

# Deregulating Business in Russia

Better progress in regions with more transparent, less corrupt and more fiscally-motivated governments

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In recent years deregulation has been a popular topic on policymakers' agenda: in 2005 and 2006 alone, 55 countries undertook reforms that lowered the costs of doing business, the World Bank reports. How can the reform achieve the desired results at the local level if started by the central government? What results did deregulation of business activity bring to businesses and the population at large?

In addressing these questions, we use a unique combination of a deregulation policy experiment undertaken in Russia in the early 2000s and detailed panel data on the actual regulatory burden on firms across regions. The data come from regularly-repeated surveys of 2,000 firms in 20 regions of Russia about their actual levels of regulatory burden in each area of regulation affected by the reform.

## Ambitious Reforms

Between 2001 and 2004, Russia passed laws that drastically simplified procedures and reduced red tape associated with entry regulation, and with the regulation of existing business. The laws introduced clear measurable limits to regulatory burden, for example, they established that registering a business requires a trip to just one government agency ('one-stop shop') and takes no more than a week; each inspecting agency, comes to inspect a business no more frequently than once in two years; licenses are valid for no less than five years. In addition, the reform foresaw a substantial amount of 'delicensing', i.e., the exemption from licensing of many business activities which previously had required licenses.

Prior to the reform, Russian firms suffered from excessive regulatory burden. It was argued that over-regulation was among the most important reasons for the country's poor economic performance during the first eight years of transition. The proclaimed goal of the reform was to induce the entry and growth of small business.

In our study we, first, examine whether the reform succeeded in bringing down administrative costs for firms.

Second, we study which institutional factors affected the level of enforcement of deregulation laws in different regions. And third, we estimate the causal effect of deregulation on outcomes — firm entry, employment in small businesses, public health, and pollution.

## Transparent and Accountable Governments Succeed

To begin with, we compare the actual regulatory burden with the official level established by the legislation and find that official regulations are poorly enforced and grossly understate the regulatory burden, as much of the actual regulation is in excess of the official levels. The difference in timing of the initial enactment of different deregulation laws allows us to estimate the effect of the enactment on regulatory burden. Controlling for all regional characteristics, macro-economic shocks, and region-specific trends we find that, on average, the enactment of a deregulation law has led to a significant reduction in regulatory burden for Russian firms in the area of regulation affected by that law.

At the same time, reform progress exhibited a large regional variation. Therefore, looking only at the largest cities may give a misleading picture about the state of regulation in the country as a whole. Moreover, the geographical variation of regulatory burden in each area of regulation prior to the reform's implementation had also been very large. So in examining what determines the success of a deregulation reform at the regional level, we take into account the pre-reform regional institutional environment. Based on our estimations we can conclude that four factors significantly boost enforcement of deregulation laws in a region:

- Government transparency;
- Low corruption;
- Presence of a strong industrial lobby, i.e. the extent to which regional authorities are under the influence of powerful industrial groups;
- Strong fiscal incentives, i.e. the extent to which regional budgets are

comprised of local taxes rather than transfers from the federal center.

## Effect Similar for All Firms

Interestingly, these institutional factors affect in the same way both the entry deregulation and the liberalization of regulations on established firms. This implies that industrial lobbies accelerate deregulation in all areas of regulation and do not use entry regulation to protect themselves from potential competitors.

According to our estimates, deregulation had a positive significant effect on firm entry and employment in small business. At the same time, no effect on either pollution or public health (morbidity from poor-quality products) has been recorded.

In concluding it is worth repeating that it is the regions with the least corrupt, transparent, accountable, and most fiscally-motivated governments that achieve most progress in deregulation.

The evidence allows us to evaluate the competing theories of the nature of regulation. Our findings are inconsistent with the public interest theory because regions with transparent and accountable governments are the ones that achieve progress in deregulation, and moreover, deregulation does not have an adverse effect on pollution or morbidity (two market failures that regulations are supposed to cure). The evidence is also hard to reconcile with the regulatory capture theory because the presence of a politically-powerful industrial lobby has the same effect on regulation of entry and existing business. Industrial lobbies accelerate deregulation in all areas and do not use entry regulation to protect themselves from potential competitors. But, in accordance with 'tollbooth' theory, the least corrupt and most fiscally-motivated governments promote deregulation the most.

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