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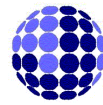

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Rules and Red Tape: Coping with Over-regulation

Scott Jacobs, Managing Director

Jacobs and Associates

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Driving Change: A New Role For Business in the Asia-Pacific

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Four dangerous regulatory myths

Myth 1: We live in an age of deregulation.

Myth 2: Regulation is bad for businesses, so the less regulation, the better.

Myth 3: Countries reform regulations because globalization forces them to reform.

Myth 4: Regulation is a means for governments to control business behavior.

Correction 1. We live in the Golden Age of Regulation

- For over a decade, regulation has increased faster than any other form of government action.
- Regulatory inflation is universal. Every indicator shows that the regulatory state is growing, not shrinking.
- Market liberalization requires more regulation, not less, as markets expand.
- International markets also rest on a framework of rules.

Correction 2. Private enterprises produce wealth within well-regulated markets

- The real aim of regulatory reform is to create competitive markets within a framework of social welfare.
- Changes in ownership through privatization are not enough. Regulation must correct market failures, non-market values, and the market itself.
- Poor and inadequate regulatory structures permit abuses and corruption to flourish in emerging markets, undermine investor and consumer confidence, and destroy rather than create economic value.

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Yet regulatory and legal frameworks are major constraints on growth in most transition countries

- Structural and economic policy reforms have accelerated in most countries. But reforms have barely changed most legal and regulatory constraints and costs affecting private sector activity.
- As a result, the domestic regulatory and legal environment is still hostile to private sector start-ups, investment, and innovation.
- Business face high transactions costs (red tape), high operating costs, barriers to entry, sovereign risks, distorted market signals, market abuses, and low consumer confidence.

The reason is not that countries regulate, but that they regulate badly.

- The problem is a mix of over-regulation, under-regulation, and the wrong kind of regulation, combined with ineffective institutions to design, apply, and adjudicate regulations.
- Deregulation is an insufficient principle for market reform. Regulatory quality is the guiding principle.
- The focus today for economic performance is not on the size of the state, but its role and its effectiveness, that is, its quality.
- Conclusion: We need smart government, not small government. Institutional reforms must strengthen both markets and states.

Six characteristics are needed in quality regulatory systems

- **Consistency with competition principles** (regulate market behavior rather than market entry and exit, neutrality among actors, respect for market solutions)
- **Security** (legal security, predictable enforcement)
- **Transparency** (clear and simple rules, openness through the entire policy process, less corruption)
- **Legitimacy** (protect safety, health, environment, the consumers, and other clear public interests)
- **Efficiency** (low-cost rules, orderly and timely decisions, move swiftly to meet market needs)
- **Expertise** (good regulatory skills and understanding of complex markets and technologies)

Reducing regulatory risk is key

- Regulatory risk reduces both the quantity of investment and the value of investment.
- The more uncertain and risky is the legal/administrative environment in which economic activity occurs, the more likely it is that aggressive rent seeking and short-term profit taking will replace longer-term investment in a competitive climate.
- Tools such as transparency and regulatory impact analysis can help reduce regulatory risk.

Correction 3. Governments reform regulations because it is in their domestic interests

- Supply-side reforms are not forced from the outside. Reform is driven by purely domestic needs such as:
  - stubborn levels of structural unemployment,
  - low levels of investment and entrepreneurship,
  - loss of competitiveness and international markets,
  - lagging growth rates,
  - high inflation,
  - diversion of fiscal resources into loss-making state-owned enterprises,
  - consumer demands for innovations like mobile phones and cheaper services and products.

Domestic benefits of regulatory reform

- **Boosts consumer benefits**
  - **by reducing prices for services and products such as electricity, transport, and health care, and increasing choice and service quality.**
- **Improves competitiveness**
  - **By reducing the cost structure of exporting and upstream sectors in regional and global markets.**
- **Fosters flexibility and innovation**
  - **and reduces risk of crisis due to external shocks.**
- **Increases job creation**
  - **by creating new job opportunities, and by doing so reducing fiscal demands on social security, particularly important in aging populations.**
- **Maintains and increases regulatory protections**
  - **in areas such as health and safety, the environment, and consumer interests by introducing more flexible and efficient regulatory and non-regulatory instruments, such as market approaches.**
- **Supports sustainable, non-inflationary growth**

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Price reductions after regulatory reforms

Price reductions in real terms (%)

Electricity	
Norway (spot market)	**18-26.2**
United Kingdom	**9-15.3**
Financial services	
United Kingdom	**70.4**
United States	**30-62.4**
Telecommunications	
Finland	**66.5**
United Kingdom	**63.6**
Japan	**41.6**
Mexico	**21.5**
Korea	**10-30.7**

Economy-wide effects of regulatory reform

GDP, long term effects (%)

Country	GDP, long term effects (%)
USA	0.9
Japan	5.6
Korea	8.6
Germany	4.9
Netherlands	3.5
France	4.8
Greece	9-11
Sweden	3.1
UK	3.5
Spain	5.6

Source: OECD, Report to Ministers on Regulatory Reform, 1997

Adding 1 percent of annual income growth in developing countries alone would amount to $56 billion a year, equivalent to 100% of all international development aid.

4. Regulation is a means of communication, not control.

- No government inspectors can control the behavior of businesses day and night.
- Governments often fall into a trap of over-regulation. Businesses comply less when there is too much regulation. To improve compliance, governments regulate more, and compliance falls further.
- Regulation works best as a compact between the public and private sector in which the roles and obligations of both are clearly defined.
- That is, regulation is a communication system based on transparency, trust, and responsiveness.

Good economic policy requires the full set of regulatory reforms:

- Deregulation is needed where markets can work better with fewer rules.
- Re-regulation and new regulatory institutions where markets work better with different kinds of rules.
- Simplification and re-engineering is needed where governments are uncoordinated and inefficient in delivering regulatory services.
- More efficient government and social regulations to achieve high standards of health, safety and environmental protection at lower economic cost.