled elite does not emerge very often.

TABLE 3

Key Drivers of Regulatory Reform in Six Countries

Driver	Hungary	Korea, Rep. of	Mexico	Australia	Italy	United Kingdom
Globalization or competitiveness	Reform was triggered by the need to create a market-based economy and join the EU.	To increase foreign direct investment, reforms had to remove explicit investment barriers and excessive regulations.	In the 1980s, competition for international capital and investment was growing, and leaders saw the benefits of liberalizing trade for assembly plants exporting primarily to the U.S. market.	Australia, a small (in population) and isolated country, was deeply conscious of the importance of keeping up with global economic trends and competition.	An important factor for Italian reform was the need to meet economic conditions for entry into the Eurozone; that need also triggered fears of falling behind in Europe.	U.K. reforms were instigated by strong support for building the Single Market, which brought with it many EU harmonization laws as well as open trade.
Crisis	An unprecedented change in political regime and collapse of the economy created new elites and growing expectations for real change.	The 1997 crisis produced the most painful economic contraction in OECD history. 1998 was the first year since 1979 in which Korea had negative growth.	In the 1980s, a collapse in oil prices and default on massive external debt, followed by five years of economic stagnation, triggered privatization, trade liberalization, and regulatory reform.	Economic crisis was not a crucial trigger, but between 1960 and 1992 Australia had fallen from being the 3rd richest OECD country to 15th.	Economic crisis was triggered by spiraling public debt and radical political changes.	Economic crisis was a crucial trigger of reforms. The country had also faced economic decline relative to its neighbors leading up to the financial crisis of the late 1970s.
Political leadership	Successive prime ministers actively backed reforms to secure democracy, the rule of law, open markets, and eventually EU membership.	The president elected in 1997 supported reforms. The National Assembly provided support by enacting legislation needed to implement them.	The president and a small group of advisers initiated extensive reforms using a top-down approach based on traditional command-and-control mechanisms. The resulting backlash slowed reforms.	Prime Minister Paul Keating, a former finance minister, was committed to adopting the National Competition Policy.	Reform was driven almost entirely by strong leadership from one ministry and the prime minister.	The election of Prime Minister Margaret Thatcher in 1979 gave the country a leader determined to reverse its economic decline and lift state economic controls.
Unfolding reform synergies	So many reforms were launched in such a short period that reform could be slowed, but not stopped—without disaster.	Initial top-down reform produced impressive results, but lack of incentives for regulatory reform within the government slowed further reforms after a few years.	Market-opening reforms increased stakeholder pressures for economic liberalization, which increased public sector capacity for good regulation.	Opening markets years earlier produced strong consensus on domestic reforms. General agreement on National Competition Policy reforms partly resulted from the clear economic	There was little success in building reform momentum outside of political and technocratic pressures. This compromised the speed, if not the implementation, of further reforms in those areas.	The country experienced a rolling succession of reforms, each of which sowed the seeds for further efforts—though the need for ongoing negotiations impeded some reforms.

TABLE 3 (*Continued*)

Driver	Hungary	Korea, Rep. of	Mexico	Australia	Italy	United Kingdom
				benefits of earlier reforms, but it took considerable effort to reach bipartisan agreement on the structure of reform.		
Technocrats	The strongly independent, professionally staffed Hungarian Competition Office played a vigorous role in privatization.	The Regulatory Reform Committee—staffed partly with academics, supported by civil servants, and co-chaired by the prime minister—is responsible for examining new and existing regulations and maintaining regulatory quality.	In 2000, an agency was created in the Ministry of Economy to impose quality and transparency on the public sector, and highly trained technocrats (economists) had legal authority and political backing to drive reforms.	Active support from the finance ministry was important. The National Competition Council, a dedicated entity created to monitor reforms, ensured consistency and transparency in reporting.	An academic minister of public administration and his aides drove reforms in league with a technocratic prime minister. But a powerful new institution did not emerge—one reason the reform faltered with a change in administration.	Reform had many institutional champions: a dedicated unit at the center of government responsible for overseeing regulatory quality, a number of task forces and other groups, and the National Audit Office.
Changes in civil society	Reform was legally based, with active involvement by Parliament and extensive consultation with stakeholders such as businesses, trade unions, and disadvantaged social groups.	Political support for reform was built on a popular campaign to eliminate corruption, which coincided with an upsurge of non-governmental organizations (NGOs) focused on the issue. NGOs grew very quickly: by 2000 there were up to 8,000, providing a new force for political change.	Early reforms were not transparent, which limited reformers' ability to gain support from private stakeholders. Later, as political support wavered, special private bodies were created to oversee the reforms and provide sustained support.	Reforms in the early 1980s reduced economic decline. Their success showed that much of the population accepted that painful reforms were essential to reaching economic goals.	Identifying Italian reforms so closely with a strong minister enabled them to be implemented in the short term, but efforts dissipated when the minister left and the administration changed.	Common law traditions against developing systemic approaches across government led to an ad hoc approach to reform that made public buy-in harder, increased costs, slowed results, and contributed to reform fatigue.
External pressure	Close relationships between government officials and outside think tanks and international organizations helped reforms through inflows of new ideas, shared experiences, and funding.	OECD membership brought new demands for openness and good regulatory practices. In 1997 the government, in cooperation with the International Monetary Fund (IMF), began deregulating the financial sector.	Mexico's close relationship with the United States—cultivated through NAFTA—helped it recover quickly from the 1995 liquidity crisis.	Opposition was defused by including in the National Competition Policy provisions for the federal government to make "competition payments" to states (contingent on successful completion of reform obligations).	Ministerial and bureaucratic resistance to further reforms and reversion to the status quo ante took hold after 2001.	Reform was aided by an active EU Commission legislating for the removal of barriers to the free movement of services, goods, and people. Inconsistency with European competition law caused modernization of U.K. law.

Political leadership was essential in the six subject countries. All six benefited from champions of reform at the center of government (a prime minister or president) or a strong cabinet minister (finance, public administration). Indeed, political leadership guided reforms away from damaging responses to crisis into more open, market-based reforms. In two countries (Australia, United Kingdom) very strong, almost autocratic politicians drove reforms forward despite strong but disorganized political resistance.

Political orientation does not seem to matter much in terms of propensity to lead reforms. In Italy, Korea, and Mexico the reform governments were on the left or nationalist. In Australia and the United Kingdom, the governments were strongly to the right on market economics. And in Hungary, ideology had collapsed. This mixed pattern seems to support theories about the "end of history" and the weakening of political ideology as a driver of reform.

However, politicians on the right seem to have been slightly more proactive in looking to the future than were politicians on the left. The best political leadership is proactive, rather than reactive, in the midst of crisis. Skillful political leadership is needed to increase capacity for change in the run-up to crisis, and to design and implement reform strategies quickly to lower the cost of lost opportunities and ease the pain of transition. Sometimes political leadership simply watches a crisis unfold without taking action, as in Japan during its long banking crisis.

Unfolding Reform Synergies

OCED countries have long recognized important complementarities across product, labor, and capital markets. These complementarities are relevant because market-oriented reforms in one area can increase pressures for reform in other areas—and even change the political economy downstream or upstream so that other voices for reform emerge. This can be called the "avalanche theory of reform," where making a small change can lead to a landslide of reforms over time.

Several mechanisms can be used to create a self-sustained and expanding reform movement. If consumers see tangible benefits early on, they are more likely to support continued reform. New interests can increase pressures for reform in other areas. Reform in one area can make costs of regulation in other areas more visible and painful. Tariff reform has stimulated reform of national product markets facing competition from imports.

Four of the six countries studied here (as well as others studied elsewhere, such as New Zealand) were able to exploit such links between reforms.[5] Australia initiated competitiveness reforms several years after tariff reforms increased pressures from foreign competition in the domestic economy. In Mexico, the integration of the North American economy through NAFTA strengthened technocrats and induced private industry associations to lobby for less government intervention. The United Kingdom carried out a rolling program of reforms, but was less successful in linking successive reforms due to a need for extensive negotiations and political investment at each stage. In the two countries that did not exploit such links (Italy, Korea), reforms slowed after a few years or halted when the administration changed.

Recent World Bank research, including the six country case studies examined here, also found that linking reforms was a powerful driver of change. It concluded that in virtually all instances reforms were linked to or resulted from trade and other liberalizing reforms, and that increased pressures from international competition often led firms to demand a better business

5 New Zealand initiated labor market reforms in the early 1990s, but only after radical regulatory reform in product markets in the 1980s contributed to massive unemployment because the labor market could not adapt to the new environment.

environment (World Bank 2006). It also noted that in India trade liberalization created a need for infrastructure investment and supply chain improvements, leading the government in 1996 to initiate reform of the country's inefficient ports by allowing private investment. Although direct causality is not clear, the regions that have made the least progress on microeconomic reform (such as South Asia and the Middle East and North Africa) also have the highest barriers to trade and foreign direct investment.

Links across policies lead reformers to debate how to sequence reforms, and how important sequencing is. The optimal sequence from an economic perspective (in terms of rapidly reducing transition costs and achieving benefits) may differ from the optimal sequence from a political perspective (in terms of maximizing political momentum for reform). There is little evidence that engineering the sequence of reforms works well. Most countries have approached sequencing pragmatically, since waiting for the optimal sequence can delay reforms for a long time. For that reason, the OECD has advised its members to carefully consider sequencing, but not to abandon opportunities while waiting (OECD 1997).

Technocrats

A popular notion in development literature is that reform can be driven by politicians and senior civil servants with training in economics or other fields who develop rational policies for leading their countries forward. These technocrats develop reforms based on the promotion of the general good—a goal formalized as maximizing the social welfare function based on a value called the "Pareto criterion." Neoclassical theory says that the general good will be promoted under certain conditions in competitive markets, a theory that has received considerable empirical support over the past 20 years. Such a theory of reform is in direct opposition to public choice theory.

Technocrats such as President Carlos Salinas of Mexico, President Lee Teng-hui of Taiwan (China), and Minister of Finance Manmohan Singh of India played significant roles in defining and driving dramatic economic reforms. Skilled technocrats at various levels of government have also been crucial to regulatory reforms in many other OECD and developing economies.

Similarly, technocrats were extremely important to the success of reforms in the six subject countries discussed here. These technocrats were most effective when they were highly trained and based in independent or reform-oriented institutions with legal mandates to advance change.

In some cases, existing technocratic institutions were given mandates for regulatory reform. Competition offices, with independent investigation and even veto authorities, were important in Australia and Hungary, as was an independent national audit office in the United Kingdom. Finance ministries were important in only a couple of these countries, which is interesting given the frequent reliance on such ministries as the counterpart for donors in developing countries.

Special regulatory reform institutions in Korea, Mexico, Australia, and the United Kingdom provided a central focus for technocrats to build new, specialized regulatory expertise. The top-down reforms in Korea and Mexico were driven almost entirely by dedicated teams of technocrats who were either Ph.D economists (Mexico) or supported by strong academic and research institutions (Korea).

These experiences suggest that technocratic drivers of reform work better with a strategic approach aimed at strengthening the muscle and capacity of pro-reform technocrats relative to parts of the state governed by public-choice motivations. Institutions can be built that give such technocrats more influence in the governing

system. This was the effect of NAFTA in Mexico and OECD accession in Korea—both events reduced the grip of politicians on policymaking and increased the power of technocrats. In effect, politicians ceded power to technocrats through legal devices in the form of international agreements.

Donors tend to choose technocrats as counterparts because they are more stable in the political process and more sympathetic to the theories and goals of microeconomic reform. As a result, technocrats play a larger role in donor reform strategies than is probably warranted.

Changes in Civil Society

Reform is not a task only for governments, even in countries with weak civil societies. Other stakeholders, such as firms and workers, can help build support for reform and share information across borders. As civil society develops, the balance of power protecting the status quo can change, and opportunities for reform widen.

This is clear from Korea, where a rapid jump in the number of non-governmental organizations (NGOs rose from a few to more than 8,000 in a few years) increased the focus on issues such as corruption, good governance, and capture of the state by the chaebol. This new political movement helped break the decades-long grip on regulation held by bureaucrats and special interests. Korean reformers included an unprecedented degree of transparency in the reforms, and ongoing media coverage kept political attention on reforms longer than otherwise would have occurred. It could even be argued that as reforms became more routine, public and media attention dropped—contributing to fewer and less effective reforms in later years.

Mexico's reforms started with little support from civil society. They were top-down, technocratic, and poorly understood by the general public. But as political support began to waver, changes to the reforms created more visible private sector advisory groups, which played a very participatory, hands-on role in the reforms. This support has helped sustain reforms even as political regimes have changed.

In Italy, limited civil society participation in and understanding of reforms made them less sustainable. Indeed, the reforms were rapidly wound down once the administration changed.

Fostering an active, reform-minded civil society is a key driver of reform—one that has been neglected in most developing countries, where donors have focused on making changes to governments. Encouraging civil society support for reform is not just a notion, but an operational strategy. Using civil society to help expand opportunities for reform requires that a crucial stage of reform precede the actual start of reforms: selling reform to an often skeptical public. Citizens need to understand why reform is so important to their future well-being and that of their children. Open dialogue with major stakeholders on the benefits and costs of reform can improve understanding on all sides of short- and long-term effects of action and inaction, and of the distribution of costs and benefits. In most countries, reform would benefit from wider, more informed debates less dominated by special interests that stand to lose the most.

The OECD has found that developing and articulating transparent policies for regulatory reform—both government-wide and for individual sectors—can generate political commitment, result in more coherent and carefully planned reforms, mobilize constituencies for reform, and focus public debate on benefits and costs. Reforms are more credible when the path forward is clearly defined, and credibility is vital if the private sector is to invest and workers are to accept bearing some risks in addition to reaping benefits.

Communication can strengthen the voices of those who support and stand to gain from reform. Important allies of reform include consumers and businesses who will gain from lower-cost, higher-quality goods and services, and employees in fields where job creation and wage growth are constrained by unnecessary regulatory restrictions.

External Pressure

One surprising finding of the six case studies is the importance of external commitments and drivers, even for governments in highly developed countries. In some cases external institutions seem to act as an escape valve, permitting a reform-minded government to shift the responsibility for reform—and hence the political costs—to external players. In other words, external drivers can weaken the public-choice driver in which individual politicians are accountable to special interest groups. External drivers have included international bodies such as the OECD and International Monetary Fund (IMF), intergovernmental organizations such as the European Commission, trade agreements such as NAFTA, and bilateral relationships with donors.

The most compelling example is in Mexico, where a trade agreement made trade liberalization a binding national obligation that reformers used to justify further privatization and economic deregulation. The trade agreement shifted discretion away from a government that was previously unable to quickly move away from special interests and toward technocratic and reform-minded institutions.

Donors have a mixed record in terms of using external drivers strategically. Most donors play a quiet game of claiming credit for reforms back home, while publicly giving credit to the reforming government. Yet there is skepticism that donors are especially effective at driving successful reforms. Recent evaluations by the World Bank have found low compliance with policy conditions for Bank structural adjustment loans, even though these policy reforms are leveraged, negotiated, and monitored.[6]

In two of the countries studied here (Hungary and Korea), conditionality for OECD membership was important in strengthening other reform drivers. Conditionality seems most effective when reform is already supported by other reform drivers, such as political leadership and preexisting commitment to change. A 2004 evaluation of the FIAS administrative barriers program found that conditionality works when it is supported by reformers in the client country who need support during the implementation phase. In Croatia and Latvia, for example, implementation of FIAS recommendations was part of World Bank structural adjustment loans. This pressure was welcomed by Croatian reformers facing political fatigue. And Latvian reformers actually volunteered the idea of putting the most difficult FIAS recommendations into the structural adjustment loan conditions.

By itself, conditionality seems insufficient to break the balance of power that maintains the status quo. But when teamed with other drivers of reform—especially reform-minded technocrats—donor pressure seems to expand or at least maintain opportunities for change.

6 The nature of conditionality, particularly as applied by the World Bank, is changing in response to perceived failings in enforcement; see World Bank (2001). For a recent review of the literature on policy conditionality, see Mosley, Noorbakhsh, and Paloni (2003).

5. CRITICAL FACTORS FOR SUCCESSFUL REFORM

The drivers of reform are the fuel that enables governments to overcome pressures to maintain the status quo. But these drivers must be channeled into a reform strategy that identifies, adopts, develops, communicates, and implements beneficial changes. The design of these changes is the real technology of reform.

This chapter identifies critical success factors for the reform strategies in the six subject countries. Its sections correspond to major components of the reform process identified in previous studies: exploiting drivers of reform, setting the reform agenda, implementing reforms, monitoring reforms, and sustaining reforms over the medium term (Table 4).

Exploiting Drivers of Reform

Making strategic use of drivers of reform—even those exogenous to the policy process—is one key to successful reform. Drivers of the status quo can be overcome only with a mix of drivers of reform. How can the drivers identified in this paper be amplified to maximize opportunities for reform?

As noted, the six countries discussed here do not show a linear cause-and-effect scenario in which a single driver of change creates and defines the success of reform. Crisis did not create reform; nor did political leadership. All six countries used a changing mix of drivers through an unfolding sequence of events. Despite country-specific situations, there seems to be a pattern to how drivers were sequenced:

- A crisis, a sense of impending crisis, or external obligations were always important at the start of reforms. They redefined the political economy of launching change, and emboldened reformers inside the government.
- Crisis and obligations generated market-oriented reforms when politicians allowed technocrats to design the way forward, define the content and goals of reforms, and spearhead their implementation.
- Market-oriented reforms became sustainable with institutionalization and mobilization of constituencies for change.

The way that these steps work together is the reform strategy, and the effectiveness of using drivers to seize opportunities for reform will vary depending on the strategy used. Korea shows the importance of using the right strategy to exploit opportunities for change: its growing NGO population was empowered through the unprecedented transparency and consultation procedures of the regulatory reform. The transparency of Korea's reforms was ideally matched to encourage and benefit from the emergence of an NGO constituency that was proactive and ready to challenge the government. In Mexico, the opportunities provided by NAFTA were realized only through the creation of new institutions charged with preparing the country to become more competitive. In both cases the governments were not satisfied with simply reacting to the drivers of reform: they also created situations where the drivers were amplified and sustained over a long period.

Hungary used the imperative of transformation and EU membership to launch its reforms, but made extensive efforts to build new institutions—both top-down and bottom-up—throughout the public administration. Rapid initial economic deregulation and constitutional reforms, driven by the prime minister's office, were followed by a period of consolidation and institution building throughout the public sector to build the mechanisms needed to oversee free markets. This pause was needed to maintain the support of an increasingly alarmed public and to build new constituencies for reform in the public sector itself. It was followed by new rounds of reforms.

Although crisis and political leadership can launch reform, institutionalizing reform is crucial to combating resistance. In Australia, the National Competition Policy reform effort began in 1994 with support at the highest levels. But in 1995 the government realized that it had to create the National Competition Council, with special powers and responsibilities, to support implementation over several years. In the United Kingdom, when political momentum faltered, government institutions—including task forces and other partnerships already established in the bureaucracy—took over and ensured that reforms continued. In Italy, however, a failure to separate the roles of politicians and civil servants undermined the sustainability of reforms.

Setting the Reform Agenda

These six countries exhibited remarkably similar reform patterns. Crisis generated market-oriented reforms when agendas were set outside traditional insider-interest processes. Reform agendas were imported from other countries, or politicians allowed reform-minded technocrats to define the goals and content of reforms. The risks of getting reform wrong are highest when pressures to reform are highest, because of a strong incentive for short-term efforts to get fast results. If reform is captured by insider interests at this stage, it may simply paper over underlying causes, leading to a harsher crisis later. Many analyses of the 1997 Asian financial crisis concluded that this was what had happened to earlier efforts to address the growing economic imbalances in the region. Thus initial agenda setting is crucial.

In all the countries discussed here—both moderately and highly developed—reform agendas were strongly influenced by international practices and pressures. Whether in the interest of the European single market, the North American market, or OECD membership, outside agendas became domestic agendas. The benefits of integration and convergence came to be seen as more important political advantages than continued deference to the insider interests that had previously enjoyed primary influence. In addition, international benchmarks of reform practices increased transparency for reforms that had gone off track.

TABLE 4

Critical Factors for Reform Success in Six Countries

Factor	Hungary	Korea, Rep. of	Mexico	Australia	Italy	United Kingdom
Exploiting drivers of reform	Institutional drivers of reform were shifted at opportune times to have reformers be the ones most adept at delivering needed results.	The country's expanding NGO population was given more power to help reforms through government adoption of transparency and consultation procedures to advance regulatory reform.	Potential opportunities arising from NAFTA accession were amplified by creating new government institutions charged with preparing Mexico to compete.	While the National Competition Policy was first adopted in 1994, the government saw the need in 1995 to create the National Competition Council to ensure the policy's implementation.	A failure to separate the roles of politicians and civil servants undermined the sustainability of reforms.	When political leadership faltered, government institutions—including task forces and other partnerships—took over and ensured that reforms continued.
Setting the reform agenda	High-level commitment to market-oriented reforms was vital to securing support from foreign investors and creditors on whom the government depended for economic growth. Though seeking a dramatic shift to free-markets, Hungary relied on existing legal and administrative frameworks to implement change. Periods of intensive reform were followed by periods of building institutions and broadening ownership of changes.	Political parties supported reforms to counter the fiscal crisis. The public supported reforms to reduce corruption. Mutually reinforcing goals sustained long-term support. The 1998 Basic Act on Administrative Reforms created the Regulatory Reform Body and mandated quality controls such as regulatory impact analysis. Reformers based these analyses on OECD guidelines and used the OECD peer review process as an external pressure to maintain the quality of reforms.	Current difficulties in furthering market-oriented reforms indicate that earlier ones were too top-down to overcome institutional resistance and build outside constituencies. Enacting federal competition and administrative practice laws provided more certainty to businesses and, through greater transparency, improved public acceptance. Market openness increased pressures for liberalization, which led to reforms in public sector capacity for good regulation.	Clear competition principles set standards of accountability for the new National Competition Council and counterpart state groups. The council was supported by the well-respected competition authority and powerful finance ministry. Clearly defined commitments and responsibilities helped increase stakeholder support for reform.	Unions involved with reform represented both public and private workers, helping to balance concerns of potential winners with those of possible losers. The sustainability of reforms was undercut because political support did not extend beyond the prime minister and a strong minister. No single, powerful new institution emerged, and the finance ministry did not play a major role. Reform momentum waned when the government changed.	Creation of the Better Regulation Task Force, containing many private stakeholders, spread ownership of reforms. It recommended necessary actions and monitored success. Ad hoc groups with both public and private members initiated reforms, and central ministries institutionalized the process. But lack of an overarching strategy slowed some reforms and results. The build-up of new initiatives was often hard to digest and coordinate with stakeholders.

TABLE 4 (*Continued*)

Factor	Hungary	Korea, Rep. of	Mexico	Australia	Italy	United Kingdom
Implementing and monitoring reforms	In just a couple months, a courageous guillotine review helped eliminate obsolete regulations. Another led to harmonization with EU legal standards.	In addition to legislating information disclosure, Korea required independent reviews of regulatory quality, supported by consultations with stake-holders.	An account-able, transpar-ent, efficient regulatory framework was enhanced by placing draft regulations and regulatory impact analyses online for public review and comment.	National Competition Policy agreements between the national and state govern-ments provided a public benchmark for all subsequent review and reforms.	The short-term goal of cutting red tape was backed up by tangible, visible tools, strategies, and structures (self-certifica-tion, one-stop shops, codification, regulatory impact analysis, e-government).	Businesses and consumers were invited to join in the reform process through participation in ad hoc advisory groups.
Sustaining reforms over the medium-term	Early market openness anchored the restructuring of government ministries.	An independent regulatory review agency at the center of government countered the pro-regulation tendency of ministries.	Three mutually supportive elements—market openness, privatization, and regulatory reforms—helped build constituencies to advance needed initiatives.	Initial bipartisan agreements meant that the public received consistent messages about the benefits of reform, helping to maintain public support despite changes in government.	Initially, strong central leadership was complemented by measures that engaged stakeholders and promoted their ownership of reform.	Strong political leadership was important to initiate the review effort because of a general cultural hostility to the development of systematic approaches across government.

Measuring the extent of problems has become a growing element of reform strategies. Governments are using an increasing range of cross-country indicators to set priorities and goals for regulatory reform. This is sensible if the indicators are sophisticated and flexible enough to advance a broad program aimed at net reductions in regulatory costs and risks—changes that actually influence business behavior. None of the six countries studied used indicators of business costs to drive reforms; rather, they were heavily influenced by indicators of macroeconomic performance. The narrower, bottom-up indicators increasingly used to set reform agendas may have a very different effect on results and sustainability.

Although experiences are mixed, the process of setting the reform agenda seems to be an important part of the strategy, communication, and political engagement needed for success. The agendas in most of the six countries were initially set by fairly narrow groups in response to a national consensus that something had to be done about a specific problem. This can be a risky period, because insider groups are strongest at this stage. But technocratic groups setting agendas already existed in the governments, newly empowered to implement reforms that they had already been promoting. Regulatory reform had been promoted for at least eight years in Korea, with few results. Italy had already adopted legislation for the European single market, but with little effect on its reams of domestic regulations. Mexico had tried for years to open its economy. Hungary had launched market-oriented reforms years earlier. These various

reform-minded groups were empowered by crisis, external pressures, and political direction to define much bolder reform agendas. Their experiences with reforms were extremely useful in showing which would not work and the way to new, innovative strategies.

These technocratic agendas, at different speeds, received support from a growing circle of public and private interests—promoting further evolution of the agendas. In most of the six countries, public-private arrangements were used to reach a shared vision on the nature of problems and desired outcomes. Mutually reinforcing goals helped maintain support for reform.

In Hungary, high-level commitment to market-oriented reforms was vital to securing support from foreign investors and creditors, who had powerful interests in maintaining rapid economic growth. Foreign investors were extremely influential in maintaining the country's focus on reform. In Korea, the main political parties agreed to support reforms to fight the fiscal crisis; the public supported them to reduce corruption.

In the United Kingdom, the 1997 creation of the Better Regulation Task Force with members of many private stakeholder groups—large and small businesses, consumer groups, unions—spread ownership of reforms and helped communicate its importance and benefits. In Australia, at the start of reform, the national government used financial incentives to bring on board stakeholders from state governments, an important step given the uncertain distributive effects of moving to a competitive marketplace with the privatization of many utility monopolies. In Italy, it helped that the unions involved with reforms represented both public and private workers—that is, the potential beneficiaries and possible losers from reform.

The six countries also show examples of the converse lesson: lack of public-private consensus on reforms reduces the likelihood of success. Mexico's difficulties in advancing further urgent reforms (particularly in the energy sector) after 2002 indicate that earlier reforms were too top-down and autocratic to overcome institutional resistance and build outside constituencies. Italy's reforms were so closely identified with a strong minister that reform efforts dissipated when that champion left office. Indeed, the six case studies provide little support for the "champion" model of reform. None of the six countries used a single strong reformer to achieve sustainable results.

Implementing Reforms

Drivers, decisions, and designs are good starts, but the fatal weakness of many broad reforms is failure in implementation. At the nexus of public administrations and interest groups, public choice incentives are highly protective of the status quo. Reforms designed by a single technocratic group or political champion can easily run into problems during implementation, when the incentives and capacities of existing institutions constrain progress. Passive resistance is common, and reforms are easily reversed. The six countries studied offer several lessons about successful implementation.

First, reforms must be tailored to the country's institutional apparatus. The six countries mostly took pragmatic approaches in this regard, building reforms into familiar institutional and legal structures, powers, and incentives—and then, if needed, creating new institutions and regimes. Hungary knew that it needed to make dramatic shifts to move rapidly to a free market economy (for which there were many external models), yet used decades-old legal and administrative frameworks (some from the 1930s) to implement change. Korea used structures in the prime minister's office, and an influential network of research institutes attached to ministries. Only the United Kingdom

built mostly new structures, but this is probably easier in a common law, rather than a civil law system.

Second, active management and resourcing of the reform process—primarily through dedicated leadership in the public administration—is essential. Governments that strengthened capacities for promoting, monitoring, encouraging, and assisting in reform across the entire government seemed to do better in implementation. The Office of Regulation Review in Australia, the various better regulation units in the United Kingdom, the Presidential Commission on Regulatory Reform in Korea, and the Economic Deregulation Unit and Cofemer in Mexico institutionalized reforms inside the machinery of government and began creating incentives for good regulation. Where such units were weaker, in Hungary and Italy, reforms were more variable in speed and scope. This does not suggest that reforms should not be embedded throughout the public sector (as discussed in the next paragraph), but that centralized, accountable, expert leadership of broad reform is closely correlated with success.

Third, reforms were more successful when governments built progressively wider networks of reform-minded institutions through the public administration. Australia built a formal network of regulatory reform bodies. In the United Kingdom, networks of regulatory reform ministers and units were established throughout the central ministries, creating a continually growing, expert bureaucracy. In Mexico, a network of regulatory reform units was created in state governments, which began competing for good regulation.

Countries that failed to build allies—Hungary and Italy—needed more political energy to keep reforms moving, and faltered faster when political attention weakened. Italy initially created partnership agreements with local authorities to seek a balance between strong central leadership to sustain common goals, and autonomy at the local level to implement local solutions. But once top-level political support weakened, local autonomy allowed a return to the previous state of affairs.

Fourth, backing administrative procedures with judicial action helped embed new behaviors in public administrations—an approach that was especially important in anticorruption efforts. The power of administrative procedures to provide new protections and rights in a regulatory system is often underestimated. Mexico adopted a new Federal Competition Law, but also amended its Federal Administrative Procedures Law to protect citizens against bad regulation. Providing greater legal security for businesses and individuals changed the conduct and perception of federal public administration in Mexico. In Korea, the Basic Law of Administrative Regulation established quality controls on new regulations. Italy embedded a "silence is consent" approach into laws affecting hundreds of formalities. These procedures have become a permanent function of government, internalized in the public administration system and protected by the public administration and courts.

Fifth, implementation seemed stronger when there was continuous learning. In Australia, Korea, and Mexico, efforts to benchmark based on good practices in similar countries and to assess, pilot, innovate, and learn from past experiences were especially important.

Although reform agendas depended on country needs, international learning was clear: all six countries moved from specific, short-term strategies to longer-term management strategies such as the OECD agenda. Italy's reform plan initially emphasized cutting red tape for citizens and businesses, but expanded to improving broader dimensions of regulatory quality through regulatory impact analysis. These goals were backed by the deployment of an array of

tools, strategies, and structures—self-certification, one-stop shops, codification, regulatory impact analysis, e-government—to promote regulatory quality. Hungary used a courageous guillotine regulatory review that in just a couple months helped eliminate obsolete regulations. A second review focused on deregulating and simplifying licenses and government authorizations, and a third used EU legal harmonization to modernize regulatory oversight. In Korea, the target for a fast 50 percent reduction in each ministry's regulations was accompanied by a suite of new disciplines and controls such as regulatory impact analysis and new administrative procedures.

Monitoring Reforms

The six countries studied suggest that integrating results monitoring with the reform process from an early stage sustains political and bureaucratic attention to reforms. Monitoring is crucial for two reasons. First, it helps maintain active management and political attention to the regulatory process during implementation. Second, it helps build some pro-reform drivers, such as new constituencies for reform in civil society.

Two types of monitoring were used in these six countries. The first was ongoing monitoring by stakeholders through consultation, transparency, and participation in the reform process. The second was more traditional monitoring, involving the measuring of results once implementation was complete. In both cases, monitoring was especially effective when it was a public-private exercise rather than one controlled entirely by government.

Clear quality standards and goals for reforms were powerful aides in pushing ahead. Even more important was monitoring progress in reaching standards and goals. Support for reform was strengthened by inviting stakeholders to participate in the effort and provide ongoing oversight.

In Mexico, the public was invited to participate in rulemaking for the first time. Draft regulations and regulatory impact analyses were posted online for public review and comment. Reviews of each ministry's efforts to produce high-quality regulations were made public. A national benchmarking project allowed citizens to compare the quality of state regulations.

The Korean government set a public target of cutting ministerial regulations by half, holding the entire government accountable for performance. This public accountability was largely responsible for the success of this reform. In addition to legislating information disclosure, Korea opened up its regulatory system by requiring and disclosing independent reviews of regulatory quality by the public-private Regulatory Reform Committee, supported by consultations with stakeholders in regulatory development.

In Australia, agreements between the national and state governments on the National Competition Policy provided an agreed, publicly available benchmark for all subsequent review and reform efforts. These clear principles for promoting competition and a constant, comprehensive approach provided explicit standards to which government efforts would be held accountable. Furthermore, the National Competition Council, working with state-level competition policy units and competitive neutrality units, was responsible for monitoring results.

The United Kingdom invited businesses and consumers to join in the reform process through participation in ad hoc advisory groups. This participation provided these stakeholders with a sense of ownership of reforms.

These experiences suggest that monitoring, rather than being a technical exercise of checking results, should be conceived as ongoing,

active oversight built into reform implementation and post-implementation. Stakeholders should be continuously and heavily involved. Properly designed monitoring actually improves the results of reforms.

Sustaining Reforms over the Medium Term

One of the main messages of this paper is that market-oriented reforms become sustainable only when they are institutionalized and constituencies for change are mobilized. The case studies describe how that was done in the six subject studies.

A point worth repeating is that well-designed reform programs do not work only within existing limits, but work actively to expand opportunities by exploiting reform drivers, relying on good design, and building allies to weaken drivers for the status quo. Moreover, efforts to sustain reform did not occur in fits and starts in any of these countries. The best scenario is an unfolding reform sequence that produces its own momentum, as in Australia and Mexico.

Public sector resistance to change is one of the most formidable obstacles to sustaining reforms. In fact, in none of the six countries was there significant opposition to reform by citizens or the private sector—only in the public sector. So, from the start the strategies in these countries aimed at institutionalizing new regulation methods, with public sector reform at the center of all of them. This lesson is easily generalized. If countries are to achieve sustainable higher growth rates, their public sectors must adopt a different culture of governance geared to market-led growth. Indeed, this could even be the definition of sustainable reform.

The imperative of public sector change must shape the reform strategy. Short-term results are strategically, but not economically, important. The most important benefit is how well short-term reform strategies prepare governments to move to more sustainable strategies. Initial reforms should lead directly to secondary reforms aimed at institutionalizing central units for regulatory reform, creating systematic consultation procedures, and building capacities for regulatory impact analysis. The six countries studied show how broad, evolving reform programs can progressively change the role and culture of governments.

Mexico did not start with public sector reforms, but adopted a comprehensive reform plan with mutually supportive elements—market openness, privatization, and regulatory reforms. Each reform revealed weaknesses in the public sector that had to be corrected. For example, rapid privatization showed that competition and regulatory oversight frameworks were not sufficiently developed to oversee private markets. Throughout the process, Mexico's reformers used the OECD peer review process as an external pressure to maintain momentum.

Korea explicitly attacked the public choice foundations of regulation. Reforms took an institutional approach that sought to reduce incentives for capture and rent-seeking behavior. Regulatory quality was ensured by an independent agency at the center of government intended to check the pro-regulation tendency of ministries.

Australia created entirely new incentives for quality regulation in the public sector. A nationally coordinated series of regulatory reviews, with performance targets and incentive payments, was essentially a wholesale assault on the cozy relationships between the public sector and producer groups that had developed over decades.

Finally, sustainable reform requires achieving growing social consensus on market-based

growth: the "liberal consensus." All six of these countries achieved such consensus partly by stoking fears about national competitiveness, but this seems like a fragile basis for long-term change. In the most successful of these countries, regulatory reforms sought to exploit and then reshape social attitudes toward markets. Australia's reforms were built on bipartisan agreements, and this political consensus meant that the public received consistent messages about the benefits of reform—which helped maintain public support across different administrations. In the United Kingdom, converging views in the European Union on market freedom, privatization, structural reforms, and (later) EU impetus for changes to competition policy provided a rationale and allies for change. In Korea, the most difficult of the six cases in terms of acceptance of markets, the ambitious regulatory reform program was supported by messages from the government that imposing market discipline was a tool for achieving important national goals, rather than a threat to social stability. The struggle between these views continues in Korea.

6. LESSONS FOR REFORMERS

The ultimate goal of this type of work is to generalize operational lessons for countries other than those studied. Reforms were hard enough in those six countries, but are likely to be even more difficult in countries with more hostile reform environments and weaker institutions in the public sector, private sector, and civil society. Still, the key question is the same: how can reforms be designed to maximize their chances for sustained success—that is, real and lasting benefits for businesses?

Though there seem to be clear patterns correlated with success, there is no single model for regulatory reform. The six countries studied show that many institutional and design factors are important in developing and sustaining reform momentum. They also show that success factors seem to be interrelated, with the more successful governments investing simultaneously in strategies such as managing the reform program, promoting ongoing public-private dialogue, and monitoring results.

These factors do not all have to be highly developed for reforms to succeed. Weakness in one area may be compensated for in another. For example, a stable political context based on cross-party consensus may be unattainable in many countries. This implies paying more attention to building pro-reform coalitions among a broad range of stakeholders that can survive the ups and downs of political enthusiasm and discord. If there cannot be stable cross-party consensus, working to develop institutions in the bureaucracy as long-lasting reform champions is another way to develop and sustain reform momentum.

Reformers seeking to launch reforms that foster higher, sustainable economic growth rates should consider the following actions.

- *Identify and exploit multiple drivers of reform.*

The reforms analyzed in this paper occurred in an unfolding sequence in which various drivers were amplified and sustained through clever reform strategies. Although substantial elements of reform were beyond their control, reformers were able to exploit and extend the pro-reform pressures from those drivers. This

shows how drivers of reform changed over time, and how strategies of reformers encouraged and supported the emergence of new drivers of change.

- *Use a crisis if available, and lock in political leadership and bipartisan political support through new institutions, formal agreements, implementing legislation, and international agreements.*

A crisis can provide an opportunity to stimulate action, but is generally a poor basis for sustained reform. The six countries show that opportunities provided by crisis should be used to lock in reform commitments and build expectations among enduring constituencies. International agreements, formal involvement by stakeholders, and new public sector institutions can help maintain reform as a crisis fades or new political imperatives take over. One approach used by several of these countries was to create new legal rights for citizens and businesses through administrative procedure laws—making it impossible to reverse the new rights later.

Spreading ownership of reform across as many stakeholders as possible ensures that reform champions emerge who will outlast the departure of any particular individual. The case studies show that sustainability is at risk if reforms rely on narrow political bases. Momentum for reform should be maintained by educating citizens on its desirability, monitoring changes, and informing the public on progress.

- *Aim for systemic change, but use one-off reforms to build momentum.*

All the countries examined here tackled reform through systemic change—in contrast to the tendency of most governments and donors to pursue narrow, one-off reforms. Because such reforms seem to promise rapid results and provide quick fixes to highly visible regulatory problems, pressure for "quick fixes" will likely continue. Donors describe them as "realistic" and "demonstration projects" that can fuel further reforms. That might be accurate if they are part of a larger medium-term strategy, but often they are not. Because the problem of poor business environments is systemic, genuine solutions must be systemic as well.

Still, one-off and visible projects can certainly contribute to systemic change. Early results help build credibility and momentum, and success breeds success.

- *Start reforms with a clear, well-designed medium-term strategy that has room to evolve.*

An effective medium-term reform strategy sustains reforms and provides a focus and rallying point for them and a basis for monitoring progress. The strategy should be based on careful appraisal of linked issues that need to be addressed. Although a piecemeal approach is possible, success may be less likely because of the higher risks of derailment and poor sequencing. The strategy should synchronize regulatory reform with public sector reform that adjusts the state's role, functions, and capacities. Personnel and budget changes should follow naturally as commitments and responsibilities are allocated through the public administration.

- *Put transparency at the heart of the process and reform contents.*

All six of the countries studied created a public reform process and public expectations for success. Reform programs were based on public participation and stakeholder involvement, while the actual reforms aimed to institutionalize greater transparency in the government's regulatory function through tools such as regulatory impact analyses, public consultations, and registries of regulations.

Transparency is not only a tool for strengthening reform drivers, it is also crucial in reducing regulatory risks—one of the main goals of reform.

Strict adherence to principles of transparency and accountability is vital to market confidence in a modern regulatory state. This is an aspect of systemic reform. Reforms should include developing new transparency habits across the public administration (for example, through administrative procedures or information access laws). New technologies such as electronic registries can also support openness, and at lower cost.

- *Maintain effective, ongoing communication at all levels.*

Communication is a key part of reform efforts. In most of the countries studied here, clear and continuous communication of reforms' purpose and progress—both to participants in the reform process and the general public—was important. If poorly informed, the public is more likely to reject reforms. Consultation mechanisms can also ensure that key stakeholders (such as businesses) stay on board. Communication of reform purposes and tools can prepare civil servants for their role in reforms, and reduce the anxiety that often accompanies change.

- *Ensure that the implementation strategy adapts to different stages of reform.*

There is a progressive "locking in" strategy as different stakeholders become involved in reform. At the beginning, political support may require pushing, commanding, and expending political capital to overcome resistance. Political leaders are better off if they build technocratic institutions early. But as reforms are adopted, laws enacted, and implementation starts, political leadership and top-down direction may need to give way to guidance, management, and increasingly open and participatory approaches involving more stakeholders. Different stages of building ownership and constituencies generally require different leadership styles, communication skills, and mixes of incentives.

Because political support is likely to shift to another crisis before long, institution building is needed to create sustained reform incentives in the machinery of government. The leading countries studied here have adapted existing institutions or built new ones to create supportive, pro-reform networks. They established "reform engines" at the center of government, supported by competition offices, networks among ministries, audit offices, finance ministries, and other pro-reform institutions.

- *Encourage change and develop relevant skills in the public administration.*

Steps are needed to equip the civil service to implement reforms—which at some stage may have to involve public sector reform. The bureaucracy must be encouraged to buy in to reforms, perhaps through changes in incentives and skills. Centrally placed structures and support from finance ministries can be very helpful in this process.

- *Monitor and evaluate to keep players on track, and publicize results to sustain reform momentum.*

Effective monitoring and evaluation of specific reform targets as well as of the complete picture are essential for sustaining reform against active and passive resistance. The main goal is to demonstrate credible benefits of reform to stakeholders and so disarm critics. A participatory evaluation process can sustain stakeholder support. Evaluation also helps keep players on track by creating feedback loops that allow reform programs to be monitored, modified, and improved over time.

- *Prepare for a long commitment.*

Effective, durable reform is a dynamic, long-term process—not a single, static program. Reforms can be expected to span more than one political cycle, probably several. Gains from

reform tend to dissipate over time with economic and social changes, and losers from reform may exert constant pressure to reverse or undermine achievements. New needs and expectations will require continuous adjustments. Regulatory reform programs that began 25 years ago can be just as dynamic as those created last year. Reform mechanisms, institutions, and processes must be robust enough to endure the long haul.

The 11 lessons above carry three key, cross-cutting messages. First, sustainable reforms must be embedded in an effective institutional framework. Such a framework is critical because it can guide, monitor, and sustain reform momentum beyond what may sometimes be the relatively short attention spans of policymakers and political cycles.

Second, the country context has implications for how reform tools and techniques can be applied. In recent years, a range of regulatory governance tools have become available to developing countries.[7] Regardless of the type of tools used—such as regulatory impact analyses or regulatory guillotines—country-specific adaptation is key to successful implementation.

Third, although some ideal sequencing of reforms could be envisaged, no prescribed sequence of reforms can be generalized across countries. For example, eliminating administrative burdens does not always precede making broader attempts at systemic reform. The imminent intertwining of reform components and the multiplicity and shifting of its drivers require that reformers have a flexible strategy with well-defined medium- and long-term goals. A clear strategy allows reformers to better exploit shifting drivers and fine-tune efforts in line with changing circumstances.

7 The general usefulness of most of these approaches is widely accepted, though additional research and testing are needed. FIAS, in cooperation with the U.K. Department for International Development and the Netherlands government, recently launched a two-year Regulatory Governance Program intended to further develop and adapt regulatory governance tools to developing countries.

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ACRONYMS AND ABBREVIATIONS

APEC	Asia-Pacific Economic Cooperation Consortium
EU	European Union
GATT	General Agreement on Tariffs and Trade
IMF	International Monetary Fund
NAFTA	North American Free Trade Agreement
NGOs	non-governmental organizations
OECD	Organisation for Economic Co-Operation and Development

IFC International Finance Corporation World Bank Group

MIGA World Bank Group Multilateral Investment Guarantee Agency

THE WORLD BANK