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Regulatory Institutions

A BLUEPRINT FOR THE RUSSIAN FEDERATION

Donato de Rosa, Nick Malyshev

**REGULATORY INSTITUTIONS:
A BLUEPRINT FOR THE RUSSIAN FEDERATION**

Donato De Rosa and Nick Malyshev

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Introduction

Beginning in the mid 1990s, the Russian authorities addressed the issue of regulatory reform through a number of deregulation and de-bureaucratisation initiatives. While commendable, the approach to reform was fragmented and its impact largely ineffective. A more concerted attempt at regulatory reform began in 2001 with the adoption of the *Medium Term Programme of Social and Economic Development for 2002-to-2004*, (henceforth, Medium Term Programme). Its objective was to redefine the relationship between the state and the economy, by delimiting the role of the state to reducing barriers to growth and creating a favourable climate for entrepreneurship and investment. One facet of the Medium Term Programme was to establish the fundamental principles of regulatory reform and a timetable for its implementation.

There are loose parallels with Russia's approach to regulatory reform and the evolution of regulatory reform in OECD countries. Across the OECD, the past two decades have witnessed a transition from episodic and unco-ordinated initiatives towards the formulation of systematic regulatory policy. Beginning in the 1970s, several OECD countries became aware of the costs connected with outdated and excessive regulation.¹ The result of such awareness has been the commitment to reform efforts, which varied widely across countries and industries, depending on a country's history and industrial features. The first reaction, pioneered by common law countries, was to engage in a deregulation effort, based on the perception that excessive and intrusive regulation was harming economic performance by obstructing innovation and entrepreneurship. Gradually, many countries began to realise that the simple elimination of regulations was not sufficient. What was needed was consideration of ways to improve the functioning of regulatory institutions. In other words, *ad hoc* reform initiatives were substituted by an organic reform agenda, specifying policies and tools, and leading to the explicit formulation of regulatory policy as a permanent feature of policymaking, under the responsibility of dedicated institutions.

However, the comparison between Russia and OECD countries, notwithstanding the considerable efforts of the Russian authorities during recent years, cannot be taken much further. This paper will argue that Russian regulatory policy has to make further progress in order to achieve the standards of overall consistency that would be necessary for durable results. Notably, the general traits of regulatory policy appear to be lacking in strategic direction emanating from a single central institution. At the same time, sectoral regulators, where they have been established, should evolve towards greater independence and acquire greater technical competence in order to approach the standards that prevail in many OECD countries. Some steps in the right direction have been taken in competition policy, with the drafting of appropriate antitrust legislation and the establishment of the Federal Antimonopoly Service (FAS). The agency is, nonetheless, not fully independent and does not have sufficient resources to be in a position to resist powerful sectoral interests.

It is precisely a clear definition of the institutional structure for regulatory reform that has been deficient in Russia. Deregulation initiatives and reorganisation of network industries have not been framed within an institutional architecture with clearly defined roles and responsibilities. In many OECD countries, on the other hand, a two-tier institutional structure has emerged as an effective driver of regulatory reform. This structure entails, at one level, an oversight body which has the responsibility of defining the long term objectives of regulatory policy and of ensuring adequate standards of regulatory quality across various regulatory domains. The second level of the structure is composed of sectoral regulators – with varying degrees of independence from the executive – which formulate regulatory policy, access rules and tariff structures for their sectors of competence. Complementary to *ex ante* sectoral regulation is the presence of competition authorities with the role of ensuring *ex post* that the behaviour of actors, especially incumbents in network industries, does not hinder market competition.

The aim of this paper is to suggest an architecture for regulatory institutions that is feasible in the Russian context. The ultimate objective is to establish regulatory institutions that facilitate the achievement of more

transparent and efficient regulatory outcomes, both in general and in regulated network industries. Such a set up would involve two areas. First, establishing a regulatory oversight unit, located at the centre of government, responsible for the strategic co-ordination of regulatory reforms and oversight of regulatory quality. Second, redefining the mandates and strengthening the capacities of the competition authority and regulators of network industries.

OECD experience contains a number of valuable lessons which could direct Russia's future efforts in regulatory reform onto a track more similar to the one observed across the OECD. Of course, an essential precondition for Russia to be able to benefit from the lessons of OECD experience is the political willingness to establish an effective system of institutions and tools for the formulation and implementation of regulatory policy. The seeds of such resolve appear to be present in a number of legislative initiatives, notably the reorganisation of the executive proposed in the *Presidential Decree of March 9, 2004*. Unfortunately, the commitment on the part of Russian authorities in the direction of implementing their own legislative measures has been sporadic and uneven, with specific policy actions not always conforming to declared intents.

The lessons Russia could draw from OECD experience in regulatory reform can be summarised as follows:

- First, countries with explicit and institutionalised regulatory policies consistently make more rapid and sustained progress than countries without clear policies (see OECD, 2002). The reason is that an explicit policy embedded in a clear institutional framework signals the government's commitment to reform, enhancing the effectiveness and co-ordination among various aspects of the reform agenda, such as competition policy, corporate governance and sectoral reforms. In this light, the Russian authorities should consider the establishment of a central oversight unit dedicated to the management of the regulatory reform agenda and to the achievement of high regulatory standards across sectors.
- Second, in order for a reform agenda to be effective, endorsement and direction at the highest political level is essential to overcome resistance to reform from within the public administration as well as to shield reforms from the reaction of particular interests that may lose out from the changed *status quo*. In the Russian context, the locus of political power is the presidential administration. Currently, the Ministry of Economic Development and Trade (MEDT) performs a number of regulatory oversight functions. These should be moved to the presidential administration within a newly established oversight unit, in order for the reform process to be more effective.
- Third, high standards of regulatory quality are possible when tools and procedures are in place to verify that new and existing regulations conform to acceptable standards. Such a "challenge" role could be performed by the oversight body, which could ensure the consistent application of regulatory tools, such as regulatory impact analysis (RIA). At present, there are no institutional provisions in Russia for the application of RIA.

- Fourth, the formulation of regulatory policy should be explicit, with objectives brought into the open. From a governance perspective, the advantage of such an approach is the transparency of goals and strategies of the reform process. Transparency, in turn, is a precondition for governments to be accountable to the public for policy outcomes and for delegated regulatory agencies to be clearly answerable towards governments for delivering the stated policy. The establishment of a formal central oversight institution would assist in achieving this goal, by performing an advisory and advocacy function for regulatory reform.
- Fifth, Russia should establish an efficient institutional framework for network industries – notably, in electricity, railways, telecommunications and gas. This should be done by clearly allocating responsibilities between sectoral regulators and the Federal Antimonopoly Service (FAS). Notably, FAS should be given a broad mandate and sufficient resources to protect competition in regulated sectors, as well as be in charge of access to regulation in order to prevent discrimination in access to network infrastructure. The functions of economic regulation (setting of end user tariffs) and technical regulation, on their part, should be attributed, respectively, to the Federal Tariff Service (FTS) and to the newly established sectoral regulators.
- Finally, in order to minimise political interference as well as the clout of incumbents in regulated sectors, sectoral regulators should be endowed with adequate resources as well as with an appropriate degree of statutory independence from the executive. Given current political circumstances, fully independent regulators may not be immediately feasible. A second-best alternative would be to establish regulators of network industries in charge of technical aspects – notably, in electricity, railways, telecommunications, and gas- as Federal Services, under – but at arm’s length from – relevant ministries or directly under the aegis of the Prime Minister’s office, on the model of the FAS and the FTS.

This paper is organised as follows. The first section describes the functions of central oversight bodies for regulatory policy and its use in the Russian context. The second section investigates the relationship between regulators of network industries and the competition authority. The last section makes some concluding remarks on developing an effective institutional architecture for the achievement of high standards of regulatory quality in Russia.

The central oversight body

When examining the regulatory reform experience of OECD countries a crucial factor for the success of regulatory reform agendas has been the establishment of a regulatory process that is both well designed and effectively monitored by a dedicated oversight institution accountable for results. An important priority for Russia could, therefore, be the establishment of a unit responsible for promoting regulatory quality and guiding regulatory reform. At present, responsibilities of regulatory oversight and strategic direction of reform seem to be shared between the Ministry of Economic Development and Trade (MEDT) and the Presidential Administration. A formalisation of such functions within a single institution, with adequate statutory powers and technical competences, would ensure greater firmness in the strategic direction of regulatory reform, and would promote greater cross-sectoral consistency and quality of regulatory policy.

The pursuit of high quality regulation has become an important priority across the OECD. A majority of OECD countries, in fact, base their regulatory reform initiatives on a published and organic regulatory reform programme, often stating reform objectives as well as principles of good regulation (Jacobzone *et al.*, 2007). In order to provide guidance for the regulatory reform agenda, 18 OECD members establish responsibilities for reform at the ministerial level, with a specific minister accountable for promoting progress on regulatory reform (see Table 1).

A majority of OECD countries have also opted for the establishment of central bodies in charge of regulatory oversight that are routinely consulted as part of the process of developing new regulation. In the context of comprehensive regulatory reforms agendas, central bodies are often also charged with reporting on the progress made on reform by individual ministries. This role ensures that the implementation of reform advances according to a timetable that may be specified in a strategic reform plan. In order to promote regulatory quality, central oversight bodies may also be in charge of reviewing and monitoring the analyses of regulatory impacts conducted in individual ministries or of performing their own analyses of regulatory impacts. This role ensures that consistent standards of regulatory quality are applied across government agencies in charge of various sectors. Central bodies are often also entrusted with an advocacy function to promote regulatory quality and reform, both within the government and with the wider public.

The practice over the past decade to integrate some type of oversight institution within the administration is confirmed by the fact that the number of central bodies in charge of regulatory policy has increased from 14 in 1996 to 26 in 2006 (Jacobzone *et al.*, 2007 and Table 2).

Mandate

The mandate of a newly established central oversight unit should explicitly formalise its role, functions and sources of funding. At present, regulatory oversight functions are dispersed across the Ministry of Economic Development and Trade, the Ministry of Justice and, more informally, the Presidential Administration. These functions need to be institutionalised and rationalised in a single unit, perhaps pooling expertise and resources from existing bodies. It is imperative to avoid creating another body that simply duplicates the roles and responsibilities of existing agencies. Although OECD experience shows some variability in the type of mandate given to oversight institutions, a permanent unit, would be particularly desirable in the Russian context. Notably, it would signal a political commitment to regulatory reform, and insulate the behaviour of the oversight unit from competing interests within the government as well as from the political cycle.

OECD experience shows that the status of oversight bodies varies widely and is dictated by countries' history and constitutional framework. A majority of OECD countries, especially larger ones, have recognised the value of a formal role for some sort of an oversight authority. At the same time, countries where policy-making has a participatory and consensus-based nature have devised more informal oversight institutions or to forgo them altogether (Malyshev, 2006). However, the first option appears to be more relevant for Russia, where the complexity of the balance of power in its central government, in addition to its federal structure, would suggest formalising regulatory oversight functions.

In many countries, central oversight bodies cut across many different functions and vested interests, within the administration and in the broader environment (OECD, 2005b). Resistance to the establishment of oversight bodies has often been based on the assertion that their function is already performed by existing policies and structures. However, it is important not to be swayed by claims that these units challenge or undermine pre-existing loci of power.

Functions

The experience of OECD countries suggests that the role and responsibilities of these bodies have been strengthened in the last few years (Jacobzone *et al.*, 2007). The OECD indicators of regulatory management systems reveal a clear trend towards an increased role of oversight bodies in consultation when developing new regulation, reporting on progress by individual ministries, and performing regulatory impact analyses. In general, the mandate of oversight units in OECD countries may include different functions, such as:

- **Supervision and co-ordination** of the regulatory policy of various regulators;
- **Reporting** on progress in achieving regulatory policy objectives;
- **Challenge** of existing and proposed regulation against quality standards, by means of tools such as regulatory impact analysis (RIA), with the consequent power of vetoing regulations that do not conform to explicit quality requirements;
- **Advocacy** of the regulatory policy agenda with the rest of the administration and the wider public, with the objective of building and maintaining support for a long-term strategy;
- **Advising** regulators on the implementation of regulatory policy; and,
- **Developing** guidance material and training.

Functions for an oversight body in Russian

A newly established central oversight body could perform a number of functions which are currently executed in a sporadic and unco-ordinated way.

Supervision, co-ordination and reporting

A major handicap of regulatory reform initiatives in Russia has been weak implementation and enforcement. A central oversight body could perform the useful role of supervising, co-ordinating and reporting on the progress of individual reform initiatives. One such initiative that would greatly benefit from the presence of a central oversight unit is the drive towards *administrative simplification* that has been the focus of frequent government activism since the adoption of the Medium Term Programme. Its objective was to redefine the relationship between the state and the economy, by delimiting the role of the state to reducing barriers to growth and creating a favourable climate for entrepreneurship and investment. Russia has been persuaded to attempt a reduction of red tape in an effort to foster product market competition, which in turn, enhances economic performance.² Various administrative simplification programmes were, therefore, conceived to reduce bureaucratic interference in business operations, especially for small and medium-sized businesses. Specifically, since 2001, several laws have limited the range of activities subject to licensing requirements, streamlined procedures for registering new businesses, and reduced officials' power to conduct arbitrary inspections.³ Some improvements notwithstanding, compliance with the administrative simplification laws has been far from complete, especially concerning the provisions on restrictions on the number of inspections (CEFIR, 2005). Moreover, the abolition of licensing regimes has sometimes been only formal, since licenses have been substituted with 'permissions' issued by regional or municipal authorities (OECD, 2006). Better co-ordination and centralised monitoring of administrative simplification initiatives would contribute to making them more effective. The central oversight body could perform such functions identifying the obstacles and proposing specific remedies for their removal.

Challenge

The function of challenging the appropriateness of new and existing regulations could be an important role for a central oversight unit. The challenge function could be performed either directly, using the resources within the unit, or indirectly, by entrusting the central body with the responsibility of reviewing and monitoring the analyses conducted in individual agencies. This would favour the introduction of *regulatory impact analysis (RIA)* as a standard feature of the regulatory process. RIA has the objective of providing effective *ex ante* evaluation of regulatory policy proposals by systematically evaluating the potential effect

of regulations. Russia could greatly benefit from the systematic implementation of RIA in its regulatory process. Russia has some mechanisms in place for assessing regulatory impacts, although these fall far short of RIA. One such case is contemplated in the technical regulation law, which requires cost-benefit analysis of proposed technical regulations.⁴ As another example, draft federal laws and normative acts that entail costs for the budget may be subjected to financial analysis by the Audit Chamber and must be evaluated by the Ministry of Finance. Another case is an initiative of the Ministry for Economic Development and Trade requiring independent evaluation of draft regulations. Broadening the scope of RIA and entrusting its implementation to the newly established central oversight body, according to uniform rules and procedures, would greatly contribute to enhancing regulatory quality across the board.

Advocacy and advising

In a country where the need for better regulation is often ill understood, it is important to advocate its merits both within government and with the wider public. A government agency with a comprehensive overview of the regulatory reform process and with the competence to assess its performance would be well positioned to perform such a function in Russia. A competent dedicated unit could also perform a useful role in advising the centre of government on the general regulatory reform strategy, which may require a certain sequencing of reforms in order to be effective. Such choices regarding the priority of reform initiatives and the complementarities among them require informed decision making, which can only be provided by in depth background analysis. In addition to advising the central government on the broad aims of regulatory policy, the technical expertise of a central oversight body could also be used by individual ministries or regulators in drafting specific regulations.

Resources

The regulatory oversight body should be equipped with sufficient financial and human resources to adequately carry out its assigned functions. In particular, in order to secure the employment and retention of highly qualified staff, recruitment policy and pay scales should be outside public sector schemes. This need stems from the fact that Russia's public servants do not receive sufficient remuneration to attract and retain highly qualified staff with risk of corruption or apathy. This is imperative if the oversight unit is to acquire the analytical capabilities and technical competence needed for it to adequately perform its tasks. Such an approach would reflect the experience of OECD countries, where oversight bodies are generally small in size – on average between 20 and 30 members- but staffed at high political and technical level.

Location

Ideally, a regulatory oversight unit should be placed as close as possible to the centre of political authority. In the Russian context, such locus is clearly within the Presidential Administration, which, on its part, has often provided nominal and, sometimes, legislative support to the regulatory reform agenda, as in the case of the *Presidential Decree of March 9, 2004*. Such location could prove useful in the Russian context where there seems to be wide overlap among different government agencies in the formulation and implementation of regulatory policy. A number of Departments within the Ministry of Economic Development and Trade currently perform functions of strategic direction and regulatory oversight.⁵ The Ministry of Economic Development and Trade is comparatively well endowed with technically competent staff and has a proven track record of consistent support for reform over the past several years. The functions and resources of these departments could be pooled and reorganised within a newly established unit, with a specific mandate of regulatory oversight, placed within the Presidential Administration.

Experience in OECD countries confirms that central bodies, where present, are best placed in – or report to – the centre of government rather than in a line ministry, which is likely to be linked to specific policy and regulatory functions (OECD, 2005b). In some instances, oversight units take the form of intergovernmental

committees, parliamentary committees or even external advisory commissions. These, albeit less formal, have the advantage of being external to the administration and, hence, in principle, more immune from the influence of vested interest within government.

Box 1. Regulatory Impact Analysis (RIA)

The widespread use of Regulatory Impact Analysis (RIA) is a clear example of the trend towards more empirically based regulation and decision-making. RIA examines and measures the likely benefits, costs and effects of new or changed regulations. It is a useful regulatory tool that provides decision-makers with valuable empirical data and a comprehensive framework in which they can assess their options and the consequences their decisions may have.

Many OECD countries have substantial experience in RIA. The majority began to introduce it during the latter half of the 1990s. The use of this tool spread rapidly, and today the governments of most OECD countries rely on at least some form of RIA. There is no single model that OECD countries have followed in developing RIA programmes. Their design has taken into account the institutional, social, cultural and legal context of the relevant country. That said, the experiences of OECD countries have made it possible to establish certain practices associated with effective RIA.

To be successful the use of RIA must be supported at the highest levels of government. The most effective programmes have been those that require RIA as a condition for the consideration of new regulations and laws. Responsibilities for RIA are generally shared between ministries and quality control bodies. In a majority of OECD countries, ministries are primary drafters of both RIAs and regulations. Ministries have better access to the expertise and information that high-quality RIA depends upon. A number of OECD countries have found that a centrally located body can have an important role in quality control and oversight of RIA. These independent bodies have the right to ask ministries to revise drafted regulation.

OECD (2005c) found that governments tend to improve RIA programmes gradually, so that over time they increasingly support application of the benefit-cost principle. This step-by-step approach should help to instil the benefit-cost principle as routine, while acknowledging the practical and conceptual difficulties this analytical method poses in the short term.

Ideally, RIA should be applied to all significant regulatory requirements, regardless of their formal legal status. But analytical capability is a scarce resource that needs to be allocated using some rule of reason. Countries often target RIA where regulatory outcomes will have a noticeable economic impact. Targeting has two significant benefits. First, focusing RIA resources on key areas enhances the credibility of its results and increases the rewards that ensuing policy improvements bring. Second, because the RIA process has to be supported at both the administrative and the political levels, it is important that stakeholders do not view RIA as simply a costly bureaucratic process that analyses insignificant policy proposals with little to be gained by the exercise.

RIA is a challenging process that needs to be built up over time. It has to be integrated into the policy-making process if the disciplines it brings are to become a routine part of policy development. RIA has been seen in some administrations as an obstacle to decision-making or legislative work. In those situations when RIA is undertaken in the early stages of the decision-making process, it does not appear to slow the process down. Where RIA is not integrated with the policy-making process, impact assessments can become merely justifications of decisions after the fact. Integration is a long-term process, which often leads to significant cultural change within regulatory ministries and among consumers of the analysis, primarily ministers and legislators.

The overall assessment of RIA is mixed. There is nearly universal agreement among regulatory management offices that RIA, when it is done well, improves the cost-effectiveness of regulatory decisions and reduces the number of low-quality and unnecessary regulations. Undertaken in advance, RIA has also contributed to improve governmental coherence and intra-ministerial communication. Yet positive views continue to be balanced by evidence of non-compliance and quality problems. The scope of coverage of RIA remains patchy and exemptions are often broad. RIA is rarely used at regional or local levels. Uneven coverage of RIA programmes seriously reduces effectiveness. Moreover, RIA is most of the time applied to a single regulation, rather than regulatory regimes as a whole. It thus can provide only very broad estimates of the cumulative impacts. Lastly, RIA has mostly been designed for command and control regulations. The increasing use of performance-oriented regulations and regulatory alternative provide substantial challenges to the effectiveness of RIA. The result of these limitations is likely to be the need for further consideration of the design and implementation of RIA requirements, including evaluation of its effectiveness in assessing the likely performance of non-traditional instruments.

Source: From Malyshev (2006).

Sectoral regulators and the competition authority

Another tier of the institutional architecture of regulatory agencies includes sectoral regulators of network industries and, parallel to them, competition authorities. Sectoral regulators have been created to manage the effects of regulatory reforms, which have rarely consisted of simply abolishing regulations and leaving full leeway to market forces. The debate in OECD countries has, therefore, revolved around the extent to which sectors affected by regulatory reform should operate according to general competition rules, enforced by an economy-wide competition authority, or according to regulations enforced by sectoral regulators. Various countries have adopted different approaches, depending on their histories and cultures of governance, as well as on the characteristics of different sectors.

While a longer term aim should be the establishment of fully independent sectoral regulators, such a course may not be possible in Russia in the near future. The general approach to all regulated sectors in Russia should, therefore, be the following:

- Establish sectoral regulators as *federal services*, subordinated to the competent ministry or directly to the Prime Minister's office, on the current model of Federal Antimonopoly Service (FAS) and the Federal Tariffs Service (FTS). Sectoral regulators should be entrusted with the function of technical regulation of network sectors. This would include standards – for safety and performance – licensing and certification but would not include the question of pricing or access.
- Redefine the functions of the FTS with respect to the newly established sectoral regulators and the FAS. Notably leave the function of economic regulation (setting of end user tariffs) with the Federal Tariff Service.
- Reinforce the role of the Federal Antimonopoly Service as the ultimate guarantor of competition and guardian against the abuse of market power on the part of incumbents. This can be achieved by entrusting FAS with the exclusive function of protecting competition in regulated industries and monitoring non-discriminatory access to network infrastructure. FAS could also be entrusted with the responsibility of periodically reviewing regulated sectors in order to assess whether sector specific regulation is still necessary, in sectors where *ad hoc* regulation was intended to be of a transitory nature, as a stepping stone to a fully competitive regime.

This general approach would improve on the reorganisation of the executive propounded in *Presidential Decree of March 9, 2004*, establishing the subordination of regulatory functions to the relevant line ministries. The 2004 decree, nominally distinguishes policymaking functions (Federal Ministries), regulatory functions (Federal Services), and service provision functions (Federal Agencies). However, the implementation of the Decree has still not led to a clear separation between service provision and regulatory functions within line ministries.

Box 2. Sectoral regulators: Different degrees of independence

Sectoral regulators have become the norm in most OECD countries since the waves of privatisations of network industries in the 1980s and 1990s. Sectoral regulators usually have the form of separate agencies at arm's length from government, with delegated powers to implement regulatory policies in specific sectors. They are primarily found in utility sectors with network characteristics, such as energy and telecoms, and in sectors where prudential oversight is needed, such as financial services (Malyshev, 2006). OECD (2002) notes that independent regulators are most effective and credible when their independence and roles are enshrined in a statute with well-defined functions and objectives. This should indeed be the longer term goal to be pursued in Russia, where sectoral regulators may easily fall prey to the appetites of various branches of the executive and of vested interests in the regulated sectors.

Against this background, the institutional format of sectoral regulators in OECD countries presents some variation, as a function of the degree of independence from government and of the extent to which their tasks are enshrined in formal statutes. For the sake of classification, independent regulators may belong to four categories: ministerial departments, ministerial agencies, independent advisory bodies, and independent regulatory authorities (Malyshev, 2006). On a spectrum where institutions are classified according to their increasing independence from the executive, ministerial departments are the least independent format for regulatory agencies. They are part of the central government and do not have the status of a separate corporate body, although they may have considerable statutory independence in performing their assigned functions. They are headed by, or report directly to, a minister. They are typically funded from tax revenue.

Ministerial agencies are part of the executive but established at arm's length from the government. These may or may not have a separate budget and autonomous management, and are sometimes subject to a legal framework where laws on administrative procedures or civil service regulations do not apply. They are ultimately subordinate to a ministry and subject to ministerial intervention.

In the longer term, Russia should consider the option of establishing full-fledged independent regulators. In OECD countries, these can take the form of independent advisory bodies, which are less formal institutions with the power to provide official and expert advice on specific regulations. A more formal independent status could be provided by independent regulatory authorities, which are autonomous agencies empowered with regulating specific aspects of an industry. They are typically under autonomous management, with their budget possibly deriving from a ministerial allocation, but they are free from political or ministerial intervention in their activity.

A majority of OECD countries have opted for a greater degree of independence by choosing the format of independent regulatory agencies. Independent regulators contribute to shielding sectoral policies from the interference of political and private interests. Given the continued presence of state ownership in network industries, in Russia as in several OECD countries, delegating regulatory functions to independent regulators contributes to separating the state's role as policymaker from its stake in these industries as owner. In order for independent regulators to effectively perform their tasks, adequate funding and a suitable staffing policy is required to attract and retain technically competent staff.

Source: See Malyshev (2006) and Smith (1997a).

*The Attribution of Regulatory Functions*⁶

1. Regardless of the model the Russian authorities eventually chose, five tasks deserve attention in sectoral regulation (OECD 1999):

- **Protection of competition:** by controlling anti-competitive conduct *ex post* and reviewing mergers *ex ante*.
- **Access regulation:** ensuring *ex ante* non-discriminatory access to inputs, especially network infrastructures.
- **Economic regulation:** adopting cost based measures to control monopoly pricing *ex ante* or otherwise ensuring adequate levels of *ex ante* consumer protection.
- **Technical regulation:** *ex ante* setting and monitoring standards so as to assure compatibility and address broader concerns, such as safety or environmental protection.
- **Periodic appraisal** of the scope and degree of market power, in sectors where competition is being introduced with the aim of recommending whether such power justifies continuation of sector-specific competition law or regulations (other than technical regulation).

When examining the allocation of functions between competition authorities and sectoral regulators, it is necessary to weigh the importance of the comparative advantage resting with each type of institution and of possible synergies descending from the combination of several functions in a single institution (OECD 1999). It is also important to consider the evolution of this comparative advantage in the longer term. Such evolution is connected with the nature of the regulated sector, which may necessitate regulation in its transition to a fully competitive regime or may, on the contrary, have natural monopoly characteristics which would make regulation a permanent, rather than transitory, feature.

A number of institutional characteristics affect the comparative advantage of competition authorities and sectoral regulators and are, therefore, relevant in deciding the attribution of functions:

- First, sectoral regulators are more prone to reduce the effects of market power, whereas the core function of competition agencies is to eliminate such power altogether. This tends to produce different interpretations on the effects of market power.
- Second, sectoral regulators typically impose and monitor various behavioural conditions whereas competition agencies are more likely to opt for structural remedies.
- Third, sectoral regulators generally apply an *ex ante* prescriptive approach while competition agencies usually apply an *ex post* enforcement approach.
- Fourth, sectoral regulators characteristically intervene more frequently and require a constant flow of information from regulated entities, while competition authorities usually act pursuant to complaints and collect information in connection with enforcement action.
- Finally, sectoral regulators usually take into consideration a broader range of goals than competition *per se*, for instance, they may be required or authorised to pursue non-economic goals, including redistribution, and thus to balance them against those of competition and efficiency.

Technical regulation involves continuous supervision and application of sector-specific expertise that is not necessarily related to competition issues. In OECD countries this function is in most cases attributed to sectoral regulators. Some of the other three functions are also sometimes assigned to sectoral regulators, depending on an assessment of comparative advantage and synergy issues that may arise among the various functions. The actual allotment of functions varies across both sectors and countries and is influenced by a country's general legal framework and regulatory history.

Expertise and institutional characteristics give competition agencies a clear comparative advantage in the **protection of competition** from both anti-competitive behaviour and the consequences of mergers. The remedies they propose tend to be structural rather than behavioural. Sectoral regulators, on their part, are better suited to be assigned **economic regulation**, which tends to be on-going rather than periodic in nature, imposes behavioural conditions and heavily relies on sector-specific knowledge. The attribution of functions of **access regulation** is less clear cut. Its goal is to foster as well as protect competition in circumstances where access to a segment of a vertically integrated incumbent firm's assets is central to the development of an adequately competitive environment. Competition agencies, because of their experience with abuse of dominance cases, may be more apt to performing this task. At the same time, such a task is very demanding in terms of resources since maintaining a level playing field necessitates processing a large volume of cost data to determine access terms, and then ensuring permanent monitoring of the compliance with those terms. These considerations suggest that sector-specific regulators are more suited for the task.

As comparative advantage considerations might suggest, significant **synergies** may be forgone when assigning competition protection to competition agencies and economic regulation to sectoral regulators. Synergies exist between competition protection and economic regulation but also between each of these functions and access regulation. They occur mainly since the same staff know-how can be applied to a number of interconnected issues, and since concentrating several policy tools in the same agency amplifies the chances that they will always be used together, thus avoiding the possibility of conflicting regulatory outcomes.

Economic regulation can be included within a competition agency or combined with technical regulation, within a sector regulator. A third alternative is for sectoral regulators to have shared or exclusive power to formulate and enforce competition law in their sector, this translates into guaranteeing non-discriminatory access to networks, monitoring other forms of anticompetitive conduct and reviewing mergers. Such a regulator may have the role of promoting the transition to greater competition, for instance by being entrusted with competition law enforcement power. This has been the case in the United Kingdom where concurrent powers to enforce some parts of the country's competition law have been given to various network infrastructure industry regulators. In the case of Russia, concurrency between the competition authority and sectoral regulators in enforcing the general competition law might not be a good option since former monopolists are likely to wield significant influence in the face of sectoral regulators.

Taking a longer term view implies considering the evolution of comparative advantage over time between sectoral regulators and competition authorities, thus suggesting a certain allotment of responsibilities between them. Where economic and access regulation are needed in a transitory phase in preparation of fully competitive markets, both access and economic regulation should be entrusted to the general competition agency, which should also engage in a periodic review of market conditions in order to assess the continued need for sector-specific regulation. On the other hand, where access and economic regulation are expected to be permanently required, as with natural monopoly transmission and distribution networks, sectoral regulators may be better suited for these tasks. In either case, responsibility for competition protection should rest with the general competition agency.

The experience of OECD countries suggests that sector-specific regulators have often found it difficult to assure level playing fields for competitors subject to different regulatory regimes. Furthermore, in many network infrastructure industries, technological change has altered the natural monopoly aspect of the network and economies of scope may cease to be a valid argument to justify sector specific regulation. For example, in electricity generation, economies of scope descending from the combination of electricity generation and distribution and by subjecting both to regulation, may be less important than the efficiency gains that could be obtained by splitting generation from distribution and relying on competition instead of regulation in the generating sector.

Another source of pressure against sector-specific regulation is that markets composed of a number of substitute products could extend across two or more regulated industries thus creating a potential for competitive distortions arising from different sectoral regulation. This problem is now being aggravated in many OECD countries by a growing tendency for the same company to be involved in more than one regulated sector. This may also be the case in Russia, with Gazprom already showing an active interest in acquiring assets in electricity generation.

Regulatory Capture

A further caveat, which is especially relevant in the case of Russia, is the potential for the competition agency and sector-specific regulators to fall prey to regulatory capture.⁷ In general, economy-wide agencies are more immune to regulatory capture than sector-specific regulators. This would be an argument in favour of locating economic regulation with the competition agency rather than with a sector-specific technical regulator.

There are several reasons why sector-specific regulators may be more prone to capture than general agencies such as competition authorities. The main reason is that regulators and firms in the sectors they regulate are likely to have a high degree of interdependence. It may even be the case that the interdependence between regulators and firms is intrinsic in the very *raison d'être* of sectoral regulators. Specifically, the continued need for a regulator depends on the fact that regulated firms retain strong control of their sectors, and the clout of firms, in turn, depends on ad hoc regulations being devised to preserve the status quo. The consequence of this relationship may be a risk that, besides sharing similar information concerning an industrial sector, regulators acquire the industry's perspective itself. For instance, a sectoral regulator may be averse to fostering greater competition, because a more competitive industry could make it more difficult for policymakers to promote cross-subsidisation schemes or forward parallel items on their agendas, such as environmental protection or energy security. All these interconnections contribute to increasing the risk of capture.

In some cases interdependence may give rise to the so-called 'revolving doors' phenomenon whereby regulators are staffed with personnel that is hired from regulated firms, which, after a spell in office with regulators, returns to work in the firms (Che, 1995). Compared with sector-specific regulators, senior decision-makers at agencies covering the whole economy are less likely to have the kind of in-depth industry specific knowledge, contacts, and outlook that would make them particularly valuable later on as employees with or lobbyists for firms in the industry.

To some extent, the risks of regulatory capture can be reduced by full transparency in regulatory decision-making. More effective, however, are means of involving affected third parties (consumers or competitors) in regulatory decision-making, preferably backed up with formal rights of appeal. To this end, in a number of OECD countries, governmental enforcement of competition laws is supplemented with private actions.

Box 3. The trade-off between independence and accountability

Squaring the circle between independence and accountability of regulators is not an easy task and the debate concerning the appropriate balance between the two is still open. As a general recipe, an essential condition for the success of independent regulators is that they respond to a long-term policy agenda, insulated from the interference of politicians and rent-seekers. In general, the independence of regulators presents constitutional challenges, since these bodies are neither directly elected nor managed by elected public officials. Furthermore, these institutions perform a role at the boundary between policy formulation and policy enforcement. Therefore, the definition of the roles of regulators and of the executive raises a number of issues, notably concerning control over the independent regulators. Nonetheless, it should be noted that regulators operate under the authority of laws and a governance architecture that can be altered by legislators and courts. Russia, presents some weaknesses in this respect, since the legislature is widely perceived as being subservient to the executive, while the judiciary is weak and not entirely autonomous from political influence.

The current set up in Russia may be justified on accountability grounds, since, in principle, regulation of network industries within line ministries ensures that the conditions of operation in the industry are established under the supervision of elected officials. Nonetheless, on balance, in the case of Russia greater separation between regulatory and ownership functions would significantly improve the efficiency of network industries. This is so because the Russia system of government, according to most observers, notoriously lacks checks and balances, both within government itself and from society at large. Maintaining a close and opaque relationship between the ownership and regulatory function of the state can only pave the way to ever more pervasive rent-seeking, obstruction of competition and inefficiencies in the sectors concerned.

From the standpoint of the governance, the experience of OECD countries suggests that accountability is better guaranteed by the choice of particular structures (Malyshev, 2006). For instance, a board is preferable insofar as it is prone to collegial decision-making, thus contributing to a greater level of independence and integrity. A board has indeed been the choice of a majority of OECD countries. Terms of appointment of the board also tend to impact on the degree of independence and the accountability of regulators. In this case, the optimal solution appears to be a term of appointment which spans the political cycle –for instance five to eight years – thus ensuring that board members are less beholden to the current political majority. Regarding the different options concerning the funding of regulators, the choice certainly has an impact on the degree of independence. For instance, funding from the state budget may reduce the degree of independence, while financing through the direct levying of fees from the regulated entities may increase vulnerability to the risks of regulatory capture. On balance, an optimal mechanism appears to be a system of automatic funding from the state budget that is not subject to political discretion.

Independence can often be constrained by the need to abide by administrative regulation, for instance, when regulators must follow a set of ministerial instructions or when their decisions are subject to ministerial appeal. Naturally, while these measures may ensure greater accountability, they are bound to affect the effectiveness of decisions by undermining the independence of regulators.

Source: See Malyshev (2006) and Smith (1997a).

Co-ordination

There may also be problems inherent in subjecting competing firms to different sector-specific regulation. Wherever there is sector-specific regulation there will be a need to define jurisdictional boundaries among regulators and this may generate uncertainty and delay. None of these problems arise where regulation is carried out either by a general competition agency or a multi-sector regulator.

If access and economic regulation and competition protection are entrusted to different agencies, co-operation and co-ordination are crucial to avoid contradictory application of the two sets of policies. Effective co-operation is essential to avoid resource duplication and ensure that technical regulators explicitly consider the implications of the adoption and enforcement of certain technical standards for competitive outcomes. In OECD countries such co-ordination is obtained by various means, ranging from informal arrangements for co-operation to legally compulsory consultation. If informal co-operation is difficult, a number of responsibilities, such as identifying relevant markets or establishing the existence of market power, are exclusively attributed to the competition agency. An alternative is to give the competition authority a broad mandate for general oversight.

In order to address the problem of co-ordination, some OECD countries have opted for hybrid institutional arrangements. For instance, in Australia the Competition and Consumer Commission is the access regulator and is also responsible for identifying situations where formal access regulation is needed. This could be a model for the FAS in its access role. In the Netherlands, sectoral regulators are set up as units within the competition authority, sharing offices and staff experts and to some extent overlapping in the membership of their decision-making officials, though applying different statutes. Similarly, in New Zealand the energy and telecoms commissioners overlap with the Commerce Commission.

If access and economic regulation functions are located outside the competition agency, that agency should be extensively involved in any periodic reviews of whether such regulation is justified by continued market power. Competition agencies should be better placed than regulators to decide this question and should have less self-interest in unnecessarily continuing regulation. It follows that they should play an important role in administering any sun-setting provisions, in cases in which regulation is of transitory nature. In a number of OECD countries regulators are statutorily required to cease regulating once a sector is sufficiently competitive, and competition agencies are involved in determining whether that threshold has been met.

Suggestions for reform

The above considerations support a number of suggestions concerning the design of newly established sectoral regulators and their relationship with the competition authority.

Attribute functions of technical regulation to dedicated sectoral institutions and leave functions of economic regulation with the Federal Tariff Service.

In view of the risks of capture on the part of sectoral interests, there may be good grounds in Russia for organising technical regulators as general rather than sector-specific agencies, on the current model of the Federal Tariff Service (FTS), which is currently entrusted with economic regulation, *i.e.* determining tariffs in regulated sectors. The reason is that being part of an umbrella body with a broad mandate over different sectors would increase the relative weight of regulators in the balance of power with the executive, which is still the owner – either outright as in the case of railways, electricity and gas or majority as in the case of telecoms – of network industries, and the incumbents in these sectors. Aggregation under a single body would also reduce the chance that technical regulations are captured by narrow sectoral interests, with the aim of using technical standards as a means to obstructing competition.

Nonetheless, given that ministries already wield powers in the setting of technical standards such a radical solution may not be feasible in the short term. A second-best alternative would be to leave **technical regulation** with dedicated regulators. Although there would be advantages in combining economic regulation and technical regulation within the same institution, this may not be an immediately feasible path. A practical option in the Russian case would be to establish sectoral institutions in charge of technical regulation either as Federal Services subordinate to, but clearly demarcated from, line ministries or as Federal Services directly subordinate to the cabinet, on the model of the FAS and the FTS. **Economic regulation**, on its part, could be left with the Federal Tariff Service, an umbrella body in charge of setting end user tariffs in several network industries. Finally, competition law enforcement should be entirely assigned to the FAS, the competition agency.

Strengthen the role of FAS as the institution in charge of access regulation and of protection of competition in regulated sectors.

Separating **competition law enforcement** from regulation means sacrificing certain synergies and having to adopt measures ensuring firms are not subjected to inconsistent demands, but it also ensures that both policies are administered by agencies thoroughly understanding them and having cultures suited to their implementation. Given that the Federal Antimonopoly Service (FAS) is relatively well established, it is advisable in the Russian case to leave it with as broad a mandate as possible. Since competition agencies certainly have a comparative advantage over regulators when it comes to enforcing prohibitions of anticompetitive behaviour and reviewing mergers, such agencies should have exclusive jurisdiction in those domains. Additionally, their mandate could also include **access regulation** with the monitoring of access to network infrastructures.

It is important to note that in order for FAS to be able to carry out its function of protecting competition in regulated sectors, economic and technical regulators should adequately perform their tasks of setting tariffs and establishing technical standards. In the past, due to the lack of appropriate *ex ante* economic and technical regulation, FAS has been overburdened by disputes between regulated monopolies and customers, alleging abuse of dominant position in such matters as service obligations, tariffs or contract terms.

In sectors expected to evolve reasonably quickly to a competitive regime, it would be desirable to locate the function of periodic review within the competition agency, which is less likely to have a narrow vested interest in specific sectors, and would therefore be better equipped to assess the need for continued regulation.

The above recommendations should contribute to more efficient regulation by clarifying the respective roles and functions of sectoral regulators and the competition authority. While such a clarification should help improve regulatory quality in the concerned sector, a longer term goal should be the establishment of fully independent regulators and of a competition authority not subordinate to the government (See Box).

Implement the transition from a command and control to an incentive based approach to regulation.

More generally, the Russians regulatory environment suffers from excessive reliance on a command and control approach, rather than incentive based approach. A move towards the latter would entail a number of advantages.

- From the institutional perspective, it would reduce reliance on the judgment of regulatory institutions, thus allowing them to focus on a more limited number of issues and reducing the arbitrariness of enforcement that is inherent in the often contradictory and vague details of the command and control approach.
- The reduction in administrative burdens that accompanies a transition towards incentive based regulation would be less onerous for firms in terms of compliance, thus liberating resources in the business sectors that can be employed in more productive activities.
- Incentive based regulation would ensure more efficient outcomes in the sectors concerned, since it would remove unnecessary restrictions to firms' behaviour and, at the same time, encourage efficiency gains in the sectors.

Enhance the capacity of the FAS, the FTS, and of the sectoral agencies responsible for technical regulation.

It is paramount to enhance the capacity of both the competition authority and sectoral regulators. An essential precondition is to ensure that their mandate grants them sufficient independence and financial autonomy (Smith, 1997c). In OECD countries there has been a transition from funding regulatory tasks from general tax revenues towards direct funding from levies on consumers directly or by imposing a levy or license fee on regulated firms and allowing them to pass the cost on to consumers through tariffs. This approach has the advantage of reducing demands on general tax revenue and imposing the financial costs of regulation on interested parties. In Russia, such an approach may not be advisable since regulators may turn out to be dependent on the powerful incumbents they regulate. Providing funding from the general budget would provide a more reliable source of income and thus be a better safeguard of agency independence. However, even such an arrangement for funding would not guarantee sufficient independence. In fact, regulators are bound to have sometimes difficult working relationships with political authorities, regulated firms, consumers, and other stakeholders. This challenge in Russia has often proved to be daunting, since regulatory experience is limited and there is little tradition of independent public institutions. In this light, Russian regulators may benefit from intensifying contacts and exchanges with more experienced regulators from OECD countries, for example by promoting "twinning" arrangements between Russian and foreign regulators. These arrangements can offer a foundation for exchanging experiences and providing ongoing support and advice.

The quality of human resources employed by regulators and by the competition agency is also essential for them to adequately perform their functions. Staff should be allowed to be recruited on competitive terms, by exempting it from abiding by civil sector pay scales. Such an approach is necessary if agencies are to be in a position to compete for talented personnel with the private sector and especially with firms in regulated sectors for staff with sector specific competence. There is no golden rule concerning the number of staff to be employed by regulators and the competition agency (Smith, 1997c). Overstaffing should be resisted since it may contribute to increasing the indirect costs of regulation. A sound general rule is to maintain permanent agency staff at a minimum, while employing specialised consultants to meet particular needs.

Improve the standards of economic analysis employed.

An important upshot of an appropriately funded agency, able to employ competent staff, is its ability to base its decisions and recommendations on rigorous economic analysis. In regulated sectors this would, for instance, imply the consistent application of a methodology based on economic incentives when setting tariff levels, rather than more opaque and arbitrary rules.

Concluding remarks

The experience of several OECD countries shows that an effective institutional architecture for the achievement of high standards of regulatory quality is composed of two types of institutions: a central oversight body and independent sectoral regulators. An oversight body, insulated from the political cycle and, as much as possible, from the pressure of interest groups, has the advantage of being able to devise and pursue a long term approach to regulatory policy. This ensures consistency of regulatory policy both across sectors and over time.

In general, high regulatory quality can be achieved when the regulatory framework is composed of regulations and regulatory regimes that are efficient in terms of cost, effective in terms of having a clear regulatory and policy purpose, transparent and accountable. High quality regulation requires an effective regulatory management system, able to formulate policy as ‘... *an explicit, dynamic, continuous and consistent “whole of government” policy to pursue high quality regulation*’ (OECD, 2005b). Such a horizontal approach is best pursued with the establishment of a central regulatory oversight body. Moreover, in countries with a federal constitutional structure – like Russia, – it is essential that the principles of regulatory quality are also applied at lower levels of government. In Russia, regional and local governments are often responsible both for the implementation and enforcement of policies emanating from the centre, but also have the faculty to promulgate legislation themselves. This implies that if the same standards and tools necessary to ensure regulatory quality at the central level are not transmitted to lower levels of government, the entire regulatory policy agenda may be jeopardised.

While an immediate move towards such a set up may not be feasible in the Russian context, a number of intermediate steps could be taken in this direction. The first such step requires the elimination of competing and overlapping structures, which seem to be proliferating both in relation to the promotion of general regulatory reform initiatives as well as within individual regulated sectors. The outcome of such rationalisation of regulatory institutions and procedures would be a clear demarcation of roles and responsibilities and the establishment of mechanisms for the accountability of regulatory institutions.

Box 4. Electricity

Existing electricity legislation provides a good foundation to achieve appropriate governance and regulatory arrangements. Nonetheless, a number of details have to be resolved, namely in the domain of enforcement. A sound regulatory framework is essential to guarantee credibility, minimise regulatory risk and encourage much needed private investment in the sector. In particular the regulatory process has to achieve standards of robustness, objectiveness, consistency and transparency. Given the unique nature of the electric power industries, the design of regulatory institutions should guarantee (IEA, 2005):

Effectively and timely communication with all involved parties.

Transparency of process, including effective consultation with stakeholders.

Consistency of the regulatory process and predictability of decision making.

Flexible use of regulatory instruments in response to changing market conditions.

Autonomy from political or economic influence.

Efficiency and cost-effectiveness of information collection and other administrative processes.

Effective accountability, including clearly defined decision making processes, public reporting, publication of the reasons underlying determinations, and a well-established right of appeal.

In several OECD countries, these objectives have been achieved with the establishment of independent regulatory institutions, both at arm's length from policymakers, and with autonomous funding provisions enshrined in their statutes. Independence is even more important when, as in the case of Russia, governments have retained some ownership in the market. Current reform proposals do not contemplate the setting up of independent regulatory institutions, nonetheless, beyond the transition phase, the Russian electricity sector would greatly benefit from their establishment.

According to present arrangements, the function of tariff setting (economic regulation) is attributed to the Federal Tariff Service (FTS), while protection of competition and access regulation are the responsibility of the Federal Antimonopoly Service (FAS). Both these federal agencies are placed under the aegis of the prime minister. Such direct subordination to the executive may be appropriate in the inception phase of new electricity markets, for instance, because a direct impulse from the top may be the only way to overcome resistance to the transition towards a new market structure, market rules and regulatory regime. However, persistence of such institutional arrangements in a more mature phase would signal a conflict of interest between the government as a regulator and the government as a shareholder. On the other hand, creation of statutorily independent regulatory institutions would send a strong signal that the government is committed to effective regulation.

Regulatory functions are currently distributed among a number of distinct market institutions, federal and regional agencies. Such complex arrangements have the potential to engender serious regulatory uncertainty or risk in the future. The current legislative set up contains some provisions to solve the co-ordination issue. Among other prerogatives, federal regulatory agencies are empowered, within their scope of responsibilities, to issue binding orders to market participants, executive bodies and local authorities; request information about emergencies and infrastructure failures; consider complaints by purchasers of electricity services and collect supporting information from electricity service providers; apply sanctions for violations of the Electricity Law or other relevant laws; and take legal action and participate in legal proceedings in relation to the application or violation of the Electricity Law.

In the longer term, it is, nonetheless, desirable to contemplate the establishment of an independent sectoral regulator, responsible for the day-to-day administration of the system, in charge of ensuring third-party access to the network and of the determination of network tariffs, market operation and system operation.

For the time being, the institutional apportionment of the various regulatory functions is as follows (IEA, 2005).

Protection of competition and access regulation

The Federal Anti-monopoly Service (FAS) is responsible for both protection of competition and access regulation. In the first domain, FAS has the responsibility for *ex ante* supervision of mergers and acquisitions, *ex-post* regulation of market conduct on a case-by-case basis, and consumer protection. In the area of access regulation, FAS guarantees non-discriminatory access to “natural monopoly” services and regulates the activities of the Trade System Administrator (ATS) that operates the wholesale market.

FAS has the function of monitoring competition in wholesale and retail markets with the objective of timely identification, prevention, restriction and/or termination of undue market power and discriminatory commercial practices. These include collusion between electricity suppliers to affect prices; unjustified refusal to enter into contracts for the sale or purchase of electricity; unjustified refusal to enter into contracts for the provision of network services, dispatch services or services of the wholesale market operator; discriminatory treatment of wholesale or retail market participants; and price manipulation, especially resulting from abuse of a dominant position in wholesale or retail markets.

Non-discriminatory access regulation is envisaged for services provided by “natural monopolies”. These include dispatch services provided by the system operator; wholesale market services provided by the Trade System Administrator; transmission and distribution services, including physical connection subject to technical requirements; and guaranteeing suppliers regulated services for retail customers. Market participants are allowed to stipulate bilateral supply contracts for these services. These contracts, incorporating regulated terms and conditions, have the objective of providing a legally enforceable right of access. Key features of these contracts include: maximum capacity entitlements; technical, safety and metering standards; user and service provider obligations (including service standards, information disclosure and obligation to pay for services); and force majeure issues. These contracts are public documents. Minimum timeframes for executing key features of the contracts are prescribed by regulation.

Economic regulation

The Federal Tariff Service’s (FTS) is responsible for developing pricing principles and tariff methodologies, and setting maximum and minimum price caps and tariffs for regulated services nationally and on a regional basis. FTS’s capacity to enforce regulated regional tariffs and to influence the activities of Regional Energy Commissions (RECs) are enhanced by certain provisions of the Electricity Law, such as the authority to repeal a REC decision in relation to regulated tariffs where it is inconsistent with the pricing principles or maximum and minimum tariffs set at the national level; the power to approve the appointment or dismissal of the chair/chief executive of a REC; and the power to approve regional tariffs in excess of published regional tariffs.

The Electricity Law stipulates that prices in the electricity sector will be determined by negotiation between market participants, with the exception of services provided by “natural monopolies”. Pricing arrangements are currently based on a cost-plus methodology, where regulated businesses pass on all costs and recover an “economically justifiable” return as determined by the regulator. Regulated prices are typically reviewed annually. It is probable that, once the inflationary situation has sufficiently stabilised and the market is in place, some form of CPI-X methodology will be introduced followed eventually by more sophisticated forms of incentive regulation based on the capital-asset pricing model and benchmarking.

Technical regulation

Technical regulation is concerned with the reliable and safe operation of electricity infrastructure and the prevention operational emergencies. The proposed technical regulatory regime will include the establishment of appropriate technical regulations, and monitoring and enforcement by government agencies to ensure compliance. Matters to be addressed by the technical regulatory regime will include technical and technological safety in the electricity sector; the quality of electricity and heat; establishment of capacity reserve standards; the design of electric and heat installations; monitoring the operation of electricity and heating infrastructure, including ensuring compliance with operational safety rules and technical standards; and compliance with specific safety requirements for the nuclear power sector.

No government agency is currently concentrating all technical regulatory function in the electricity sector. In the spirit of this paper, it would be appropriate to establish a federal service, dedicated to technical regulation in the electricity sector, under the aegis of the Ministry of Industry and Energy. This new agency should cumulate the various technical regulatory functions that are currently dispersed across various agencies.

Source: See IEA (2005).

Box 5. Railways

The regulatory framework adopted for the railways will be critical in determining the performance of the system both financially and in terms of quality of service. An appropriate regulatory framework is necessary to ensure the development of competition, which is particularly important given rail's high modal share. At present the Federal Antimonopoly Service (FAS) and the Federal Tariff Service (FTS) are the only two agencies with regulatory functions in the sector and are respectively responsible for protection of competition and economic regulation. Both of these agencies need additional human and financial resources to adequately perform their tasks. In the immediate future, access regulation should be codified and assigned to the FAS in order to ensure a sufficient level of competition in the sector. Additionally, a new technical regulator needs to be established, in order to relieve the incumbent RZD from setting the technical standards for its own operation.

In general, the burden of regulation on the government, in terms of financial resources, expertise and institutional capacity, varies greatly with the type of regulatory framework adopted (ECMT, 2004). Regulatory systems in OECD countries have been most successful when, through the design of the industry structure, they both reduce the scope of prescriptive regulation and reduce the need for intervention by regulatory authorities. Such systems rely on competition in place of regulation. The limited public resources available in Russia strongly argue for adopting a structure for the rail industry that reduces the need for regulatory intervention and minimises the burden on government.

The key regulatory task is to encourage both investment and efficient operation of the railways, in line with the government's prime objective of reducing costs. To this end it will be important that the regulators have both adequate information and economic expertise to make judgements on issues such as tariff structures and access charges that are fundamental to efficiency. The regulatory authorities should be making economic assessments, not simply overseeing application of the letter of the law.

In the longer term, it may be advisable to consider the establishment of a fully independent regulator, with the broad objective of protecting the public interest from an economic and commercial viewpoint. This body should be independent in its organisation, funding decisions, legal structure and decision-making both from the government and from the infrastructure manager or any carrier. This would ensure avoiding potential conflicts of interest.

For the time being, the institutional apportionment of the various regulatory functions is as follows (ECMT, 2004).

Economic regulation

The Federal Tariff Service (FTS) is currently responsible for setting tariffs. The methodology it uses is based on Schedule 10-01 and establishes tariffs on the basis of a detailed classification of goods being carried. A transition towards a more analytically founded cost-plus methodology is needed if tariff determination is to be more conducive to more efficient outcomes.

The fundamental purpose of rail tariff regulation in Russia in the past has been to help control prices throughout the economy. Tariff regulation and the tariff structure have undergone successive modifications, aimed at introducing incentives for greater efficiency. Nevertheless, the overriding purpose of tariff regulation remains to help balance economic development. Higher value freight, and particularly freight carried to or from the ports for export or import, is charged higher tariffs and the revenues used to support the transport of low value commodities, especially long distance movements of coal and ore. Periodic revision of the tariff rates and structures are undertaken to respond to changes in economic conditions for socially important parts of the economy including large industrial customers of the railways.

The basic methodologies followed by current tariff schedules were formulated in amendments to tariff regulations adopted in the late 1980s and early 1990s, namely Tariff Price List No.^o 10-01 of 1989, which regulates pricing of domestic freight traffic; Tariff Price List No.^o 10-02-16 of 1993, which regulates pricing of domestic and international passenger traffic and the Tariff Agreement between CIS and Baltic States that was the model for the Railway Tariff policy of the CIS for International Freight Traffic, which regulates the pricing of international freight traffic.

Technical regulation

The railway operator itself RZD is currently responsible for the setting of technical standards, such as safety certification, enforcement and the monitoring of the safety standards and rules. This solution is far from ideal, since the incumbent in this way can potentially use this function to erect technical barriers to entry into the sector. A practicable option in the near future may be the establishment of a federal service responsible for technical regulation under the Ministry of Transport.

Experience in the EU underlines that safety certificates need to be issued by a safety regulator that is independent in organisation, funding decisions, legal structure and decision-making from any infrastructure manager or carrier. The safety certificate should set out the railway company's safety requirements and ensure the safety of services on the routes it operates. In order to obtain a safety certificate, the company would need to comply with regulations laying down the technical and operational requirements specific to the rail services being provided.

Access regulation

No agency has been mandated with establishing the rules for non-discriminatory access to the network infrastructure. Such a function could be attributed to the Federal Antimonopoly Service (FAS). The access regulator may also need to take other measures to reduce barriers to entry and these are likely to be greater if there is a dominant railway undertaking. For example the regulator may need to ensure that surplus second-hand rolling stock belonging to RZD, is not unreasonably withheld from potential new entrants, especially where it is specific to a particular type of traffic; intervene to ensure that potential new entrants are able to obtain locomotive drivers or training for new drivers, as well as receiving equal access to train paths; provide assistance to potential new train operators in meeting licensing and safety requirements.

Protection of competition

The Federal Antimonopoly Service (FAS) is currently performing the task of ensuring protection of competition in the railways sector.

Source: See ECMT (2004) and Thompson (2006).

Notes

1. Several empirical studies, notably at the OECD, have emphasised the cost of excessive regulation for economic performance. See, for instance, Alesina et al (2005), Bassanini and Ernst (2002), Conway *et al.* (2006), Conway *et al.* (2007), de Serres *et al.* (2006), Griffith *et al.* (2006), Nicoletti and Scarpetta (2003), Nicoletti and Scarpetta (2005), Scarpetta and Tressel (2002).
2. See Conway, De Rosa, Nicoletti and Steiner (2006); and Conway, De Rosa and Nicoletti (2007) on the benefits for economic performance of regulations that are less restrictive of competition.
3. For details, see OECD (2002a, pp. 80-104).
4. Law 184-FZ of 27 December 2002, On technical regulation.
5. These include the Department for strategy of economic and social reform, Department for state regulation of tariffs and infrastructural reforms, and the Department for state regulation of the economy.
6. This section is based on OECD (1999) and Smith (1997b).
7. See, among others, Stigler, 1971, Peltzman, 1976, Laffont and Tirole, 1991. See Dal Bó (2006) for a comprehensive survey of the literature.

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Table 1. Policy drivers for regulatory quality

	<i>Functions of the body in charge of regulatory oversight</i>					<i>Advisory body receiving references from Government to review broad areas of regulation, collecting the views of private stakeholders</i>	<i>Specific minister accountable for promoting progress on regulatory reform</i>
	<i>Consulted as part of the process of developing new regulation</i>	<i>Reports on progress made on reform by individual ministries</i>	<i>Authority of reviewing and monitoring regulatory impacts conducted in individual ministries</i>	<i>Conducts its own analysis of regulatory impacts</i>	<i>Advocacy function to promote regulatory quality and reform</i>		
Australia	Y	Y	Y	N	Y	Y	Y
Austria	Y	Y	N	N	Y	N	Y
Belgium	Y	Y	N	Y	Y	Y	Y
Canada	Y	Y	Y	N	Y	Y	Y
Czech Rep.	Y	N	Y	N	Y	N	Y
Denmark	Y	Y	N	Y	Y	N	Y
Finland	Y	N	N	N	Y	N	Y
France	N	N	N	N	N	Y	Y
Germany	Y	Y	Y	Y	Y	N	N
Greece	Y	Y	Y	Y	Y	N	N
Hungary	Y	N	N	Y	Y	N	Y
Iceland	Y	N	Y	Y	Y	N	Y
Ireland	Y	N	Y	Y	Y	Y	Y
Italy	Y	Y	Y	N	Y	N	Y
Japan	Y	Y	N	N	N	Y	Y
Korea	Y	Y	Y	Y	Y	Y	Y
Luxembourg	N	N	N	N	N	Y	N
Mexico	Y	Y	Y	Y	Y	N	Y
Netherlands	Y	Y	Y	Y	Y	N	N
New Zealand	Y	N	Y	N	Y	N	N

	<i>Functions of the body in charge of regulatory oversight</i>					<i>Advisory body receiving references from Government to review broad areas of regulation, collecting the views of private stakeholders</i>	<i>Specific minister accountable for promoting progress on regulatory reform</i>
	<i>Consulted as part of the process of developing new regulation</i>	<i>Reports on progress made on reform by individual ministries</i>	<i>Authority of reviewing and monitoring regulatory impacts conducted in individual ministries</i>	<i>Conducts its own analysis of regulatory impacts</i>	<i>Advocacy function to promote regulatory quality and reform</i>		
Norway	N	N	N	N	N	N	Y
Poland	Y	N	N	Y	Y	Y	Y
Portugal	Y	Y	Y	Y	Y	N	Y
Slovak Rep.	N	N	N	N	N	N	...
Spain	Y	N	N	N	Y	N	Y
Sweden	N	N	N	N	N	N	Y
Switzerland	Y	N	Y	Y	Y	Y	N
Turkey	Y	N	N	N	Y	N	Y
UK	Y	Y	Y	Y	Y	Y	Y
USA	Y	Y	Y	Y	Y	N	Y
EU	Y	N	Y	N	Y	Y	N

Source: Jacobzone et al. 2007.

Table 2. Oversight bodies in OECD countries

Countries	Name & location	Date	Main mission	Resources & comments
Australia	Office of Regulation Review in the Productivity Commission	1998	<ul style="list-style-type: none"> - Advise departments/regulatory agencies on appropriate quality control for development of regulatory proposals and review of existing regulations - Encourage right use of regulation and reduction of unnecessary regulation - Examine and advise the government on Regulation Impact 	- Approximately 20 staffs
Austria	The Legal Service of the Federal Chancellery		<ul style="list-style-type: none"> - Secure regulatory quality at federal level surveying the compliance of drafts with national constitutional law, European law and regulatory policies - Securing the clarity, comprehensibility and coherence of regulation - Develop new regulatory policies and legislative guidelines 	
Belgium	Agency for administrative simplification in the Prime Minister's Office		<ul style="list-style-type: none"> - Initiate simplification projects in all domains, Stimulate simplification projects, Co-ordinate the simplification policy on administrative level - Develop tools (measure administrative burdens) 	
Canada	Regulatory Affairs and Orders in Council Secretariat, Privacy Council Office		<ul style="list-style-type: none"> - Develop and manage the government's regulatory reform and research agendas - Support to the Cabinet on regulatory matters, including secretariat services for the Cabinet committee that approves most federal regulations 	* The President of the Treasury Board has a mandate for promoting the implementation of Smart Regulation in Canada
Czech Rep.	Department for Regulatory Reform and Reform of Central State Administration		<ul style="list-style-type: none"> - Prepare strategy materials in the area of central state administration reform and regulatory reform, co-ordination of these reforms - Oversight of RIA quality 	- The Department has 22 employees 5 of which are dealing with regulatory reform agenda

Countries	Name & location	Date	Main mission	Resources & comments
Denmark	Division for Better Regulation in the Ministry of Finance		<ul style="list-style-type: none"> - Ensuring high quality in new and existing regulation. - Develop Governments regulatory policies, and co-ordinate the preparation and examination of the governments annual law planning programme - Co-ordinate the governments annual action plans for simplification - SCM-measurement of the administrative burdens and assist other ministries in performing Business Impact Analysis as part of their RIA-process * Ministry of Justice, a division on law quality is monitoring the legal coherence and quality of draft regulation 	<ul style="list-style-type: none"> - Ministry of Finance: a Head of Division and six heads of section - Danish Commerce and Companies Agency: a Head of Division and fifteen heads of section. - Ministry of Justice: a Head of Division and four heads of section.
Finland	Bureau of Legislative Inspection, Ministry of justice			
France	Missing.			
Germany	Regulatory control council		<ul style="list-style-type: none"> - This body will be associated to the Federal Chancellery and has to assess the red tape and the necessity of new and existing laws 	Regulatory control council is scheduled to begin its work in autumn 2006.
Greece	Central Regulatory Impact Unit, General Secretariat of the Government, Prime minister's Office		<ul style="list-style-type: none"> - Co-ordinate the vertical ministerial units and provide guidelines on RIA - Draft reports for the prime Minister's edicts & Ministers Council regulations - Report the progress of better regulation policy to the Parliament * Ministry of the Interior, Public Administration is responsible for some parts of the better regulation agenda, such as simplification and codification 	
Hungary	Ministry of Justice		General quality assurance and control of the legislation	

Countries	Name & location	Date	Main mission	Resources & comments
Iceland	Consultative committee on official monitoring rules , office of the Prime Minister		<ul style="list-style-type: none"> - Examine monitoring rules or the implementation of specific activities - Comment on parliamentary bills/draft government instructions on rules - Keep track that the review of monitoring rules is consistent with Act. No.° 27/1999 and present suggestions for review where appropriate - Advise government authorities on the review of monitoring rules and implementation of monitoring in keeping with the objectives of Act. No.° 27/1999 <p>* The Prime Minister reports to parliament every three years</p>	<ul style="list-style-type: none"> - The committee has no permanent staff but uses the staff of the ministry and independent consultants
Ireland	Better Regulation Unit in the Public Service Modernisation Division, Prime Minister's Department		<ul style="list-style-type: none"> - Overseeing regulatory impact analysis - Supporting implementation of EU Action Plan of Better Regulation and representing Ireland at other international bodies - Performing advocacy role in relation to better regulation issues at national level 	
Italy	Presidency of Council of Ministers		<ul style="list-style-type: none"> - Promoting regulatory policy/monitoring/reporting/co-ordinating ministries activities 	<ul style="list-style-type: none"> - RIA unit has 4 staff members and 5 advisors, under the supervision of the Head of Department
Japan	Council of the Promotion of Regulatory Reform		<ul style="list-style-type: none"> - Researching and deliberating what is necessary to push ahead with structural reforms of social economy, 1) necessary items about the reform of the nature of the regulations when outsourcing central/local governments' operations/office works; 2) other fundamental items about the nature of regulations 	
Korea	The Office of Regulatory Reform (ORR), the Prime Minister's Office	1998	<ul style="list-style-type: none"> - Support the Regulatory Reform Committee which examines newly establishing or strengthening regulations of each ministry <p>* The Regulatory Reform Task Force (RRTF) under the Office of regulatory reform plays the role of improving existing regulations, or bulk regulations that affect many ministries.</p>	<ul style="list-style-type: none"> - ORR: 40 staff (1 deputy minister level; 2 director general level; 10 director level, 4 Special experts, 23 staffs) - RRTF: 53 staff (3 director general level; 6 director level, 23 special experts, 15 staffs)

Countries	Name & location	Date	Main mission	Resources & comments
Luxembourg				
Mexico	Federal Regulatory Improvement Commission, Ministry of Economy		<ul style="list-style-type: none"> - Improve the quality of the regulatory framework by means of the Biennial Programs of Regulatory Improvement (PBMR) - Integrate & maintain updated the Federal Register of Formalities and Services - Review/improve federal drafts generating fulfillment costs to the citizens - Collaborate & offer technical support to the States and Municipalities to establish regulatory reform programs 	
Netherlands	Bodies within the Ministries of Justice, Finance, Economic Affairs and Council of State			
Norway	Ministry of Modernisation			
New Zealand	Ministry of Economic Development		<ul style="list-style-type: none"> - The RIA Unit has issued guidelines for the preparation of Regulatory Impact Statements - Review RISs and provides adequacy statements on them - Provide training & advice on regulatory issues to officials to build capability for undertaking regulatory impact analysis 	<ul style="list-style-type: none"> - From the 8 staff in the Regulatory Policy Unit, approximately 4 full-time equivalents are dedicated to the work of the RIA Unit - Other Ministry of Economic Development staff may assist
Poland	Inter-ministerial Regulatory Quality Team (Minister for Economic Affairs and Labour is the head of the team). Secretariat within Economy Competitiveness Department in the Ministry of Economic Affairs and Labour		<ul style="list-style-type: none"> - Development of draft government positions on regulatory reform - Undertaking measures on administrative simplification & eliminating needless administrative burdens and procedures to entities - Development of RIA system - Providing access to information and dissemination of knowledge - Other issues pertaining to regulatory quality as commissioned by the Council of Ministers or the Prime Minister <p>* The team is a consulting and advisory body to the President of the Council</p>	<ul style="list-style-type: none"> - The Team is composed of representatives, including those in the rank of a secretary of state, undersecretary of state, president or deputy president, from 21 ministries and bodies of state administration

Countries	Name & location	Date	Main mission	Resources & comments
Portugal	Missing.			
Spain	Ministry of Public Administration, Prime Minister's Office		<ul style="list-style-type: none"> - Prime Minister's Office: dealing with quality on drafting regulations - Public Administration Ministry: dealing with Better Regulation Policy and promoting of government wide progress on regulatory reform - Comisión de Secretarios de Estado y Subsecretarios: monitoring the quality of all regulations produced by ministries before presenting the text to the Council of Ministries 	
Sweden	<p>Legal Secretariat within the Prime Minister's Office</p> <p>Division for Legal and Linguistic Revision, Ministry of Justice</p> <p>Better Regulation Unit, Ministry of Industry, Employment and Communication</p>		<ul style="list-style-type: none"> - No specific body responsible for promoting the regulatory policy. The head of the Legal Secretariat within the Prime Minister's Office has a special responsibility for general quality of regulations including regulations being lawful, consistent and uniform <p>The role of the Better Regulation Unit within the Business Division at the Ministry of Industry should also be noted for its role with RIA and SMEs.</p> <ul style="list-style-type: none"> - All ministers have a responsibility for promoting regulatory reform <p>* The Division for Legal and Linguistic Revision in the Ministry of Justice, language experts and legal advisors provide legal and linguistic services to the officials in the ten ministries</p>	
Switzerland	Federal Chancellery, Federal Office for Justice, Seco, Federal Finance Administration			
Turkey	Administrative Development Department, General Department of Legislative Development in the office of Prime Minister,		<ul style="list-style-type: none"> - Collects legal drafting, pick them and determine the drafting in force, to keep the register of legislation in force, encode them bring them into one text, monitor them under data processing system and publish them. - Investigate and research in order to state target, policies and measures related to improvement of public administration, evaluate the results, prepare proposals, contact with appointed bodies and co-ordination of the studies carried out for the improvement of public administration. 	

Countries	Name & location	Date	Main mission	Resources & comments
United Kingdom	Better Regulation Executive (BRE), Cabinet Office * previously carried out by the Regulatory Impact Unit	2005	<ul style="list-style-type: none"> - Scrutinising new policy proposals from Departments and Regulators; - speeding up the legislative process to make it easier for Departments to take through deregulatory measures; - working with Departments and Regulators to reduce existing regulatory burdens affecting business and frontline staff in the public sector - Newly added mandate of the BRE <ul style="list-style-type: none"> ▪regulate only when necessary; ▪set exacting targets for reducing the cost of administering regulations; and ▪rationalise the inspection and enforcement arrangements for both business and the public sector 	<ul style="list-style-type: none"> - In addition to the BRE, there are the Better Regulation Units (BRUs) in each department, Staffing levels: 70 (April 2005 figures) Resources £3.4m (2004/05 outturn).
United States	Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget		<ul style="list-style-type: none"> - Manage and co-ordinate Federal rulemaking, and oversees Federal information management, statistical policy, and information technology policy 	<ul style="list-style-type: none"> - OIRA's staffing level was 50 "full time equivalents" and its budget was \$7 million (In Fiscal Year 2005)
European Commission	Secretariat General to the Commission Better Regulation Unit		<ul style="list-style-type: none"> - Co-design, co-ordination, monitoring and reporting - Monitor the process and evaluate the appropriateness of the IA produced by the sectoral services. 	<ul style="list-style-type: none"> - Better regulation unit backed by 3 units (consultation of interested parties, monitoring IA quality, enforcement) - 20 persons for Better regulation unit (5 administrators with support staff + administrative staff responsible for maintaining registers on expert groups and committees / comitology)

Source: Jacobzone *et al.*, 2007.