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Global Challenges and Policies of the European Union
– Consequences for the "New Member States"

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EUROPEAN UNION "BETTER REGULATION" PROGRAM AND ITS IMPACT ON THE COMPETITIVENESS OF NEW MEMBER STATES

1. Introduction

Almost all reports and studies analyzing the consequences of two last EU enlargements (2004 and 2007) underpin the role of institutional business environment and regulation quality as an important factor of New Member States economic development. 10 of 12 New Member States are countries which have transformed their economy from the central planning system into the market economy. They have to change the relations between institutions, the market and civil society to accelerate their growth. Regulatory reform introduced in 1995 by the OECD and continued by EU (2002) helps to achieve this goal by increasing competition through economic liberalization, including privatization and withdrawal from government intervention into market functioning.[1] The impact of regulatory reforms on growth is not easy to measure, but there exist some OECD studies showing positive correlation between the regulation quality of product markets and the productivity of capital and labour, mostly in the medium and long term.[2] Especially important are the gains of innovation achieved through market-opening, increased flexibility in the labour market and the creation of new job opportunities.

Regulatory reform should not be limited to the deregulation process. Quite often market liberalization is not sufficient to maximize gains from structural

[1] S.H. Jacobs, *The Second Generation of Regulatory Reforms*, http//www.imf.org/External/Pubs//FT/seminar/1999/reforms/jacobs.htm.

[2] *Regulatory Reform in Japan*, OECD, Paris 1999, *Regulatory Reform in Mexico*, OECD, Paris 1999, *Regulatory Reform in Netherlands*, OECD, Paris 1999, *Regulatory Reform in the US*, OECD, Paris 1999.

reforms because of high costs linked to regulatory gaps and non-efficient markets harming consumers. In such cases re-regulation and institution building could bring more benefits but the costs of "imperfect government" should be lower than the costs of "imperfect markets." S.H. Jacobs introduces the useful notion of "second generation regulatory reforms" which can reduce the costs of imperfect government through efficient cooperation between the state and civil society.[3] The introduction of the civil society involvement (consumer activism, trade unionism) into regulatory reform process is a relatively new element in the debate on the regulation reform impact on economic development. Efficient civic institution increases the citizens' acceptance of regulatory reform, reduces the risk of political conflicts and builds public confidence. Stronger support of political parties for reforms and higher public confidence allow to avoid excessive regulation which constrains innovation and economic growth.

In Japan, where the state traditionally dominated over market and civic institutions were relatively weak, regulatory framework happened to be inconsistent and very sensitive to interests of various groups. The change of state-market-civil society relation has improved regulation quality and helped move to more efficient economy.[4] In Mexico and Spain due to changes in value system and institutional environment, the number of regulations has diminished significantly in a period of 6 years.

2. European Union "Better Regulation" Program

The "Better Regulation" Program was formally introduced at the level of European Commission and Member States relatively late, in 2002, as a priority of the Lisbon Strategy (2000).[5] But it has been on the EU agenda since 1992 Edinburgh summit addressing the quality of legislation. All the 15 Member States took part in a regulatory reform program within OECD as well.[6] The basic program objective is to simplify the Community and national regulations and to reduce administrative burdens, which are particularly onerous and costly to medium and small enterprises, as well to improve the credibility of EU institutions among community citizens.

In 2002-2007, a significant progress was achieved in implementing reform objectives. A number of documents have been published among which the most important are:

1) Methods of Regulatory Impact Assessment,[7]

2) Communication from the Commission on EU common methodology for assessing administrative costs imposed by legislation,[8]

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[3] S.H. Jacobs, *op. cit*., p. 8.

[4] *Regulatory Reform in Japan*, OECD, Paris 1999, p. 10.

[5] Communication from the Commission, "Action Plan 'Simplifying and Improving Regulatory Environment'", *COM* (2002).

[6] The program was introduced in 1995.

[7] *SEC* (2005) 791.

[8] *COM* (2005) 518.

3) Communication from the Commission on the outcome of the screening of legislative proposals pending before the legislator,[9]

4) Communication on the strategy for simplification of the EU regulatory environment,[10]

5) First and Second Strategic Review on Better Regulation in the European Union.[11]

All these documents create an important basis for the application of good regulatory principles, at the level of the European Commission, the European Parliament and EU Member States. The entities involved in the reform took part in their preparation, the number of consultations organized by the Commission has been growing each year (for example in 2005 there were 293 consultations against 37 in 2004). More and more often the consultations are held via the Internet, which speeds up the collection of documents and facilitates the process of making them available to the public.

In 2005 the EC adopted a new strategy to simplify the existing legislation. A three year rolling program proposed by the strategy consists of 100 initiatives which foresee the repeal or modification of 222 legislative acts with successive amendments of 1400 related regulations.[12] In 2008 the EC confirmed the political commitment to a simplification process by adding 53 new initiatives to its program for the period 2008-2009. To accelerate the implementation of the renewed strategy the EC launched an Annual Progress Report which monitors progress in each Member State and develops specific recommendations that are endorsed by the European Council.[13]

Action Program to reduce administrative burden on business by 25% before the end of 2012 was adopted in January 2007. 10 proposals delivered already concrete results, they decreased costs put on business by 1.3 billion euro.[14] The estimation is based on the study on measuring administrative burden, prepared by the Commission in 2006.[15] Administrative costs are defined as the costs in meeting legal obligations to provide information on enterprises activities, either to public authorities or to private parties. They are different from compliance costs linked to generic requirements of the legislation which are not easy to measure and compare. Information Obligations (IOs) constitute the building blocks of any administrative costs reduction program.

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[9] *COM* (2005) 462.

[10] *COM* (2005) 535.

[11] *COM* (2008) 13.2.

[12] “Report from the Commission ‘Better Lawmaking 2005’”, *SEC* (2006) 737, p. 4.

[13] “Regulatory Reform Strategies Converging with Europe’s Best Regulatory Environment” 2007, www.regulatoryreform.com.

[14] “Better Regulation and Enhanced Impact Assessment”, *SEC* (2007) 926.

[15] “Measuring administrative costs and reducing administrative burdens in the EU”, *COM* (2006) 690.

There are 4 sources of administrative costs: international law, EC law, national law, and regional law. International law always needs transposition to the domestic law, part of EC law is directly applicable ("Regulations"), part needs transposition ("Directives"). The EU program aims at identifying IOs and measuring the administrative costs from EC regulations and directives. The Member States carry on the measurement of information requirements originating in national legislation only. A common EU methodology to measure administrative costs has been developed based on the Standard Costs Model. The model was first used by the Dutch Ministry of Finance and later it was applied by several Member Countries. The reduction of administrative costs at the EU level by 25% in 2012 could increase the level of EU GDP by 1.4% (150 billion euro) in medium term.[16]

Regulatory Impact Assessment (RIA) is a key tool for EU institutions in designing better laws: it helps to improve the quality of new regulation, gives more information to decisions makers and enables to communicate decisions more effectively.[17]

The main features of the EU Regulatory Impact Assessment (RIA) system are:

- proportionate analysis: the more significant regulated action, the greater the effort to quantify and monetize its impact,
- consultation of interested parties,
- "to regulate or not to regulate" – considering alternative policy options that are capable of achieving the proposed objectives as: self-regulation, securing a voluntary agreement, information and education campaign,
- an integrated approach used in which all relevant impact is assessed in one single framework.

3. Effects of regulatory reform

Regulatory reform produces short- and long-term effects. In the short term countries reforming their regulation could expect: more transparent and stable legal environment attractive for investors, faster growth of employment, higher propensity to innovation, more competitive economy in regional and global markets, consumer benefits by reducing prices for services and products and by increasing choice and service quality, maintaining and increasing high levels of regulatory protection in areas such as health, and environment.[18] In the long term regulatory reform could result in increase of productivity, and higher flexibility of economy enabling faster adaptation to market changes.[19]

[16] G.M.M. Geluff, A.M. Lejour, *Five Lisbon Highlights: The Economic Impact of Reaching These Targets*, CPB Document 104, The Hague 2005.

[17] "Better Regulation and Enhanced Impact Assessment", Information Note from the President to the Commission", Brussels, 19 June 2007.

[18] S.H. Jacobs, *op. cit*., p. 2.

[19] Jacobs & Associates, *International Leader in Regulatory Reform*, Washington, D.C., 2007, www.regulatoryreform.com.

The quality of regulation is crucial in the process of competitiveness growth but there do not exist good methods to measure it. The most developed are indicators measuring product market regulations although some of them do not cover all EU member states. Other indicators are based on survey data and have a certain degree of subjectivity which makes them less useful for cross-country comparisons.[20] OECD is promoting the indirect method of regulatory quality measurement by building indicators on regulatory management system. They serve to assess countries' regulatory practices. The concept of quality in regulatory management developed by the OECD refers to the three OECD documents published in 1995, 1997 and 2005. They present recommendations on improving the quality of government regulation,[21] consisting of four components:[22]

1) build a regulatory management system that can lead the reform and promote good regulations tools throughout the entire public sector (special regulatory unit at the centre of government and a responsible minister),

2) build the institutions to carry out good regulation (trained and skilled regulators, one-stop shops, regulatory registries),

3) improve the quality of new regulations (systematic use of RIA, transparency and stakeholder consultations),

4) upgrade the quality of existing laws (targeted de-regulation, Standard Cost Model approach, Regulatory Guillotine).

Individual countries are assessed and compared using information on the existence of those four components in their national regulatory system.[23]According to the OECD between 1998 and 2005 the progress was achieved in building institutions promoting quality in regulatory management, strengthening the responsibilities of these bodies, having more frequent consultation and analyzing regulatory impact.[24] Regulatory quality indicators, based on checking the presence of main regulatory management system components in national programs, do not, however, explain differences in the efficiency of their implementation. The case of Poland can be a good example here. The country has established all institutions and procedures, required by the OECD principles of a good regulation, but the quality of regulation is still perceived as the main obstacle in the improvement of Poland's competitive position. In other words OECD check-list measures formal side only of recommen-

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[20] *European Competitiveness Report 2006*, p. 66.

[21] *Recommendations on Improving the Quality of Government Regulation*, OECD, 1995; *Policy Recommendations on Regulatory Reform*, OECD, 1997; *Guiding Principles for Regulatory Quality and Performance*, OECD, 2005.

[22] *Regulatory Reform Strategies Converging with Europe's Best Regulatory Environment*, www.regulatoryreforms.com/pdfs/, p. 5.

[23] "The OECD found that countries with explicit regulatory policies consistently make more rapid and sustained progress than countries without clear policies" (*Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance*, OECD, Paris 2002).

[24] 2005 OECD regulatory indicators questionnaire /GOV/PGC/REG(2005)12/ANNI.

dation fulfilment. That should be treated as a necessary but not sufficient condition of the progress in regulatory reform. Very important is the evaluation of a way institutions work, RIA documents are prepared and consultations are carried on. It is not easy, however, to construct the indicators of this type.

4. SIGMA Program – a joint initiative of the OECD and the EU to improve regulatory environment in the New Member States

The program was established in 1992 and is mostly financed by the EU. The best results of SIGMA Program have been obtained in the area of regulatory reform management system.

Table 1. Some examples of the New Member States progress in the implementation of "Better Regulation" Program

Country	Examples of progress in the reform
Cyprus	One-stop shops and improved inter-ministerial coordination
Czech Republic	Administrative simplification, improved RIA
Estonia	Progress in e-government, use of web to communicate
Hungary	Progress in effectiveness of RIA
Latvia	Good structures of institutions managing regulatory reform
Slovenia	Progress in training civil society in consultations techniques
Lithuania	Progress in regulatory reform management system
Malta	Renewed RIA procedures
Poland	Renewed RIA procedures
Slovak Republic	Progress in RIA policy
Romania	Progress in drafting Better Regulation strategy
Bulgaria	A stage similar to Romania

Source: E. Donelan, *Better Regulation in New Member States*, Public Administration Conference: Public Policy-New Developments in 2007, Bucharest, Dec. 6th 2007.

Data in Table 1 show that all New Member States have focused on formal procedures and legal effectiveness rather than on economic efficiency of regulation.

What are the reasons of that approach? First of all, so called check-list, used by the OECD and the EU to provide information how many recommended institutions and procedures have been introduced in individual countries, seems to be effective in motivating governments to build institutional capacity. Second, economic efficiency is much more difficult to measure and there exists a quite long time-lag between improvement in regulation and its impact on GDP growth or employment. The last factor makes economic effects of regulatory reform less attractive for governments which operate in accordance with political cycles of elections calendar. Third, there is a lack of skills and experience of public administration to measure benefits and costs of new regulation, the work of bodies responsible for regulation quality is not well coordinated, the low level of social capital resulting in a low level of trust between administration and citizens and distrust in private ownership are provoking government to over-production or even inflation of provisions regulating business environment and citizens to escape to a grey sector of economy. All those factors being the legacy of the previous system do not allow to properly monitor the institutions responsible for the quality of regulation. Their position is not strong enough to block sectoral interests of individual ministries, which quite often are realized at the cost of public interest. In countries with well developed democratic institutions, the control of the bodies responsible for "Better Regulation" is exercised by strong private sector and strong civic society organizations, both pushing for law-making process reform. New Member States do not yet have a habit to respond continuously to all irregularities in the public administration's operation and enough skill to enforce changes favourable from the point of view of public interest. It is the main reason why Poland despite having introduced in 2001 all the elements

Table 2. Strong and weak points of regulatory reform in New Member States

Strong points	Weak points
Legislation rigorously reviewed from the point of legality and constitutionality	Lack of multi-disciplinary approach, law has to meet the test of economic efficiency
Better Regulation treated as no "one shot" policy	Lack of continuous effort to maintain monitoring of its implementation
Political support for the reform visible in some countries (Cyprus, Poland, Slovenia)	In other NMS support less tangible, not enough personal commitment of senior officials
References to Better Regulation in all NMS strategic plans, Better Regulation-type policies adopted	Many plans include ideals and ambitions, not realistic goals
Reduction of administrative burdens may get some attention of politicians and citizens	Regulatory reform issues not attractive for voters, compete with other domestic issues
Practices to assure quality of legislation put in place	Practices focus on political objectives of law projects, technical or legal issues and neglect whether impact assessment and consultations are properly used
Requirement to undertake RIA for new legislation introduced	Being formal is only frequently ignored or exists in name not in substance because of lack of clear methodologies and training
Effective democratic institutions, many of them well resourced	Legislative branch of government dominated by executive. Dynamic but not effective role of parliament
A "zero tolerance" approach to enforcement	Existing capacity limits this approach, more realistic approach needed as development of a risk-based policy or policy imposing fees for inspection
New generation of officials emerged. That generation is better prepared to take up improvement of regulatory management	Executive and legislative branches of government do not cooperate well

Source: based on "Regulatory Management Capacities of Member States of the EU that Joined the Union on May 2004", Sigma Paper No. 42, Gov/Sigma (2007) 6.

necessary to carry out a regulatory impact assessment in compliance with the EU standards is not using this significant tool properly.[25]

Information collected in Table 2 confirms a thesis that New Member States pay not enough attention to economic efficiency of regulation. The competitive position of these countries will be not improved unless the attitude towards regulatory impact assessment will not change. The quality of these documents depends not only on regulatory reform management but on overall administration performance in three areas: policy, people and systems.[26] A study made by the World Bank shows that all three areas of NMS public management system need to be reformed,[27] especially needed are reforms aimed at increasing the quality of civil service. The lack of skilled and experienced people working in public administration is to the large extent caused by politicians blocking the creation of civil service based on professional merits; additionally an inadequate incentive and management systems do not make work in civil service sector attractive enough. Weak civil service produces RIA of a poor quality and in some extreme cases provides false information on impact of new regulation on economy. The poor quality of RIA creates a good environment for corruption, is friendly for politicians and their particular interest but hostile for business sector and citizens.

5. Regulation quality and competitiveness

Performance management benchmarks presented in Table 3 could be, in my opinion, used as proxy for the quality of regulation and the position of the country in "Doing Business" ranking relates well to the quality of the investment environment being an important indicator of competitiveness.

Collected by the World Bank data show a high level of correlation between good performance in administrative capacity indicators and institutional business environment. For example two Baltic states (Latvia and Lithuania) which have effective policy coordination and good results in human resources management are evaluated as countries attractive for investors (rated among top 25 out of 175

[25]A review of 163 major economic legislative drafts from 2002-2004 indicates that the bodies responsible for assessing the impact of regulation do not carry out their duties well. Only 28% of all assessments indicated costs or benefits of a given regulation, even fewer ones, only 12%, quantified effects of regulation. Numerous reservations are provoked by the method used to estimate the effects, the selection or reliability of data, frequent practice to underestimate the costs and overestimate benefits (R. Zubek, K.H. Goetz, *Final Report on the Ernst & Young "Better Government" Program*, www.sprawnepanstwo.pl).

[26] "Administrative Capacity in the New EU Member States", World Bank Working Paper No. 1/5, World Bank EU8 QER 2008.

[27] NMS have very mixed results in the administration performance, the strong improvement has been made by Baltic States, much worse situation is observed in Hungary, the Czech Republic and Poland.

countries). Poland, Hungary and the Czech Republic having weak administrative capacity are on low positions in the "Doing Business" ranking (Poland 75th, Hungary 66th, Czech Republic 50th) which means that their economies are less competitive. Relatively high position of Estonia (17th) in the assessment of investment climate is correlated with significant improvement in using e-Government tools increasing the efficiency of government service delivery and the transparency of administration.

Table 3. New Member States results in performance management versus their position in "Doing Business" ranking

<table>
<tr><th rowspan="2">Country</th><th rowspan="2">Performance management CAF* rating scale 0-5 (EU average 2.5)</th><th colspan="4">Human resources (SIGMA standard scale from 1 to 7)</th><th colspan="2">World Bank ranking out (out of 175 countries)</th></tr>
<tr><th>legislation</th><th>horizontal management</th><th>politico- -administrative relations</th><th>incentives</th><th>2007</th><th>2006</th></tr>
<tr><td>Poland</td><td>0.5</td><td>6/7</td><td>6/7</td><td>7</td><td>5</td><td>75</td><td>74</td></tr>
<tr><td>Hungary</td><td>0.5-1.0</td><td>5</td><td>5</td><td>5</td><td>–</td><td>66</td><td>60</td></tr>
<tr><td>Czech Republic</td><td>0.5-1.0</td><td>6/7</td><td>6/7</td><td>–</td><td>–</td><td>52</td><td>50</td></tr>
<tr><td>Slovakia</td><td>1.0</td><td>6/7</td><td>6/7</td><td>7</td><td>–</td><td>36</td><td>34</td></tr>
<tr><td>Slovenia</td><td>0.5-1.0</td><td>5</td><td>5</td><td>–</td><td>–</td><td>61</td><td>56</td></tr>
<tr><td>Lithuania</td><td>3.0</td><td>5</td><td>5</td><td>2</td><td>3</td><td>16</td><td>15</td></tr>
<tr><td>Latvia</td><td>3.0</td><td>5</td><td>5</td><td>3</td><td>2</td><td>24</td><td>31</td></tr>
<tr><td>Estonia</td><td>0.5-1.0</td><td>5</td><td>5</td><td>–</td><td>–</td><td>17</td><td>17</td></tr>
</table>

Notes: a) HR management: 1 – SIGMA program standard achieved, 2 – standard substantially achieved, 3 – standard only partially achieved, 4 – standard not yet achieved but progress being made, 5 – standard not yet achieved, 6 – standard not likely to be achieved in medium term, 7 – standard unlikely to be achieved under present arrangements. b) World Bank "Doing Business" ranking is based on the review of the Business Environment and Enterprise Performance Survey (measure of regulations for starting business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, enforcing contracts and closing a business). c) CAF ranking: 0 – no evidence of an approach, 1 – an approach is planned, 2 – an approach is planned and implemented, 3 – an approach is planned and implemented and reviewed, 4 – an approach is planned and implemented and reviewed on the basis of benchmarking data and adjusted accordingly, 5 – an approach is planned and implemented and reviewed on the basis of benchmarking data and adjusted accordingly and fully integrated into the organization.

* CAF – Common Assessment Framework, first adopted in 2001 in the EU countries, was designed as the agreed system for administrative quality assessment It is based on a logic of introduction of performance principles in public management. Source: "EU-8 Administrative Capacity...", p. 18, and CAF framework at: www.eipa.nl/CAF.

Source: "EU-8 Administrative Capacity in the New Member States: The Limits of Innovation?", World Bank Study, Dec. 2006, Report Number: 36930-GLB.

It is too early to observe the impact of regulatory reform on the competitiveness of the New Member States. This kind of reform requires several years to be accomplished. The relatively long “waiting time” for the reform results is one of the main obstacles for its continuous implementation. Lack of effects in one political cycle means that the success of the reform depends on good cooperation among politicians, senior administrative officials and civic society organizations. Experience of countries with high regulation quality shows that the third element: an active civic society is really crucial to the efficiency of the regulatory reform.[28]

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[28] E. Freyberg, “In search for a perfect regulation”, [in:] W. Bieńkowski, J. Brada, M.J. Radło (eds.), *Growth versus Security: Old and New EU Members Quest for New Economic and Social Model*, Palgrave Macmillan, 2008.