Business Associations, Business Climate, and Economic Growth:
Evidence from Transition Economies

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This article develops linkages between business associations and economic growth viewed through the prism of new institutional economics. The literature on economic regulation, collective choice, and rent-seeking often portrays interest groups as redistributing wealth. In this article we develop a model of interest groups, focusing on business associations, whose actions are not necessarily a zero-sum or a negative-sum game. By promoting a better business climate, market-enhancing business associations can help to build the foundation for economic growth. We provide several examples from the transition economies of Central and Eastern Europe in the 1990s and 2000s. We also develop a set of criteria that can be used to differentiate market-enhancing from redistributive associations.

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Introduction

Interest groups are rarely portrayed in a positive light. In economic theories of regulation, collective action, rent-seeking, and others, interest groups are commonly described as seeking some sort of redistribution through a political process. For example, the economic theory of regulation advanced by Stigler (1971) and Peltzman (1976) has been called the capture theory of regulation, to reflect the idea that interest groups exert influence over policymakers, effectively capturing the legislative process.[1] Although Olson's (1965) work on the logic of collective action concentrates on the inner-workings of interest groups, it also develops a rather negative view of such groups as seeking protection for members, leading him to later declare (1982) that interest groups stifle economic growth in societies where they proliferate.[2] Some theories show how interest groups can be beneficial in the provision of public goods, in instances where markets fail to do so.[3] However, if we look at interest groups in the private sector – business associations, chambers of commerce, trade groups, and others – they are most commonly portrayed as lobbying for some set of benefits for their members at the expense of other groups, whether they are subsidies, trade protection, or price breaks.

Conventional work on interest groups focused almost exclusively on developed market economies. The transition process in Central and Eastern Europe in the late 1980s-early 90s brought to the forefront a new set of questions in regards to the role that interest groups can play. As countries began to explore free markets and mechanisms to put them in place after decades of command-style economic disasters, private-sector interest groups emerged as primary participants in this process. In some instances, these were state-created chambers of commerce, acting as guardians of a set of interests of insider firms in the political process. In others, these

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[1] George J. Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science* 2 (1971): 3–21; Sam Peltzman, "Toward a More General Theory of Economic Regulation," *Journal of Law and Economics* 19 (1976): 211–40. See also Joel Hellman, Geraint Jones, and Daniel Kaufmann, "Beyond the 'Grabbing Hand' of Government in Transition: Facing up to 'State Capture' by the Corporate Sector," *Transition* 11, No. 2 (April 2000), Newsletter of the World Bank and the William Davidson Institute.
[2] Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups,* (Harvard University Press, 1965); Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (New Haven: Yale University Press, 1982).
[3] For instance, Richard F. Doner and Ben Schneider, "The New Institutional Economics, Business Associations, and Development," (International Labour Organization, International Institute for Labour Studies, Business and Society Programme DP/110/2000, 2000); Ben Ross Schneider, *Business Politics and the State in Twentieth-Century Latin America* (Cambridge: Cambridge University Press, 2004).

were newly formed business organizations, seeking ways in which they could solve the collective action problem and engage the nascent private sector in the policymaking process.

On the books, managing the transition process was simple. All one needed to do was put in place governance mechanisms, promote free trade, let economics rather than politics determine market prices and the allocation of goods, and attract investment. However, while economics provided a whole set of recommendations on *what* needed to be done, there appeared a conspicuous knowledge gap in *how* all of these things can be done. Who facilitates the reform efforts? How is policy developed? How does one build a business climate conducive to productive rather than redistributive activities?

Each country in the transition process had its own set of problems, initial conditions, key players, reform approaches, and priorities, and, as a result, development outcomes. However, across all countries, private sector interest groups were participants in successful reform efforts. Acting as the liaison between policymakers and economic agents, business associations and chambers of commerce could channel information and reform recommendations from businesspeople, facilitating the development of a business-friendly environment. As such, some business groups emerged as engines of economic growth and development, seeking to increase the size of the economic pie through the political process, rather than simply trying to capture a larger share at the expense of others.

In this paper, we concentrate on this positive role of business associations and chambers of commerce in facilitating the development of a good business climate. We present a set of criteria used by the Center for International Private Enterprise (CIPE) in its work around the world to distinguish redistributive from market-promoting interest groups and to build the capacity of interest groups to develop a business-friendly economic environment. We also provide case studies from Romania, Hungary, and Russia.

Setting the scene

Following the collapse of the Berlin Wall, many questions arose that economists, political scientists, and other experts may have been able to answer in theory but were clearly not prepared to answer in practical terms. How can transitions to market economies be managed? What are the key components of successful transitions? How does one design and implement an economic reform agenda? Who are the key players and what are their roles?

Institutional economics provided a body of knowledge to support the transition process, yet little practical experience. Nonetheless, countries that employed that knowledge enjoyed a successful emergence of market and democratic mechanisms, although not without their share of pains and setbacks. The success of these countries in restructuring fundamental institutions and building new ones is becoming more and more evident today. For example, the countries in Central and Eastern Europe (CEE) are rapidly moving towards full integration with the global economy, yet Central Asian countries and some other former Soviet Republics are becoming increasingly isolated. Such macro-level comparisons present a fascinating picture of the different paths these economies have taken, yet, deconstructed, the differences in economic and political institutions are even more revealing.

What can we take away from these countries' experiences in building institutions as a foundation of economic growth? The lessons are many, but fundamentally we saw that efforts to develop market institutions are intrinsically linked to initiatives that support the development of democratic mechanisms. We view democratic mechanisms in light of participatory policymaking, transparency, and good governance, rather than electoral procedures and processes. In this sense, the chief advantage of democracy over any type of authoritarian regime is the replacement of the central planner in the creation of market rules with market agents themselves through representative institutions.[4]

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[4] Much of new institutional economics, beginning with Ronald Coase and Douglass North, is concentrated on this problem of how to create systems of feedback and accountability to create incentives for sound economic policy. Douglass C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge University Press, 1990).

We also saw that macro-level reforms, although important in their own right, cannot suffice without reforms on the micro level. What we want to highlight here is the importance of paying due attention to the development of a good business climate: an environment within which private sector activity flourishes; entrepreneurial potential is realized; and efficient contracting and enforcement of property rights contribute to higher productivity, job creation, and overall economic growth. In this paper, we will explore how firms, represented by business associations, can provide information and create political support for rules that foster a better business climate.

The emphasis on the business climate is not incidental – in fact, in many cases it came from the simple need for capital on the part of economic agents directly responsible for generating economic growth: entrepreneurs. A bad business climate results not only in the general inability of firms to attract investment, but also leads to the outflow of the little remaining funds to other, more investment-friendly destinations. A bad business climate means that economic agents have to expend valuable resources on overcoming regulatory burdens rather than on productive activities.

From an investment perspective, a business climate can be assessed through the FDI criteria developed by the U.S. Chamber of Commerce. The text box below presents a list of the 12 major factors that most foreign direct investors evaluate when deciding whether to enter a particular market. The list was drawn up by the U.S. Chamber of Commerce based on surveys of multinational firms. Experience has shown that the same factors will be used, to one degree or another, by major domestic investors and those interested in portfolio investment as well.

As can be seen, decision-making on investment is more of an art than a science. A country like China can afford to score substantially lower on some ratings simply because of the size of its market. A smaller country, like Slovakia, has to work much harder on the fundamentals in the areas of institutional reforms, macroeconomic stability, rule of law, and the like. Countries endowed with natural resources such as oil or gas find that foreign investors will overlook key factors because there are few alternative sources of energy and they simply have to assume the risk. For most countries, however, we have seen that it is essential to work on these key issue areas to attract investment.

THE TWELVE FACTORS FOR RATING INTERNATIONAL INVESTMENT

The following factors are generally accepted as the principal criteria guiding a company's overseas investment decisions:

1. Internal Market — the size and potential for growth of another country's domestic market, especially the purchasing power of its customers are key. You don't invest in a market where you have little potential to make a profit.
2. Freedom of Access to the Market — the strength of the competition as well as the degree of government (theirs and ours) interference to entering a country's market. The freer the market, the more attractive it becomes as an investment opportunity.
3. Labor Force and Raw Materials — while the investor brings capital, technology, and management to the table, the quality of the indigenous work force and the availability of in-country raw materials are also important ingredients in the recipe for success.
4. Protection from Currency Devaluation — simply stated, if you make an investment in dollars, and then the local assets (valued in the local currency) are devalued, you have lost part (or possibly all) of your original dollar-based investment.
5. Remittance of Dividends, Interest, Royalties and Technical Assistance Payments — if you can't get your money out of the country, then why invest?
6. Property Rights Protection — likelihood that a company's property, real or intangible (patents, copyrights, etc.), will be stolen.
7. Export Potential — ability to source from an operating unit in one market to serve nearby markets or maximize a company's global efficiency by trading among its various operating entities in different countries to round out its product lines.
8. Regulatory Burdens — the cost of government intervention on business (and profits) in a country.
9. Favorable Taxation and Tax Incentives — although tax incentives geared to attract initial investments are important, the final investment decision is usually based on how a country's taxation will affect the normal operating environment.
10. Low Political Risk — an investor's ability to rely upon the integrity of the host government and its ability to maintain local law and order is essential to any long-term investment.
11. Predictable Macroeconomic Management — confidence that the economy in which the investment takes place will be managed in a competent and predictable way. Simply stated, belief that the rules of the game will not change in the middle of a contest.
12. Reliable Infrastructure Support — the ability to consummate transactions and get products and services to market is critical. Whether it is reliable transportation services, power generation, insurance and accounting services, a competent financial system, or other basics, investments cannot yield reliable returns without them.

Source: U.S. Chamber of Commerce, Center for International Private Enterprise

Within a few years of the transition, many countries began to understand the importance of a good business climate. At the same time, questions arose pertaining to how such a climate could be developed. In that regard, the demand for effective policymaking began to emerge. It quickly became evident that although there was a high demand for rules that would sustain a good business climate, there was often a lack of political will. To fill that void, new mechanisms for policymaking had to be created so that command economies and their variants could be successfully replaced with market-oriented institutions. Barriers to this process certainly existed, such as the absence of institutions conducive to participatory policymaking.

Traditionally, in CEE and the former Soviet Union (FSU) countries, there has been a relatively clear division of economic agents. There were those who had access to the system and those who did not. Economic decisions in regard to economic agents (individual entrepreneurs and firms) were made 'behind closed doors' and were political rather than economic in nature. In that sense, the traditional notion of a marketplace guided by *fair* application of rules and regulations did not apply. Less efficient producers could obtain a more favorable application of laws based on their relationship with those who had the authority to make the decisions. As such, the relationship between political agents and economic agents differed significantly from the relationship we observe in democratic market economies.

In places where outright favoritism in rule-making and implementation predominated, we observed the emergence of so-called crony capitalist systems. Such systems resembled some features of modern capitalist systems, yet lacked the fundamental principles of fairness and transparency. They gave rise to business groups or individuals who, through closely knit relationships with policymakers and bureaucrats, could tilt market scales in their own favor, enriching themselves while destroying the competitive potential of the economic systems within which they operated. In Russia, they became known as *oligarchs*.[5]

Moreover, the pervasive nature of such relationships between business and government caused a vacuum in policy creation. In many countries, there was no policymaking as developed

[5] For more see Hellman, Jones, Kaufmann on state capture – get full info from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=240555

economies experience it. On the policy side, there was often no capacity to incorporate citizen input in the creation of laws. This lack of capacity could be either technical, such as lack of venues and means of analysis, or human, such as lack of qualified staff. On the side of the private sector, there may have been the capacity to criticize but little capacity to analyze the environment and come up with policy reform suggestions that were meaningful and useful for policymakers. In between the two sides, mechanisms of transparent, open relationships between the private sector and policymakers were lacking as well. For example, in some countries draft laws weren't published for comment, and in others, laws weren't properly distributed once passed. Sometimes businesspeople discovered the existence of laws only after breaking them. In countries where there were too many, often contradictory, laws on the books, bureaucrats had discretion to apply them selectively.

In such an environment, a concerted effort was needed on all fronts: building the capacity of the private sector; working with policymakers to increase their skills; as well as developing transparent relationships between business and government that were based on notions of mutual advantage, growth, and prosperity rather than hostility and distrust.

A collective action problem

As reform efforts got underway in transitioning economies, the collective action problem quickly emerged as one of the key barriers. Good policies, as outlined below in more detail, require the participation of the private sector in their creation. What we saw in many instances, however, is that the private sector was not equipped to participate in reform efforts. It had little to no experience in developing voluntary business groups aimed at moving the transition process forward, rather than fighting to capture some set of rents.

Here, we are making a key distinction between market-promoting and redistributive associations. Certainly, not all business associations are advocates for free-market reforms. Some associations may act as vehicles for business groups to capture the state, for example. These types of business associations act as barriers to, not facilitators of, economic reform. Other types of associations, particularly those based on the Continental mandatory membership model of associations, have few incentives to address the institutional deficiencies and act as 'the voice of business.' Those types of associations act more as quasi-governmental service providers.

On the other hand, voluntary membership-based associations are often much better candidates to advocate for institutional reforms, given their freedom from dependency on governmental revenue and greater incentives to represent the interests of their members. From another perspective, voluntary business associations can act as 'the voice of business' in the political reform process, bringing the issues companies face on a day-to-day basis and possible solutions to those problems before policymakers. Most associations develop an internal policymaking process to identify issues of concern, discuss and debate possible positions on how the issue should be addressed, and formulate a consensus among member representatives on the association's advocacy position. This process is quite similar to the legislative process and can be thought of as a form of internal democracy. In most voluntary and independent associations, the policymaking process culminates in the installation of a board of directors that is representative of the interests of the underlying membership. Frequently, where membership interests cannot be unified, particularly in the peak or encompassing form of associations such as the U.S. Chamber of Commerce or the German Federation of Industry, the association declines to become involved in the issue and leaves it to sectoral organizations to address.[6]

In light of this, painting all interest groups with the same brush is a mistake. Different groups pursue different agendas and have a different effect on the composition of economic, social, and political institutions. For the purpose of our analysis, however, it is useful to focus on two main categories: market-promoting associations and redistributive associations. The key difference between redistributive and market-promoting associations is that redistributive groups seek to shield their member companies from competition by, for example, erecting trade barriers, thereby limiting the functioning of markets. Market-promoting associations, on the other hand, seek to improve the functioning of markets, such as by supporting measures to improve contract

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[6] The above definition might be thought of as an "ideal type" in the sense used by Max Weber in his analysis of types of political-economic regimes. For more details on association management see Larry S. Milner (ed.) "Business Associations for the 21st Century," Center for International Private Enterprise, 1997 (available at www.cipe.org). See also Markus Pilgrim and Ralf Meier, "National Chambers of Commerce: A Primer on the Organization and Role of Chamber Systems" (CIPE, 1995, available at http://www.cipe.org/programs/ba/pdf/Chamber_Primer.pdf).

enforcement or reduce transactions costs in the form of business registration procedures. One cannot say with certainty *ex ante* which associations will pursue which of these behaviors. However, the governance structures of associations and their member firms' interests will shape the motivation of association leadership to seek rents; or to provide member services consistent with fair market competition; or to create new market-oriented rules.

Unfortunately, we saw that in many cases redistributive associations exceeded market-promoting associations in numbers and strength. However, CIPE developed a program that has helped to identify, develop, and strengthen voluntary associations and help them assume the role of engines of economic reform. Macro-level approaches have not worked in this case, meaning that one cannot simply take a look at a country's laws governing associations and make a decision regarding their status. We've seen that a micro approach – evaluating each individual association – provides a much more balanced and precise view of interest groups. CIPE identifies their strengths and weaknesses, considers their capacity to promote and implement reform, and, finally, makes the decision on whether their efforts can help to grow the economy rather than simply capture rents.

Building the capacity of associations

CIPE has developed and implemented tools to build the capacity of business associations to conduct economic reforms: a diagnostic tool, a capacity-building program for association executives, and advocacy tools. These are employed together in a process known as a reform agenda. A diagnostic tool is used by CIPE to evaluate an association and determine whether its nature is consistent with a market-promoting rather than redistributive interest groups.[7] A capacity building program is aimed at building up the core competencies of associations so that they can advocate effectively for a better business climate on behalf of their members. Advocacy tools help elements of the private sector identify common concerns, provide information to policymakers, and develop proposed solutions.

[7] CIPE's diagnostic tool is available as part of the Virtual Business Association (http://www.cipe.org/vba).

The diagnostic tool is used to conduct interviews with association staff, executives, members, and other groups such as media. It consists of a set of questions that guide the interview process. Rankings are assigned to answers given to each question. The tool includes the following sections:

- Overview – this section includes questions on the history of an association's creation, the regulatory environment within which it operates, the association structure it follows, and some general details about the economic conditions in a country.
- Vision, mission, goals, and objectives – this section takes a more in-depth look at the purpose of an organization, evaluating not only its mission and objectives, but also an organization's commitment to upholding them through its actions.
- Governance – governance of associations is an important topic and this section evaluates the governance mechanisms that are in place and their impact on the performance of an organization.
- Membership – this section helps to evaluate the membership structure of an association, its effectiveness in attracting and retaining members, as well as the quality of its membership services.
- Finances – this section helps to evaluate the financial sustainability of an organization as well as transparency records in dealing with members, the board, and staff.
- Public policy – this section evaluates the record of an association in participating in the public-policy process as well as evaluating the outcomes of its advocacy activities.
- Activities and services – this section takes a more in-depth look at the services an organization provides to its members.
- Human resources – this section evaluates the caliber of the staff that runs the organization.
- Communication infrastructure – this section evaluates the effectiveness of an association in communicating with their members and outside groups.
- Public relations – this section evaluates the effectiveness of an association's efforts to inform policymakers, media, the public and other groups about its activities.

The diagnostic is often conducted by association professionals, who rank organizations within the categories listed above and develop a list of their strengths and weaknesses. As a follow-up to the diagnostics, CIPE organizes capacity-building programs. Through these programs, CIPE reaches out to association executives and helps them to develop the necessary skills to advocate effectively on the behalf of their members. In the early stages, the focus is placed on building organizational capacity, while at the latter stages the programs target advocacy and coalition-building skills. CIPE also links business associations and chambers of commerce with their counterparts in other countries so that they can share successful approaches to reform. Once associations have the institutional capacity to promote a better business climate, they can begin to take the necessary steps toward implementing the reform agenda.

Steps in the reform agenda

A good business climate, as noted above, does not appear in a vacuum – it arises as the result of comprehensive reforms in both the political and economic arenas. Effective business associations as agents of change can help facilitate the reform process on the one hand while political agents open to transparent policymaking can aid it on the other. CIPE has identified seven key steps in designing a reform program. The first step deals with identifying the initial conditions. Publicizing those initial conditions through media; town hall meetings; and other activities carried out by private sector associations, think tanks, universities, and government agencies, is also a key step in building and sustaining public interest.

Steps in Building a Reform Agenda

1. Identify the initial conditions – what are the most important barriers to market entry and what are the true costs of doing business? Publicize these findings in both the financial and popular press.
2. Locate the key points of change – what are the institutional reforms that will generate a private sector supply response? Demonstrate the benefits to business, to the economy, and to society as a whole.
3. Mobilize business associations, think tanks, and other civil society organizations to join in a collective action program to advocate for institutional reforms.
4. Generate specific policy recommendations such as reductions in entry barriers, reform of customs procedures, or simplification of tax administration. Be as specific as possible; general ideas such as "reduce tax rates" are rarely addressed.

5. Manage expectations by setting out achievable goals that can demonstrate to the business constituencies and to the public that reforms can be achieved.
6. Mount an aggressive advocacy campaign that effectively communicates complex ideas in simple and attractive ways to build the case for policy reforms.
7. Recognize the government officials, political leaders, and businesspeople who act upon the reform agenda.

Identifying key points of change

The second step in the reform process, identifying the key points of change, may be the most strategically important step. When there is a crisis, as in the early days of transition or in the midst of a financial meltdown, it is possible to take a holistic approach by targeting fundamental reforms and galvanizing support for these reforms. Shock therapy in the case of Poland is a familiar example. Another would be the comprehensive system overhaul undertaken by the well-known Estonian reformer Mart Laar. Estonia is an excellent example of a country that implemented fundamental reforms that transformed the system through a currency board, privatization, comprehensive tax reform, and, interestingly, supplying free internet to the entire population. Conversely, János Kornai's recent work shows that sequential reforms in countries like Hungary had the same cumulative effect through a process of incrementalism.[8] Lacking the clear and present effect of a crisis, reformers were not able to mount a holistic set of major reforms. Rather, a series of reform packages were put into place that created major changes and built the institutions of a market system.

Fundamental reforms can work in times of crisis because the choices are limited and the need for action is clear. Absent a crisis, the incentives and choices facing political leaders are very different. In these instances, it is important to identify institutional changes that are feasible and that will actually benefit entrepreneurs, workers, and citizens. Further, it is important to be able to show success in order to maintain credibility. Whether the issue is reducing corruption, simplifying the customs regime, or streamlining business licensing and procedures, the private sector and the general public has to believe that it is possible to spearhead reform, to generate change, and to have a positive effect. Success breeds success.

[8] János Kornai, "Presidential Address," delivered at the 14th World Congress of the International Economic Association in Marrakech, Morocco, on August 29, 2005.

One way of identifying small changes that will produce systemic change is to determine the facts on the ground – the issues and barriers being experienced by the entrepreneurial sector. There are a number of useful techniques that can be used to identify barriers and to demonstrate their impact on businesses. One technique that has been used in a number of countries is known as the national business agenda (NBA). Building an NBA actually follows all of the steps outlined above. The crucial strategic step of locating the key points of change is accomplished through focus group meetings held with small representative groups of businesspeople throughout the country. CIPE has worked with groups in countries as diverse as Russia, Peru, and Egypt to carry out such programs.[9]

Key Features of Successful National Business Agendas

Several CIPE-funded projects have assisted various groups – businesses associations, coalitions of think tanks and associations, and other private sector organizations – to formulate policy positions, represent a unified voice before the government, and educate their members on policies that affect them by helping them develop a national business agenda. The key to any national business agenda is participation. For example, the Montenegro Business Alliance National Business Agenda for 2005 contained the following steps:

- Analyzing policies and forming recommendations;
- Meeting with members in open forums to discuss alternatives;
- Publishing in the media to gain input from concerned parties;
- Formulating policy reform programs;
- Publicizing the agenda; and
- Engaging in advocacy directed at the government, including the executive and the legislative branches.

These activities strengthen democracy by giving the private sector a greater role in shaping economic reform and commercial policies. In the next section, you will find examples of how business associations in different countries contributed to reducing barriers to formality and high business costs by developing national business agendas as a basis for advocating for market-oriented policy reform.

CIPE's National Business Agenda Handbook is available at www.cipe.org

[9] The "National Business Agenda Guidebook: The Voice of Business," is a handbook on how to develop a business agenda and includes case studies. Go to: http://www.cipe.org/publications/papers/pdf/NBAGuidebook.pdf

Mobilizing for Collective Action

The third point, mobilizing business associations, think tanks, and other groups to advocate for institutional reform, can differ markedly from country to country. In some countries, the principal business associations, often including the chamber of commerce, are under the direct or indirect control of the government. This can be the case when the national law on associations is modeled on the Continental European system of mandatory membership, resulting in a corporatist form of associations. In other cases, the control can be more indirect, such as when the associations are controlled by a handful of firms with close ties to government or even rent-seeking organizations.

However, it is possible in nearly every country to identify countervailing associations that represent the interests of smaller firms, firms with an interest in access to the international system, and others who want to see a free-market economy develop. In addition, think tanks or public policy institutions that aim to develop democratic, market-oriented economies have developed in many countries around the world. How these organizations develop and the techniques that they use to advocate for change has become a major focus of new thinking in the multilateral development agencies, in the Organisation for Economic Co-operation and Development (OECD), and for organizations like CIPE.[10] The most important criterion in putting together an effective coalition for reform is to ensure that all of the individual members demonstrate an understanding and a commitment to market economics and democratic practices.

Policy Recommendations

Generating specific policy recommendations is the fourth step. The focus group approach mentioned above, as well as a larger survey of the investment climate, can help identify the barriers and the issues. However, actually formulating specific reforms that can address these issues requires both creativity and some degree of expertise in policy analysis. The next section of the paper will present some case studies that will illustrate the types of specific

[10] For a collection of essays on the rise and effectiveness of think tanks see James G. McGann and R. Kent Weaver (eds), *Think Tanks And Civil Society* (New Brunswick: Transaction Publishers, 2000).

reforms that tend to be most useful. One of the key points to recall in this step is to resist the temptation to simply say, for example, that the tax system needs to be *fundamentally reformed*. Policymakers, legislators, the media, and others need to know what specific reforms are most important. Is it a reduction in the level of taxes, a simplification of the tax payment system, or the outright elimination of some portion of the types of taxes? The beauty of the flat tax, which was part of the reforms used by Mart Laar in Estonia, is that it is simple to explain, easy to administer, and generates the necessary revenues. The challenge is that it is difficult to mobilize sufficient support, absent a crisis, to overcome the resistance to such a major change. In cases where a crisis is occurring or a political leader is willing to undertake such a major reform, the flat tax is clearly an excellent choice. In other cases, it might be better to attempt a simplification of the administration or reductions in the numbers of taxes.

Managing Expectations

Managing expectations is also a key part of the reform process as shown in step number five. The key point to recall here is that holding the coalition of associations, think tanks, and others together requires a sense of momentum. People need to feel that their efforts are having an effect and that further progress is possible. Certainly, the most committed members will be willing to persevere over a long stretch of time. However, gaining enough support to be effective in the public policy arena also requires that all actors involved gain a sense of accomplishment. In times of normal politics (absent a crisis or change of system), setting some specific but important goals for reforms helps maintain this momentum. It is also important to manage the expectations of the coalition members and the general public by promising progress but being realistic about what it will take to accomplish the coalition's goals.

The Advocacy Campaign

Designing and launching the advocacy campaign is also a blend of art and science. It is vital that each of the policy reforms are well-researched and fully developed to be able to demonstrate to the policymakers, the technocrats, and the international community that the reforms are viable and in the best interest of the country. In some cases, this may involve some sophisticated economic research and analysis. In other cases, the issue may be so clear cut that research is not entirely necessary, but the analysis and presentation still must be completed and made available to the public. However – and this is absolutely vital – the actual advocacy campaign has to take these analytical materials and transform them into simple public policy messages that take into account the practical politics of decision-making. In those countries in the process of building a democratic system, this is obviously easier since access to the media and to the political process is more or less open. However, even in many authoritarian regimes, substantial progress in advocacy is possible, albeit much more difficult.[11]

Perhaps the most well-known example of a brilliant reformer who took very complicated institutional and economic analysis and transformed it into a simple and powerful public policy message is Hernando de Soto. De Soto's think tank, the Institute for Liberty and Democracy asked a powerful question about Peru. The question was, "why do average Peruvians succeed in developed countries but cannot succeed in Peru?" As de Soto himself attests, he put down his books and opened his eyes by visiting the shanty towns and talking with street vendors, backyard manufacturers, and others in the underground economy. What he found and documented brilliantly was a vast informal economy comprising some thirty to forty percent of the economic activity in the country. The analysis stage of this argument produced several insightful books, including *The Other Path* and *The Mystery of Capital*. In addition, de Soto's communications strategy was to create a new awareness that informal entrepreneurs were blocked out of the system by a wall of red tape. He created the famous saying that 'it takes 289 days to legally register a small business in Peru.' That one sentence galvanized a coalition and created a process of change. Interestingly enough, the World Bank's "Doing Business" indicators cited earlier are based on de Soto's early work.

[11] Hernando de Soto, *The Other Path*, Harper and Rowe, 1989 and *The Mystery of Capital*, Basic Books, 2000. For an interview with de Soto on "The Economic Answer to Terrorism," see CIPE's *Overseas Report*, Fall 2002, at: http://www.cipe.org/publications/overseas/pdf/CIPE_HDSinterview.pdf

Recognition

It is also vital to recognize those who assist the campaign by actually implementing the policy reforms as noted in step 7. While this may seem obvious, it is often forgotten that politicians, government officials, the media, and others need public acknowledgement of the roles they played. In both new and established democracies, the incentives for policymakers to advance reforms are to garner votes, funding, and publicity.

CASE STUDIES

The three following case studies, based on CIPE's work in Romania, Hungary, and Russia, illustrate the benefits and challenges of participation by private sector interest groups in market-oriented policy reforms. Each case deals with the micro-level problems faced by firms in the business environment of the 1990s. Business associations in the three countries had varying capabilities and interest in addressing these problems through policy reform. CIPE worked with some of the more reform-oriented representatives of the private sector to develop their capacity to solve the collective action problem. CIPE's programs addressed both selective incentives and collective incentives. Associations were strengthened through the provision of selective incentives in the form of services to member firms that complemented rather than distorted markets. At the same time, CIPE assisted associations and think tanks in developing policy solutions; means to communicate information to policymakers; and private sector coalitions to back collective solutions.

Romania[12]

Business climate

For the first seven years of its economic transition, Romania was very slow to build the foundations for private sector growth. Private enterprises became legal in 1990 but languished in a trying institutional environment. Red tape, corruption, inadequate access to information, and underdeveloped markets thwarted emerging entrepreneurs. The informal sector represented as much as 25% of the economy.

The government accelerated reforms in 1997, including privatization; however, it continued to favor state-owned enterprises, especially inefficient heavy industries, at the expense of smaller private companies. Private businesses faced unfair competition from the state sector, which often monopolized information, raw materials, and energy. Romania had "become a leading example of the perils of special-interest politics":

> "Far from providing entrepreneurs with the conditions needed to operate freely and profitably, the Romanian government continues to develop legislation that favors established interests [that] can circumvent the democratic process at the expense of small and medium entrepreneurs who struggle to have their voices heard in policy development circles."[13]

In the Romanian case, the "established interests" were located within the state sector and heavy industry. The private sector, dominated by small and medium-sized enterprises that represented Romania's economic future, was largely shut out of the political process and denied the benefits of greater institutional, market-oriented reform.

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[12] Ion Anton, "Assessment of Economic Restructuring in Romania," (Bucharest: International Center for Entrepreneurial Studies, 1994); Ion Anton, "From Entrepreneurship Education to Policy Advocacy," *Economic Reform Today* 4 (Washington, DC: CIPE, 1998); Center for International Private Enterprise, "Romanian Business Association Development Project Final Report, 2000–2003"; Center for International Private Enterprise, "Rebuilding Romania Through Private Sector Development," CIPE Case Study No. 0501 (2005, available at http://www.cipe.org/publications/papers/pdf/IP0501.pdf); Cristina Grecu and Despina Pascal, "Creation of Regional Advocacy Centers: The Advocacy Academy Association in Timisoara," (CIPE, 2006).

[13] Anton (1998), p. 23.

State of business organizations and business representation

Initially, private entrepreneurs attempted to protect their interests individually. A minority who had connections to former communist structures succeeded in obtaining the resources they desired and were perhaps satisfied with the status quo. Other entrepreneurs contended with an unfavorable legal environment in addition to economic and competitive challenges. They sought the removal of restrictive or contradictory laws as well as the creation of new laws and policies that would nurture entrepreneurship and a market economy.

A congeries of independent business associations formed in order to pressure the government for such changes, yet these associations were weak and divided, thus unable to articulate or promote their common interests. Most of them operated in isolation from each other, failing to specialize their programs or coordinate pressure on government. Their weaknesses were compounded by competition from established chambers of commerce, which tended to be aligned with the interests of the state sector.

CIPE performed a diagnostic evaluation of over 20 business associations in July 2000. Many associations suffered from a shortage of funds and a lack of knowledge about how to implement services for the private sector. Fewer than ten percent of the associations had a membership strategy, and none had adequate capacity to recruit or retain members. A number of associations, motivated primarily by the desire to tap donor resources, existed in name only. More than 60 percent of associations had limited if any involvement in the public policy arena; the remainder focused on sector-specific issues. The business community, including some business associations, tended to rely on influence within government rather than policy advocacy.

Association development and advocacy strategy

Over a three year period, from 2000 to 2003, CIPE helped transform Romania's private sector associations and through them the business climate by: (1) strengthening the associations themselves; (2) facilitating and institutionalizing coalition building across associations; and (3) introducing and executing advocacy techniques.

CIPE worked with individual business associations on improving their governance, professionalizing staff, capacity building, strategic planning, and membership development. CIPE acted as a mentor in all these areas, offering guidance and good practice while encouraging Romanians to drive every aspect of organizational change. The associations audited their existing programs and redesigned them to reflect member demand, thereby attracting and retaining members as well as broadening sources of revenue. Organizations participating in CIPE's membership development program achieved an average of a 26 percent increase in new members, a 31 percent increase in retention rates, and a 20 percent increase in revenues. At least 28 associations that CIPE worked with achieved sustainability.

As an outgrowth of several earlier CIPE training programs on association management, a Strategic Alliance of Business Associations (SABA), the first of its kind, formed in the mid-1990s. Approximately 80 associations joined this coalition to engage in dialogue within the private sector and then provide input to the government on economic policy. CIPE provided funding and technical assistance. SABA enjoyed a good measure of success in furthering policy discussions and opening channels to the government. However, the government, in spite of its commitment to private sector development during this period, was not well-equipped to handle and act on policy inputs. Gaps in the formal process, combined with political conflict within the government, ensnared the policy process.

Several years later, in 2002, CIPE brought together a number of its Romanian partners and projects in the highly successful Open Doors Advocacy Campaign. The combination of stronger associations, a framework for coalition building, and new grassroots advocacy techniques won broad political support for specific policy recommendations. This coordinated initiative involved three coalitions representing distinct economic sectors, which compiled their recommendations into a single policy document and pursued a joint campaign. CIPE provided management assistance to the sectoral coalitions, while SABA aided in developing a broad support base.

The groups identified and prioritized general issues such as corruption, bureaucracy, taxation, overregulation, freedom of information, and lack of transparency. Each of the three coalitions also identified and prioritized issues for their respective sectors. For example, firms in the tourism industry were opposed to the 3 percent tourism tax assessed on top of the 19 percent value added tax. They also wanted the government to set up regional tourism bureaus. The information technology and communications sector sought a reduction in employee taxes for IT firms, as well as the creation of an information technology park. The light manufacturing sector was concerned about the high level of taxation on profits (21 percent) and high export duties, and also desired a labor code that was fair to employers and employees alike. Each coalition unveiled its legislative agenda in a press event featuring senior government and business leaders.

The three coalitions then launched a grassroots advocacy tour of ten cities to create support for their legislative agendas and expose 1,000 business leaders to advocacy concepts. This advocacy tour not only generated a great deal of positive press, it convinced many government officials that popular support could be obtained for the reforms necessary to rejuvenate the economy. The Open Doors Campaign garnered over 1,000 individual signatures and 40 supporting organizations with an aggregate membership of more than 3,000.

Following through on the advocacy tour, the coalitions held Advocacy Days in 2002 and 2003, during which a total of 300 business participants had the opportunity to meet with government officials and attend public hearings. These events highlighted the importance of public involvement in policy decisions, transparent legislation, freedom of information, and accountability in government. Although sector-specific issues were featured in the campaign, the various recommendations were presented as part of a single package in order to demonstrate that the private sector was speaking with a united voice.

The campaign described so far accomplished the goals of articulating private sector needs and views, coordinating them, building support, and presenting the agenda to government. All this generated pressure on policymakers to respond to an informed, representative, and transparent set of business recommendations of wide significance to the economy. As crucial as such input is, policymaking also depends on the ability of legislative and executive institutions to accommodate and act on this input. In Romania, CIPE also instigated a forum and an institutionalized process to accommodate input and debate on economic issues.

This forum was a public hearing process established by a new institute known as the Advocacy Academy. The Advocacy Academy was created with CIPE support by a consortium of business associations in western Romania to provide advocacy assistance to business associations. It helps associations design advocacy campaigns and provides them with data on current issues. It was created in part to sustain the type of initiatives that CIPE has coordinated, once CIPE withdraws from Romania.

The Advocacy Academy hosted its first public hearing in June 2003, which was attended by nearly 400 government officials and private sector leaders. The hearing focused on a proposed law, drafted by the Ministry of Justice, to govern advocacy professionals. In written and oral testimony, 38 representatives supported different points of view on regulating direct advocacy. The Open Doors Campaign proposed that the law should establish fair and transparent procedures to initiate lobbying, but should *not* regulate who can lobby. Based on the hearings, a panel of experts drafted a report. 80% of the panel's recommendations were incorporated into a law that is now being prepared for parliamentary approval. Subsequent hearings spotlighted the labor code, information technology outsourcing, and taxation of tourism.

Outcome

Largely due to the efforts of business association advocacy coalitions within the framework of the Open Doors Campaign, Romania passed a Freedom of Information Act. After IRIS and the coalitions developed a procedure to analyze and monitor the regulations under which SMEs operate, several ministries, including the Ministry of SMEs, have embraced initiatives to systematically reduce unnecessary bureaucratic constraints. Further, the Ministry of SMEs approved development of a strategic plan for SME competitiveness and the Minister requested members of the Pro Globe (manufacturing) coalition to submit nominations for a task force. Thirteen specific changes to the Romanian Labor Code, recommended by a panel of experts after input from a public hearing, were submitted to the Minister of Labor. The Minister agreed that the recommendations were appropriate and established a private sector task force to analyze specific sections of the law prior to the creation of the implementation norms.

Coalitions for the individual sectors also obtained many of the changes they wanted, with tangible results. The Ministry of Tourism approved the creation of regional tourism bureaus, which within a year after their formation were already generating hundreds of thousands of dollars through their promotional activities. Also, the three percent Special Tourism Tax was cancelled as of June 2003. The government passed a law to create three technology parks. Employee taxes for information technology workers were reduced and within 18 months Romanian IT companies had added over 1,500 new jobs. In the manufacturing sector, the Pro-Globe Coalition obtained amendments to the labor code that it had sought.

Reforms advanced by the Open Doors campaign created an estimated 2,850 jobs and over $10 million in economic impact, not counting the effect of the reduced tax regime on tourism and information technology companies. From 2002 to 2003, wages rose in the information technology industry by nearly 38 percent, in the tourism industry by 28 percent, and in light manufacturing by 18.6 percent. Industry experts acknowledged that changes in laws, many of which were proposed by the coalitions in the Open Doors campaign, led to these wage increases.

Hungary[14]

Business climate

Although Hungary experienced a very significant output contraction and economic decline, by 1994 a private sector economy was emerging. Incorporated private firms had increased from around 10,000 in the late 1980s to over 200,000, while the total number of firms, sole proprietorships, and individual entrepreneurs had increased from 200,000 to 700,000. The government had liberalized the international trade regime, opened up competition, eased foreign investment rules, and begun to create market institutions. Contract, bankruptcy, and accounting laws and regulations were passed, and business registration was liberalized.

Despite these advances, Hungary had lost its position as reform leader to Poland and the Czech Republic. Privatization had stalled in the industrial sector. The relative lack of savings and capital inside the country, combined with a complicated voucher system and bureaucratic tangles, meant that only a relatively small number of the best firms were actually sold.

A wide number of bureaucratic hurdles and legal barriers impeded business formation and economic growth. At the same time, enforcement of pro-market legislation lagged. In 1993, CIPE conducted an opinion poll of Hungarian entrepreneurs, which found that 37 percent fully agreed, and an additional 35 percent slightly agreed, with the statement that "the majority of entrepreneurs avoid tax laws." Even more significant was the fact that 64 percent fully agreed with the statement that "regulations change so frequently that they are almost impossible to follow." The extent of informal enterprise – 30 percent of GDP – strongly indicated a lack of progress in structural adjustment and institutional reform.

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[14] Center for International Private Enterprise, *Crossed Paths: Straightening the Road to Private Sector Growth,* Spring 1994; John D. Sullivan, "Interim Evaluation: Project on Legal and Regulatory Reform in Hungary," (CIPE, October 26, 1994); Paul Marer, "Center for International Private Enterprise in Hungary, 1989–1999: CIPE's Contributions to Strengthening Private Enterprise and Building Democracy," independent evaluation report (CIPE, July 1999, available at http://www.cipe.org/programs/evaluations/pdf/hungary_evaluation.pdf); Center for International Private Enterprise, "CIPE in Hungary: Paving the Road to Reform," *Economic Reform Today* 4 (1999); Terry Cox and Laszlo Vass, "Government-Interest Group Relations in Hungarian Politics since 1989," *Europe-Asia Studies* 52, no. 6 (September 2000).

State of business organizations and business representation

In the early 1990s, almost a thousand business associations competed for members, as bodies with ties to the state transformed themselves and new associations multiplied. In an attempt to bring order to interest representation, the government passed a Law on Chambers of Commerce in 1994, which required membership in a state-run chamber of commerce, but also permitted firms to join voluntary business associations. The private voluntary associations were obviously at a disadvantage to the chambers when seeking members and income. Moreover, representatives of the private sector vied against representatives of state-owned firms in seeking to influence policy.

Business-oriented research institutes also appeared during this period. Some of these were better organized than the associations. Yet, many lacked a clear sense of identity and direction. While most of the institutes had well-developed research capabilities, few had the ability to effectively analyze the results of the research. Fewer still were accomplished in policy formulation. There was a general need among research institutes for a consistent management and organizational structure.

A CIPE public-opinion poll confirmed in 1993 that Hungarians were supportive of a democratic system but had mixed views on the benefits of a market economy. In this context, private sector representatives had the freedom to take part in shaping ideas and economic institutions, and at the same time faced major hurdles as they were breaking new ground. The very concept of advocacy was new to Hungarians. Not all of the business organizations were comfortable with this new role. On the government side, a lack of norms and institutions promoting information sharing complicated matters. Business representatives found it impossible to gain access to draft legislation for most of the 1990s. Legislation became available to the public only after it had been passed.

Association development and advocacy strategy

CIPE conducted four business association management training sessions in Hungary between 1996 and 1998 to strengthen the capabilities of independent, voluntary business groups in the areas of advocacy, services for local businesses, and administration. Association development was a long-term process in Hungary, given the newness of most associations and the thorough transformation of older ones. CIPE's training programs prepared association leaders to drive advocacy once a market-oriented, democratic framework had been established.

During the 1990s, however, it was the think tanks that drove policy reform in Hungary. CIPE took an active role, forging an alliance of like-minded organizations and individuals able to effectively work toward the common goal of legal and regulatory reform. Consistent with CIPE's philosophy of embracing local knowledge, an advisory board composed of Hungarian business luminaries and leading economic experts was established for the program. They assisted CIPE in identifying the most pressing economic issues and the policy think tanks and research firms best suited to analyze them.

In 1994, CIPE and its Hungarian partners produced a groundbreaking report, *Crossed Paths: Straightening the Road to Private Sector Growth.* In this report, Hungary's leading research institutes made policy recommendations relating to the financial sector, the informal sector, the real estate market, privatization, tax policies, and local government's role in private sector development. Their key recommendations included:

- Lowering the corporate tax to 30 percent, eliminating the minimum tax, and simplifying and reducing VAT rates
- Social security reform, especially decreasing mandatory social security contributions to 15–25 percent
- Establishing "all in one" offices, which would house representatives of all relevant agencies in order to reduce bureaucratic hassles
- Developing a new land valuation and registry system to boost real estate markets

From 1996 to 1999, CIPE hosted a series of 19 roundtable discussions to focus public attention on vital issues and bring public and private sector stakeholders together in a forum where solutions could be proposed and vetted. The series began with broad topics of legal and regulatory concerns and narrowed to targeted aspects of reform implementation and modification. At each event, the government officials responsible for drafting the proposed legislation or policy document were invited to discuss the issue and present the government's thinking. The advocacy coalition was then able to respond to the issues, address alternative points of view from the private sector stance, and follow-up with media campaigns and other advocacy activities to seek to influence the decision-making process. Through roundtables, public conferences, research, and other activities, CIPE and its partners created a strong public awareness of topics such as improving the small business environment, enforcement of property rights and contractual obligations, competitiveness and fair competition, combating corruption, and banking and capital market reforms.

The final roundtable conference, held in June 1999, concentrated on growth and investment. Well over 100 people attended, including top policymakers, Hungarian government representatives, representatives from international organizations, business leaders, and journalists. At the conference, President Arpad Goncz of Hungary acknowledged CIPE's efforts to support Hungary's progress toward a market economy. High on the conference's list of recommendations were measures to ensure open debate among the private sector and policymakers on economic matters. Specifically, the recommendations called for increased transparency in policymaking and regulatory processes, as well as expanded opportunities for public commentary on potential legislation. Furthermore, the conference recommended that greater attention be given to practical implementation and enforcement of new laws.

One of the central recommendations of the 1994 report was to reform social security. In Hungary's existing pension system, all contributions were immediately cycled into payments. As the society aged, revenues could not keep up with pension spending, despite Hungary's high payroll taxes. Payroll taxes reduced both the demand and supply of labor, driving economic activity into the informal sector and further eroding the tax base. Among the goals for a reformed system were to rely on privately managed and funded pensions operating in a well-regulated and competitive environment; provide a more transparent system; create private institutional investors, thereby promoting capital market development; increase competition in the financial system and availability of investment funds; increase the overall savings rate; and significantly reduce labor market distortions and encourage employment in the formal economy.

CIPE acted as a catalyst for pension reform, bringing together teams of international experts, the World Bank, Hungarian private sector groups, and the Hungarian Government. The program drew on CIPE's experiences in Chile and Argentina, where partner organizations were instrumental in reforming outmoded pension systems. CIPE coordinated six teams working on a comprehensive approach to related aspects of the problem. The legal team analyzed related Hungarian laws and drafted the new laws. The macroeconomic team obtained necessary statistical and demographic data and developed models. The institutional development team surveyed the international institutional background and proposed the normative text of the law. The analytical team examined the life paths of alternative systems and compared actual results to model calculations. The investment team surveyed investment regulations and prepared proposals for supervision and regulation of investors. The public relations team conducted opinion polls, contacted journalists, held discussions with the public, and distributed 300,000 brochures to broaden the public's awareness of the pension reform and help citizens understand their rights and obligations, as well as the benefits that could be gained from the new system. CIPE worked with a variety of Hungarian associations and chambers to increase their members' understanding and support of the proposed reforms.

Outcome

Five years after the 1994 *Crossed Paths* report was issued, the Hungarian government had adopted nearly two-thirds of the report's 41 recommendations. Attila Chikan, Hungary's former Minister of Economy, said "among the institutions [that] promoted Hungary's transition, CIPE has definitely been playing a major role from the very beginning. CIPE managed to find the key areas where important debates and discussions could be held."[15]

[15] Marer, 1999, op. cit.

One of the biggest success stories of the legal and regulatory reform program was the role CIPE and its partners played in bringing about pension reform in Hungary. Legislation adopting the new system was passed by Parliament in July 1997 and further supplemented with implementing governmental decrees in September 1997. The new Hungarian system followed international models in diverting a significant portion of the mandatory pension contributions from the centrally managed system into one of privately managed individual accounts. Known as a "three-pillar" model, the system included a reduced and modernized "pay as you go" state pillar, a privately managed second pillar into which workers could opt (with incentives to encourage those under age 45 to do so), and a third, completely voluntary, supplementary private pillar. The system cut the cycle of paying past pension promises through current salaries in exchange for new promises of future pensions. This "rollover debt" would be handled in a more transparent fashion and have a positive effect upon the economy and capital market.

A good example of a successful partner association was the Hungarian Franchise Association (HFA). This association benefited from CIPE's association management training program and also worked with CIPE on an advocacy project. Relatively new in Hungary, franchising represented an important avenue to market entry for small business, since franchise businesses have a markedly lower first-time failure rate than independent ventures. HFA's advocacy campaign aimed to clarify the legal status of franchise agreements. After highlighting the issue at a conference and negotiating with the Ministry of Justice and the Hungarian Competition Office, in December 1997, HFA obtained a block exemption to the Competition Act (introduced in January 1997). HFA also established a code of ethics for franchises.

Russia[16]

Business Climate

The Center for Economic and Financial Research (CEFIR) in Moscow has been carrying out a program since 2002 to measure the barriers to doing business faced by firms on the ground. It has consistently reported a gap between what the law stipulates and what entrepreneurs actually experience when attempting to deal with governmental agencies. The chart below is from CEFIR's original survey.

The Reality Gap in Russia

Activity	Legal Mandate	Reality (average/mean)
Registering a Business	5 Days	26-29 Days
Registration Cost	2,000 Rubles	4,692 Rubles
Number of offices required to visit	One	Three
Licensing Costs	Not to exceed 1,000 Rubles	16,600 Rubles

Source: CEFIR and World Bank Survey 2002

As can be seen, the old Russian proverb "trust but verify" continues to be applicable. The difference between the law on the books and the law in day-to-day life can be the difference between successful reforms and a façade of progress. For this reason, it is vital to ensure that the

[16]Center for Economic and Financial Research, "Monitoring of Administrative Barriers to Small Business Growth, 2002–2005," available at http://www.cefir.ru/index.php?l=eng&id=32; William E. Pomeranz, "Whither Russian Property Rights?" *Economic Reform Feature Service* (Washington, D.C.: CIPE, 11 March 2004); William Pyle, "Collective Action and Post-Communist Enterprise: The Economic Logic of Russia's Business Associations," William Davidson Institute Working Paper Number 794, September 2005; Center for International Private Enterprise, "Strengthening Local Democracy in Russia: The Case for Business Associations," CIPE Case Study No. 0505 (February 16, 2006, available at http://www.cipe.org/publications/papers/pdf/IP0505.pdf).

analysis of the investment climate found through an examination of the law actually represents day-to-day life.

In 2003, the Chamber of Commerce and Industry of the Russian Federation (RCCI) identified a set of fundamental problems. Registration, licensing, certification, and complicated tax codes frequently prevented the launching of business operations, provoked businesses to "escape" into the informal sector, or even shut them down entirely. Frequent changes in laws exacerbated confrontations between the SME community and government agencies for audit, reconciliation, and oversight. Inspectors had abundant opportunities to extract bribes from businesspeople. The beleaguered businessperson found bribery to be a more efficient means of protecting his or her rights than pursuing a judicial remedy. Property rights rested on shaky foundations. Although many factories and buildings had been privatized, the land on which they rested was still owned by regional or municipal authorities intent on maintaining a revenue stream from rental payments.

State of Business Organizations and Business Representation

Hundreds, perhaps thousands, of voluntary, multi-branch associations and chambers of commerce emerged in the 1990s. Their independent status was protected by law. Growth in membership of these organizations picked up around 2000. In a survey of the associations, William Pyle found they offered diverse, market-supporting services such as innovation and investment services, provision of information, training and recruitment services, and trade promotion.[17] Member firms tended to pursue market-oriented restructuring and investing at a higher rate than those that did not belong to an association.

Regional associations, especially those serving small business, were working against tremendous odds with very limited resources. In 2003, eighty percent of the associations surveyed belonged to coalitions such as RCCI, the Russian Union of Business Associations OPORA, the Russian Union of Industrialists and Businessmen, or a regional association

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[17] Pyle, 2005, op. cit.; see also Pyle, “Russia’s Business Associations: Who Joins and Why?” *Economic Reform Feature Service* (CIPE, July 17, 2006, available at http://www.cipe.org/pdf/publications/fs/071706.pdf

dedicated to small business development. The rest acted independently. Association activities ranged from working with a regional governor's council on small business assistance to organizing protests. They worked with local administrations and legislative committees, commenting on policy and draft laws and trying to influence budgetary decisions. Associations made presentations at legislative dumas; conducted surveys; arranged training programs; organized demonstrations and competitions; joined in discussion groups, conferences, seminars, and congresses; participated in press briefings, television programs, and other media events; and, in a few cases, developed specialized internet sites and hotlines.

Association Development and Advocacy Strategy

One of the larger coalition-based advocacy campaigns to generate reform is taking place now in Russia. The program is a partnership between RCCI, OPORA, and CIPE. The choice was made to focus first on the administrative regions of Russia and, only much later, return to the national level. This decision was made for two reasons. First, the analysis of the reality gap described earlier demonstrated that national law was not being implemented by local administrations. Therefore, it was determined that creating grassroots coalitions at the local level could create a demand for implementation (political will) that could then force reform to be implemented throughout the country. The second reason was that the national executive authorities in the years 2002-2005 had been preoccupied with other issues. The coalition partners felt that the best strategy would be to generate successes in the regions and then use that evidence as proof that further changes were needed at the national level.

The approach that was taken to generate a reform program was to first identify potential partners in the different cities and regions of Russia. The next step was to carry out training programs for them to build strategic plans and the advocacy skills needed to mount campaigns at the city level that would promote economic reform. Coalitions were formed that included think tanks, business associations, and like-minded civil society organizations interested in creating a better business climate. Based on the focus groups and the work that was done, regional business agendas were laid out for eight different regions of Russia. Participants worked in small groups with colleagues from their region to identify common obstacles and key development objectives.

They then mapped out strategic coalitions to address individual issues. The business agendas they created identified very specific barriers and proposed very specific reforms to deal with those barriers. CIPE, as well as the Russian Chamber, provided technical assistance to these associations to sustain their advocacy campaigns.

Outcome

The results that were attained are examples of the cumulative power of collective action. In terms of administrative barriers, in the Krasnodar region, for example, the governor signed a single-window decree simplifying land transactions. Although the number of required documents remained at 20, the time for reviewing the documents was reduced from a period of 6 to 24 months to a period of 2 to 6 months. The mayor of Khabarovsk signed a similar decree on November 30, 2003, introducing a single-window procedure for small-business registration. This decree reduced the time for registration procedures from 30 to between 7 and 15 days. The Primorsk Coalition reduced the number of documents required to register a business from 7 to 1 and the time to register from 40 days to 7. Similar kinds of reforms were put into place in the area of inspections, information, property and leasing, finance, taxes, and capacity and services.

The impact of this was a 45 percent growth in coalition membership during the project period. As each reform policy was implemented, others could see that it was having a positive effect and joined the reform effort. Policy changes in administrative barriers, taxation, microcredit, protection of entrepreneurs' rights, and rental costs all sustained strong reform programs across the regions.

The coalitions' recommendations were incorporated into a federal law signed by President Putin on the SME taxation systems, which reduced the list of business activities that require licensing from 125 to 103, extended protection of property rights, gave entrepreneurs the right to challenge inspections by state licensing bodies, and guaranteed protection to SMEs in state contracting competitions. As a result, there was a new willingness to engage in dialogue, which is a fundamental component of the democratic process. There was also a growing recognition and acceptance that the business community has a constructive role to play in the policymaking process, and that business is a legitimate segment of society, worthy of protection and promotion.

Conclusion

In his speech at Harvard University, Dani Rodrik (1999) asked a fundamentally important question: "How are good institutions acquired?" echoing the concerns of other NIE scholars, such as Douglass North (2003).[18] While the necessary tools exist to identify 'good' institutions – institutions that countries must have in place in order to achieve high-quality economic growth – there is still little known about how such institutions emerge or how they are developed. Over the past decade and a half, transitioning economies have become a test tube for many theories and approaches. Rodrik divides suggestions that have been made (and tested) in regards to the best way of facilitating institutional development in two categories: one can either copy an international blueprint or experiment locally.

In this paper we outline the path of institutional development in some transitioning economies, where business associations played a key role in the process. CIPE's experience of working in more than 100 countries shows that there has to exist a healthy mix of international experience and local knowledge in generating institutions and institutional reforms. An emphasis on local realities is important, in that, regardless of international experiences, a host of different factors influence the design and outcomes of reforms – including the initial conditions and key players involved. In other words, no country has the same mixture of initial conditions in the form of resource endowments; institutional arrangements; leadership capacity; and private sector actors including associations, think tanks, political parties, and civil society.

However, this does not mean that countries and reformers cannot learn from each other. The development of a good business climate through private-sector advocacy presented in this paper is one approach that can be used successfully to generate sustainable economic growth. In

[18] Dani Rodrik, "Institutions for High-Quality Growth: What They Are and How to Acquire Them," IMF Seminar 1999. www.imf.org/external/pubs/ft/seminar/1999/reforms/rodrik.htm; Douglass North, "Promoting Institutional Reforms in Latin America," Keynote Address delivered at a conference organized by CIPE and the Ronald Coase Institute, University of Sao Paulo, Brazil, December 12, 2003 (available at http://www.cipe.org/about/news/conferences/lac/Pirla/pdf/DouglassNorthConference.pdf).

fact, one of the key purposes of this paper is to begin the process of building a base of knowledge on how to build good institutions in the face of external constraints; variable initial conditions; and that most elusive of factors, political leadership and its correlate, political will. Knowledge management has become very widespread in the management realm but has hardly begun among those interested in development.

As we try to show, not all business associations are the same. Olson was not necessarily wrong when he concluded that interest groups can stifle economic growth. However, he presented only one side of the development equation. The reality of the other side of the equation is that collective action problems can be solved in market-enhancing ways, where the end result is an improved business climate and expanded market opportunities for wealth creation. Findings by Pyle (2006) and Marer (1999) confirm that business association can, in fact, have a positive impact on the development of markets.

It can be said that on the level of private-sector interest groups, there is a battle between market-enhancing and rent-seeking interest groups, and the side that gets the upper hand in policy reform can have a significant impact on countries' economic fate. In the case of rent-seeking organizations, Olson's predictions will hold, as studies on state-capture, corruption, weak governance, and crony capitalism conclude. Yet, if market-enhancing private-sector organizations can succeed in creating a good business climate through bottom-up, participatory policymaking, then countries have a much better chance of generating long-term economic growth.

Importantly, our experiences also show just how important a blend of politics and economics is in getting reforms to work – and that the two cannot be viewed as separate fields. Political gridlock can slow down economic development and create confusion and frustration on the part of reform advocates and within society at large. Lack of political will to reform and weak governance mechanisms can significantly reduce the potential of conventional economic ideas to take root and economic reforms to deliver as theory predicts. Democratic governance is a key part of designing policy and implementing changes. It creates opportunities for transparent policymaking, where key information flows from economic agents to policymakers and where individuals in government and the private sector can be held accountable for their actions.

Successful reforms do not only require functional government and responsible political actors – they also require responsible private actors.[19] Many would suggest that the private sector responds to incentives – if institutions are weak and incentives exist to break the law, the law will be broken. Yet, what we've also seen is that ethics and leadership play a very important role in getting firms to commit to building a functional rule of law system, where the ultimate reward is a stable, competitive, and predictable business-friendly environment.

[19] It is for this reason that, in the wake of the Enron and other corporate governance failures, the New York Stock Exchange began requiring companies to maintain an ethics code and to post public notices on those occasions when the code was waived. This might be an innovation worthy of replication.