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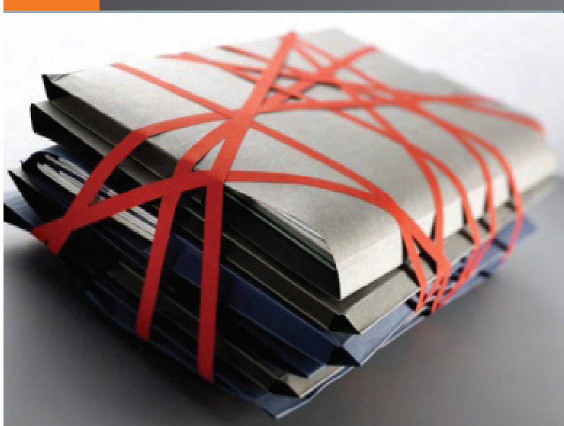
Better Regulation for Growth

Regulatory Governance in Developing Countries



Investment Climate Advisory Services I World Bank Group

IFC International Finance Corporation World Bank Group

MIGA World Bank Group Multilateral Investment Guarantee Agency

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BETTER REGULATION FOR GROWTH

Governance Frameworks and Tools for Effective Regulatory Reform

Regulatory Governance in Developing Countries

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About the Investment Climate Advisory Services of the World Bank Group

The Investment Climate Advisory Services (IC AS) of the World Bank Group helps governments implement reforms to improve their business environment, and encourage and retain investment, thus fostering competitive markets, growth and job creation. Funding is provided by the World Bank Group (the International Finance Corporation—IFC, Multilateral Investment Guarantee Agency—MIGA, and the World Bank) and over 15 donor partners working through the multi-donor IC AS platform.

The findings, interpretations and conclusions included in this note are those of the author and do not necessarily reflect the view of the executive directors of the World Bank Group or the governments they represent.

Better Regulation for Growth Program

The Better Regulation for Growth (BRG) Program was launched in 2007 by the Dutch Ministry of Foreign Affairs, the UK Department for International Development (DFID) and IC AS of the World Bank Group.

The objective of the BRG Program is to review and synthesize experiences with regulatory governance initiatives in developing countries, and to develop and disseminate practical tools and guidance that will help developing countries design and implement effective regulatory reform programs. Reports and other documentation developed under the BRG Program are available at: www.ifc.org/brg.

Foreword

This paper has been prepared as part of the Better Regulation for Growth (BRG) Program, a joint knowledge management program by the Dutch Ministry of Foreign Affairs, the UK Department for International Development (DFID) and The Investment Climate Advisory Service of the World Bank Group. The purpose of the BRG Program is to synthesize, develop and disseminate practical tools and guidance that will help developing countries design and implement effective regulatory reform programs.

The BRG Program has produced a series of analytical and guidance papers on regulatory governance in developing countries, including publications on:

- institutions for regulatory reform;
- comparison of tools to review existing regulations;
- RIA in developing countries;
- indicators of regulatory quality;
- regulatory reform and competition policy; and
- case studies on regulatory reform in developing countries.

The purpose of this report is to introduce the so-called "regulatory governance agenda," and to assesses its relevance for developing countries in promoting sustainable growth and private sector development. The report reviews the evidence of impacts of regulatory governance initiatives, and how regulatory governance tools have been applied in developing countries so far.

The report has been prepared by Scott Jacobs and Peter Ladegaard.

An early draft of this document was discussed at the Technical Meeting of the Advisory Panel of the Better Regulation for Growth Program held in The Hague on November 13-14, 2008. Comments to this draft were provided by participants to this meeting: Andre Nijsen, Andreja Marusic, Andrea Renda, Claudio Radaelli, Colin Kirkpatrick, Delia Rodrigo, Edward Donelan, Esra Yilmaz, Eva Buitenkamp, Fabrizio de Francesco, Greg Bounds, Jeroen Nijland, Josephine Kanyi, Ksenija Vidulic, Lars Grava, Margo Thomas, Mustafizur Rahman, Nick Godfrey, Richard Sandall, Stephen Rimmer, Scott Jacobs and Ulrich Ernst. Advanced drafts of the report benefited from additional comments from Simeon Djankov, Stephen Rimmer, Gunther Schoenleitner, Claudio Radaelli, Richard Sandall and Martin Bilberg.

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Executive Summary

The use of regulation as an instrument to reach economic and social policy objectives has increased dramatically over the last decades. Regulation of private behaviour has become a fundamental tool of government in managing more complex and diverse societies and for allowing competing interests to be balanced. Regulation has rapidly expanded as demands on governments have increased, and as budget constraints shifted government action to off-budget expenditures.

Yet most governments experience frequent regulatory failures that undermine the capacity to achieve policies important to citizens and consumers, and that also increase the costs and risks of commercial activities. Failures are due to persistent and common patterns of over-regulation, under-regulation, poorly designed regulation and implementation, and weak institutional capacities.

A range of regulatory reform tools and instruments has been developed and implemented over 30 years to help governments improve the effectiveness, efficiency and transparency of fast-growing regulatory systems. Widely used in developed countries, many regulatory governance tools and approaches have only recently been introduced to developing countries.

This report introduces key components of the evolving regulatory governance agenda, and discusses its relevance to developing countries in promoting sustainable growth and private sector development. The paper identifies failings and knowledge gaps relevant to the implementation of regulatory governance initiatives, and discusses how lessons learned can guide reformers and donor organizations in their efforts to promote sustainable growth and private sector development through better and more efficient regulation.

Regulatory governance is referred to here as the systematic implementation of government-wide policies to promote a regulatory system that is effective, efficient, transparent, and accessible. The report argues that a well-functioning national regulatory governance system is composed of four building blocks that are mutually reinforcing and interactive:

1. **Regulatory policy**—an overarching political statement about how a government will use its regulatory powers. Modern policies include statements about the quality of regulation and regulatory procedures.

2. **Regulatory institutions—**the administrative and political bodies through which regulations are made, implemented, and adjudicated.

3. **Regulatory quality tools and processes**—the administrative and political procedures through which regulations are developed, adopted, implemented, monitored, and reviewed. Such procedures include use of Regulatory Impact Analysis (RIA), consultation mechanisms, and benchmarking and review tools such as the Standard Cost Model and "guillotine" reviews.

4. **Regulatory policy instruments and outputs**—the legal instruments through which regulatory policy objectives are reached. They are found in the stock of existing regulations and the flow of new regulations adopted each year, and can include regulatory as well as alternative, non-regulatory policy instruments used to reach regulatory policy objectives. The policy instruments are outputs of the policies, institutions, and procedures.

The economic impacts of regulatory systems are well documented. While it is generally recognised that regulatory systems can generate a wide range of benefits and are a vital component of modern societies, they also impose costs. A range of estimates of the cost of regulation places the annual direct compliance costs at several percentage points of GDP, not including efficiency losses and dynamic effects. Reducing direct and indirect regulatory compliance costs across a broad front, while achieving or enhancing the benefits of regulation, can significantly boost performance at microeconomic and, depending on scale, macroeconomic levels. There are, however, three caveats to regulatory cost-cutting.

- First, a reform that reduces costs in an ad-hoc manner affecting a relatively small number of regulations may not generate economically relevant gains, because gains may be marginal compared to the overall regulatory constraints and burdens.
- Second, reforms that induce market competition seem more effective than those that only reduce business costs.
- Third, a reduction in regulatory costs must be sustained over time to generate durable market reactions. One-off reforms followed by re-regulation are unlikely to create a benign investment climate.

It is important to take a broad approach when reducing unnecessary regulatory burdens and costs, and to lock in the gains from such reforms with effective procedural safeguards.

A regulatory governance system operates within complex policy processes driven by a wide range of incentives, mandates, capacities, and influences, and its impacts on economic behavior is usually indirect. However, there is growing evidence that good regulatory practices, even if crudely measured, are positively linked to microeconomic performance at the level of the firm. Successful application of regulatory tools and instruments that ensure efficient, effective and transparent regulation will also create greater regulatory quality and predictability, which will eventually impact business investment decisions. In other words, the "regulatory governance toolbox" is relevant to sustainably cutting business costs and increasing competition by addressing the critical issues of market institutions and incentives. Given the endurable and entrenched regulatory cultures in many countries, regulatory governance reforms that directly change policy processes seem a necessary step to sustain reforms over time.

The importance of the regulatory governance agenda to developing countries is sometimes questioned, particularly when building roads and hospitals seem more urgent. The administrative requirements of regulatory governance reforms can seem to pose unacceptably high costs, or require preconditions not present, and the political/institutional environment is sometimes said to require other approaches than those offered by good regulatory governance. (There is no parallel debate about whether these tools are appropriate in OECD countries, since there is already wide acceptance of their value.)

This report argues that, while some concerns about the difficulty of the agenda are valid and are still inadequately addressed, the potential benefits of regulatory governance are higher in developing countries than in developed countries. Governments of developing countries more often regulate against competitive and well-functioning markets, and they implement regulations more poorly. Hence, the benefits of regulation are lower and the regulatory costs are higher. The economic gains of targeted regulatory governance reforms are likely to be greater where inefficiencies and regulatory costs are higher. The social gains of better regulation in promoting the quality of development are also likely to be very high.

However, there is still much to learn. Future reforms can benefit from a careful look at past mistakes and disappointments. Designing an effective reform program that is feasible under tight time and resource constraints and capable of changing entrenched regulatory practices is difficult. Earlier attempts to promote regulatory governance reforms in developing countries have often disappointed either in the concept, design or implementation phases. There is no clear recipe for when and how to *apply* many of these tools, their most effective *scope*, their *sequence*, and how to *target* them in a context of limited administrative and reform capacities.

Reformers and donors have made persistent mistakes that must be addressed in future programs:

1) **Getting incentives right.** Repeated evaluations have found that perverse incentives inside governments have stalled or reversed reforms. But few donor-supported reforms have explicitly dealt with incentives. Attention must be paid to "getting incentives right" within a regulatory reform program.

2) **Seeing the forest, not only the trees.** The size and complexities of the regulatory system are not always understood or appreciated. Regulatory instruments are the products of the regulatory system. Where reforms touch only specific regulations, the reforms cannot address the root causes of regulatory failures. Faced with short time frames and few resources, reformers often pick "low

hanging fruit" and hope that good practices are learned and institutionalized later. But regulations emerge from a system where incentives and habits are strong, and that is fully capable of making the same mistakes over again. There is little evidence that easy pickings lead to hard and sustainable reforms. It is more important, more relevant to markets, and more difficult to change *how* regulation is made and implemented in the future. As evidence accumulates, the reform community seems to be swinging away from easy and short-term reforms to more systemic reforms.

3) **Plug-and-play doesn't work.** A problem in the design phase is the over-use of other-country models that are exported to the reforming country. Regulatory reform is highly contextual, and should be tailored to suit existing government structures than has been the case in many previous programs.

4) **Realistic time horizons.** The short time period often allowed for reform is unrealistic, given the cultural and institutional issues to be addressed. Regulatory reformers should move beyond what is immediately "doable" to what is actually "needed". The time horizon and tools for successful reform should go beyond immediate results into the creation of sustainable practices.

5) **Focus on implementation.** Implementation of even well-designed reforms remains a continual challenge. Reforms are highly vulnerable during the implementation phase. There is no generalized implementation framework that demonstrably improves success. However, many reform programs seem designed for failure because their timeframes, strategies, and resources are not consistent with implementation needs.

6) **Early and continuous assessment of results.** Development of the regulatory reform agenda is hampered by a lack of focus on monitoring and evaluation. Evidence linking particular regulatory governance reforms to changes in market performance or to government policy effectiveness is thin in OECD countries, and practically absent in developing countries. A primary reason for this is a lack of effort by reformers to integrate monitoring and evaluation into program design. Better data on the gains from reform can play an important role in generating momentum for further and more comprehensive regulatory governance reforms.

Although the paper offers no clear "yes" or "no" answers to these important questions about the relevance and benefits of regulatory governance in developing countries, it concludes that regulatory governance reforms are likely to be relevant to developing countries when they are linked to other government priorities, when certain preconditions are in place, and when the design of the reform is context specific.

A successful regulatory reform program in economic terms includes a mix of components, including one-time reductions in existing costs, and regulatory governance tools aimed at sustaining lower costs, reducing policy risks, improving resource allocation, and building a regulatory framework for socially beneficial growth.

Some systemic reforms, such as consultation with business and other stakeholders about regulatory issues, appear to be either easier or more adaptable than other reforms, such as RIA. But neither consultation nor RIA is effective without the other. A sequenced approach that focuses step by step on a multi-year program, as defined in a national regulatory policy, is better than the usual ad-hoc approach to regulatory reform.

Development of an institutional strategy, complete with supportive incentives, is also a critical part of the regulatory governance agenda, since, in a regulatory system, institutions are the main determinants of the quality of outputs (regulations and implementation). As implementation of the OECD agenda demonstrates, country-specific adaptation is needed for developing countries.

Many of the issues raised in this paper are analysed in further detail in other papers of the BRG Program. In combination, the BRG Program's synthesis, analysis and further development of regulatory tools and approaches should enable practitioners and policymakers to better design and implement regulatory reform programs in the future.

1 Introduction

The use of regulation as an instrument to reach economic and social policy objectives has increased dramatically since the 1940s. Regulation of private behavior has developed as a fundamental tool of government in managing more complex and diverse societies and allowing competing interests to be balanced through a flexible governing instrument.

The externalities of individual regulations and the impacts of the accumulation of regulation are much better understood today than they were a few decades or even a few years ago. This experience shows that the regulatory instrument is too often used carelessly. There is evidence that most governments experience frequent regulatory failures—due to persistent patterns of over-regulation, under-regulation, and poorly designed regulation and implementation—that undermine policies important to citizens, consumers, and businesses, and that simultaneously increase the costs and risks of commercial activities.[1] In many countries, regulatory failures have reached such a level that the regulatory system as a whole has become little more than a bureaucratic way of life or a way to generate power or money for special interests, with little concern for the hidden costs in lost lives and economic growth. The cumulative effects of many regulations are even less managed. No government has a clear overall understanding how it regulates, what happens after it regulates (and sometimes even why it regulates), much less the interactive effects of hundreds, thousands, or tens of thousands of regulations adopted and revised in past years.

Reforms that increase quality[2] in regulatory procedures and requirements - and more importantly, in regulatory institutions, capacities, and incentives - can simultaneously improve a country's quality of social life and the conditions for economic activity. While such reforms have been pioneered (and are still being developed) in OECD countries, they are equally or more important for emerging, developing, and transition countries, where poor quality regulation and implementation are formidable barriers to entrepreneurship and investment, and where regulatory failures expose people and the environment to horrific risks.

Improving the quality of regulation as a governance instrument has become a core element of most national reforms to foster investment and promote economic growth, as well as good governance and the rule of law more broadly. Among the many causes of the financial crisis in the United States, the regulatory issues illustrate the point. Several regulatory failures emerged over a period of years. The institutional structure was fragmented with nine separate and mostly ineffective financial regulators. The regulatory system was outdated, depending on risk models that did not include the more exotic financial instruments. Perverse incentives were built into the market, as the rating agencies, paid by the institutions that issued debt, had financial incentives to produce excessively high ratings of financial instruments. They faced little competition since they enjoy a government-created monopoly on the rating business. The financial crisis was an expensive means of diagnosing regulatory failures. How much better to take preventive action to reduce the risk of failure?

Yet regulatory governance reforms are more complex and difficult than commonly accepted by many initial reformers and donors. The regulatory system that implements procedures and produces rules responds to internal incentives, resists change, and is quite capable of reversing changes not in the interests of insiders. Due to constraints from politics, timing, and resources, but also risk aversion, regulatory reformers and donors often seek easy wins, the "low hanging fruits," that too often are just marginal and unsustainable changes to complex systems. It is easy to make small changes to the huge and dysfunctional regulatory jungles seen in most countries, but it is more important, more relevant to markets, and more difficult to change how regulation is made and implemented in the future.

Even facing these challenges, governance-based regulatory reforms seem to be paying off. There is growing agreement that good regulatory practices, even if crudely measured, are positively linked to microeconomic performance at the level of the firm. There is also recognition of the value of a range of regulatory governance tools in improving government accountability and performance in terms of policy results.

Partly driven by evidence of widespread regulatory failure, the notion is becoming mainstream that a regulatory governance system is needed to build and safeguard quality through regulatory policies, institutions, processes, and instruments (much as a fiscal and budgeting system is needed to safeguard the quality of government taxing and spending[3]). Most developed countries are pursuing this regulatory quality agenda to some extent, but most developing countries are just beginning to integrate regulatory governance tools into their systems (and most international regulatory regimes have not yet begun). This is an ideal time to take account of what we have learned in order to accelerate and improve the results of these reforms.

There is much to learn. The challenges are enormous. Many such reforms have disappointed, either in the concept, design or implementation phases. And there is skepticism about the priority that should be placed on these reforms relative to other pressing needs in developing countries. There is no clear recipe for when and how to *apply* many of these tools, their most effective *scope*, how to *sequence* them, and how to trade off their benefits and costs in a context of limited administrative and reform capacities.

As important, there still seems to be "conceptual confusion" about what the regulatory governance agenda covers, and what it does not. This to some degree is a reflection of the novelty of regulatory policy compared to many traditional development policies, and also reflects the normal development of a new management field.

Another factor hampering the development of regulatory governance is that the constituency for these reforms is undeveloped. Regulatory governance, often seemingly technocratic and remote, has not found a natural political constituency in many countries, or the institutional and ministerial underpinning enjoyed by other policies. Communication of the key ideas to potential allies has not been very effective.

The purpose of this report is to introduce and present key components of the regulatory governance agenda, and to discuss its relevance for developing countries. The paper identifies failings and knowledge gaps relevant to the implementation of regulatory governance initiatives, and it discusses how lessons already learned can guide reformers and donor organizations in their continued efforts to promote sustainable growth and private sector development through better and more efficient regulation.

Following the executive summary and this introduction, the paper is divided into the following sections:

- **Regulatory governance—What is it?** This section defines and introduces basic concepts of regulatory governance.
- **Regulation and economic growth.** In this section, the links between regulatory governance reforms and economic growth are clarified.
- **Major building blocks of a regulatory governance system.** This section explores the main building blocks of a regulatory governance system and highlights elements of relevance for developing countries.
- **Application of regulatory governance tools and approaches in developing countries.** This section summarizes the pros and cons for applying regulatory governance tools in developing countries, and summarizes the recorded results and experiences with regulatory governance tools in three developing countries.
- **Looking ahead: Should donors and governments invest more in regulatory governance?** The paper concludes with the lessons learned and not yet learned, and challenges ahead for the regulatory governance agenda in developing countries.

Endnotes

1. By "regulatory failures" we generally refer to regulatory outcomes where key features of regulatory quality—effectiveness, efficiency and accountability—have been significantly violated, e.g. in the form of massive and unforeseen compliance costs or failure to protect or stablize markets according to stated objectives.
2. Defined below based in part on characteristics relevant to incentives bearing on firms in markets.
3. The parallels between regulatory governance and other major government management reforms are clear. The emergence of modern budgeting in the United States in the early 20th century, for example, was due to Progressive Era reformers reacting against what was described as the "bureaucratic feudalism" of legislatures, to the dominance of political machines at the local level, to waste and inefficiency, to a lack of leadership and accountability, to government structures that hid more than they revealed to the public, to the dominance of special interests, to the lack of goals and the ability to implement them, and, mostly, to the inability of government to respond to the need for new and expanded services in a rapidly changing society characterized by industrialization, urbanization, technological advancements, the development of a national and international economy, population growth, and large scale immigration. See "Development of Modern Budgeting" by the California Department of Finance at http://www.dof.ca.gov/fisa/bag/history.htm

2 Regulatory Governance: What is it?

This section provides an overview of how concepts of regulatory reform have changed over time, and defines key terms. Section four provides further details of the components of a national regulatory system.

2.1 Development of Regulation and its Reform

The study of regulation is not new, and is rooted in economic, political science, legal, and public management disciplines going back a century or more. Theories of regulation have merged in different ways in the practice of regulatory reform. As a result, the concept of regulatory reform has assumed several meanings over the last 30 years. **Box 1** provides a brief historical summary of the development of the concept of regulatory reform from a deregulation approach based on concepts of market failure to the current approach emphasizing multifaceted "regulatory quality" as essential to modern governance.

Box 2 defines key concepts used in the field of regulatory governance. Several of these definitions build on those used by the OECD. Given the evolving nature of the regulatory governance agenda, the definitions are intended to clarify basic points as used today, rather than being definitive last words.

The term "regulatory reform" is applied to all of the variants in Box 1, and more besides. Most students of regulatory reform find that academics, donors, international organizations, and reformers use the basic "terms of the trade" in different ways without clear definitions. Sometimes it seems that those writing about regulatory reform are unaware that other definitions exist. This lack of precision masks important differences in the goals, design, and results of different varieties of regulatory reform. Unsurprisingly, it is often quite difficult, particularly for a practitioner, to understand if the particular reform being proposed is suited to the needs and capacities at hand. If we are to understand the choices and results of regulatory reform, the development of a "common language" is important for meaningful and efficient exchanges between stakeholders in the "regulatory reform industry." Clarity in the terminology of regulatory reform can have positive practical effects.

BOX 1

Varieties of Regulatory Reform— From Deregulation to Regulatory Governance, and Back to Cost-cutting

Since the 1960s, economists have studied the microeconomics of regulatory intervention in markets. Theories based on concepts such as market and government failure and transaction costs tried to define the effects of regulation in specific situations. Normative and positive theories of regulation based on concepts of private interest and public interest tried to explain how regulation is used in the political economy, and to predict the form and pace of regulatory reform. The modern school of law and economics applied neoclassical ideas to the analysis of legal problems. Much reform today is based on principles developed in those bodies of work, even if practitioners are not aware of it.

Modern regulation began in the age of industrialization in response to sometimes spectacular market failures. Regulatory reform began much later in history in part in response to businesses' concern with regulatory costs and competitive pressures. Deregulation and "regulatory relief" were the key principles of the 1980s, often coupled with privatization, based partly on the "small government" ideology, but more often on a growing body of applied microeconomics about the costs and benefits of regulation. This phase was a natural reaction to the rapid growth of regulation in an era when the market impacts of regulation were simply not recognized.

However, the principles of deregulation did not adequately recognize that modern governance can meet the needs of complex societies only if governments regulate, and regulate well. A different concept was needed if regulatory reform was to be mainstreamed in government policy. During the 1990s, the OECD played a key role in further developing the regulatory reform agenda. Deregulation was integrated into a much broader framework of *regulatory quality* that integrated microeconomic (including, for the first time, trade and competition policies), new public management, and rule of law reforms.

These ideas evolved further in the 2000s into institutionalization of good regulation capacities into the machinery of government, which was called the "regulatory governance agenda" The OECD's 2002 book, *From Interventionism to Regulatory Governance*, and its 2005 "Principles of Regulatory Quality and Performance" emphasize the need for a "whole-of-government" approach to regulatory reform based on "systemic" reform approaches. In essence, regulatory governance was seen as a core discipline in managing the regulatory functions of the state, comparable to fiscal and human resource management. The first Principle of Regulatory Quality and Performance states that governments should "commit to regulatory reform at the highest political level, recognizing that key elements of regulatory policy—policies, institutions and tools—should be considered as a whole, and applied at all levels of government."

The tree of regulatory reform continues to grow new branches. For example, the *Doing Business* indicators of the World Bank Group focused from 2002 on pruning selected costs to businesses in a practical application of the old traditions of "regulatory relief," but are now evolving toward a broader view of the quality of selected government regulatory services. Trade regimes are applying specific regulatory quality principles in tackling "non-tariff barriers," trade facilitation, and safeguards against protectionism.

The study of regulatory institutions has also deepened in recent years in a new comparative economics that seeks to identify how institutions differ systematically among countries, whether these differences have consequences for economic and political performance, and which are appropriate in what circumstances.[1] Much of this work is based on Barro's earlier work on the determinants of growth.[2]

BOX 2

Defining Basic Terms in Regulatory Reform

Regulation: The diverse set of instruments by which governments set requirements on businesses, citizens and the public sector. Regulations include laws; formal and informal orders and subordinate rules issued by all levels of government; and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers.

Deregulation: Elimination of regulatory requirements for which social welfare costs are judged to be higher than social welfare benefits.

Regulatory relief: Cutting regulatory costs to businesses with the intent of stimulating business growth. "Regulatory relief" initiatives do not assess the benefits of regulation, it merely focuses on cost reductions.

Regulatory quality: A regulatory framework in which government agencies seek to develop and implement regulations and regulatory regimes that are *efficient* in both a static and dynamic sense in terms of using economic, social, and environmental resources to their greatest value; effective in terms of achieving a clear public policy purpose; *transparent*; and *accountable* for results.[3] To these quality standards, this report adds *flexibility*, since regulatory rigidities in the face of changing context and needs are common and among the main contributors to regulatory failures.

Regulatory reform: This refers to a wide range of measures of deregulation, regulatory relief, regulatory quality initiatives, re-regulation, and institution-building. The term is a generic reference to any change in regulatory policies, functions, procedures, instruments, or capacities.

Regulatory management: Refers to the construction and exercise of a management capacity in the machinery of government to control the quality of regulatory activities. A key feature of good regulatory management is the capacity to design and manage *policy mixes*. Good regulatory management is not about choosing one particular instrument (i.e. self-regulation), but often about managing complex mixes, where one instrument works alongside others.

Regulatory policy: This term has two distinct meanings. 1) It refers to the substantive policy content of regulation. Some reforms seek to distinguish between regulatory policy and regulatory design. For example, the *Doing Business* indicators and the Standard Cost Model are based on the assumption that regulatory costs can be reduced while leaving regulatory policy unchanged; 2) "Regulatory policy" is also used by the OECD as a *meta*-narrative for the multifaceted program of a government to improve its use of regulation. The national regulatory policy agenda aims to improve four major elements: regulatory policies, regulatory tools, regulatory development (policy) processes, and regulatory institutions.

Regulatory governance: A holistic term that refers to the systematic implementation and operation of government-wide policies on how to use regulatory powers to produce quality regulation within the procedural values of the governing system (such as democratic processes). Good regulatory governance is grounded in the view that ensuring the quality of regulation is a permanent and essential role of government, not a one-off set of improvements, and that institutional capacities should be designed around a clear view of the appropriate use of regulation in society.

2.2 Goals of Good Regulatory Governance

Governments can legitimately pursue narrow or wide regulatory reforms, but, eventually, sustainable reform requires changes to the institutions, capacities, incentives, and even the role of government. That understanding of the systemic nature of sustainable reform explains why there is a progression in many countries toward the more holistic concept of regulatory governance.

The regulatory governance agenda encompasses a variety of goals important to economic, social, and environmental development. Some countries use regulatory governance to promote political development, as well, for example, to increase democratic accountability and participation of citizens in governance. For purposes of this paper, the most common goals of regulatory governance are identified as achieving a regulatory system that is:

1. **Effective:** The relationship between the goals of public policy and the results of the regulation. The closer the results of the regulation to clear goals, the more effective is the regulation.
2. **Efficient:** A scale representing the relationship between benefits and costs at any moment in time. Regulation that is efficient one day can be inefficient the next as effectiveness, valuation of benefits, and opportunity costs change. Any reform that increases benefits while holding costs constant, or that reduces costs while holding benefits constant, increases efficiency.
3. **Transparent and accessible:** The capacity of stakeholders to understand the entire cycle of regulation through problem and goal definition, development, adoption, implementation and adjudication. The more easily and thoroughly a stakeholder can get information about the regulatory activities of a government, the more transparent are those activities. Among the transparency tools are consultation/engagement methods that provide opportunities for stakeholders to participate in the development, monitoring, and revision of regulations. Opportunities should be "meaningful." That is, the information and views of stakeholders should be obtained in a way that is relevant, timely, and responsive to policy development.

The central goal is to ensure that regulations efficiently produce economic, social, and environmental benefits, that is, that benefits (widely defined) justify costs (widely defined), that costs are the minimum needed to produce any level of benefits, and that resources are allocated to their highest values. In this concept, regulation, like government spending, is neither good nor bad in itself, and can produce either substantial social benefits or substantial social costs. Costs are always compared to benefits to determine if a regulation is efficient. The relevant impacts of regulation go beyond market impacts to include, for example, distributional issues valued by a society. Efficiency can be constrained by other legitimate values, such as the desire for consensus or risk avoidance or protection of basic rights. Ideally, decision-makers will understand the trade-offs in reducing efficiency to achieve other goals.

The idea is that, just as fiscal management can increase social welfare by better allocating resources, so can regulatory governance. There is also a strong dynamic element to good management. As society, technology, and market conditions change, the benefits and costs of any particular regulation change over time, sometimes very rapidly. Successful regulatory governance adapts the regulatory function to produce maximim net social benefits over time.[4]

Achieving a regulatory system that is as efficient as possible over time and within the constraints of other social values requires actions on many different levels. The main challenge is one of institutions and incentives. Good regulatory governance rests on a system of institutions, driven by supporting incentives, that set transparent goals for regulation; apply, advocate, and monitor regulatory quality; and implement a host of better regulation tools. These tools could include RIA, public consultation, measures to regularly update existing regulation, alternatives to regulation, and measures to promote regulatory transparency, access, and user friendliness.

Endnotes

1 S. Djankov, E. Glaeser, R. La Porta, F. Lopez-de-Salinas, and A. Shleifer, "The New Comparative Economics," *Journal of Comparative Economics* (December, 2003) Vol. 31.4, pp 595-619.

2 His most-cited paper is Dr. Robert J. Barro, "Economic growth in a cross section of countries," *Quarterly Journal of Economics* 106[2]:407-43, May 1991.

3 Adapted from OECD (2004), *Taking Stock of Regulatory Reform: A Multidisciplinary Synthesis*, Paris.

4 One of the criticisms of ex ante regulatory impact assessment (RIA) methods is that they assess the quality of a regulatory intervention at a point in time, an assessment that might not be relevant to the future.

3 Regulatory Governance and Economic Impacts

The overall goal of regulatory governance is to increase net social benefits, which ensures that both benefits and costs are considered in judging the effects of reforms. This is obviously a broad agenda that can include many sub-agendas. Many regulatory reforms simplify the agenda by aiming to reduce the cost impacts of regulation as part of economic development and poverty reduction strategies. In these reforms (often called "business enabling environment" or "investment climate" reforms), the costs of regulation are the main focus. This section reviews the evidence of whether regulatory reform can translate into lower costs and policy risks for businesses, while increasing competitive pressures, all of which change the commercial environment to induce better performance of firms in markets and, ultimately, productivity.

Links between various kinds of regulatory reform and economic growth have been explored in numerous studies.[1] This evidence can be described as persuasive that the quality of regulation (measured in various ways) matters for economic performance. Cross-country surveys and assessments point to regulatory risks and costs as factors affecting firm performance and market incentives, acting through a wide range of influences such as potential return on investment, cost of capital, incentives for innovation, and market opportunities.[2]

This section looks at the evidence of regulatory reform initiatives in five categories or goals of reform:

1. Sectoral liberalization, with de-regulation, re-regulation and development of regulatory oversight regimes to deal with market failures.
2. Broad-based regulatory reform initiatives focused on market entry and competition.
3. Reforms aimed at reducing regulatory and administrative compliance costs.
4. Reforms aimed at improving regulatory quality tools, procedures and institutions.
5. Impacts of regulatory governance reforms on informality.

The distinction between these five types of impacts is to some extent artificial since one type of reform, for example "cost-cutting," can have impacts on other areas such as market entry and informality. The distinction is important, however, since each kind of initiative has different overall effects, achieves different goals, and has different constraints, conditions, and risks. For example, regulatory reform seems to have different effects on economic performance depending on whether it achieves a one-time reduction in costs, or opens up markets to more competition. Cutting costs without inducing competition will result in windfall profits, but not better performance or consumer welfare.

Hence, it is important for reformers to understand the likely consequences of different reform approaches and to compare them with the goals of the reform. The literature on regulatory reform suggests that reformers sometimes expect results that are not likely given their reform design. Clarity in linking reform design to results can improve results.

The following sections will focus primarily on categories 3-4, reflecting the horizontal, non-sectoral focus of the Better Regulation for Growth Program.

3.1 Sectoral Liberalization Has Positive Effects in Competitive Markets

The term "regulatory reform" in much of the literature in the 1980s and 1990s refers to sectoral liberalization of various kinds. There is ample evidence that, where markets are competitive, sectoral deregulation, often but not always accompanied by privatization, produces positive effects in terms of price reductions, more innovation and consumer choice, and higher quality. Where markets are not

BOX 3

Links Between Broad-Based Regulatory Reform and Welfare-Enhancing Market Competition

Reforms that reduce competition-restraining regulations, cut tariff barriers and ease restrictions on foreign direct investment to "best practice" levels in the OECD area could lead to gains in GDP per capita of up to 2 to 3 percent in the European Union, where productivity is already higher than in most developing countries.[6]

Regulatory environments that favor trade and competition have a positive impact on economy-wide productivity even when other potentially important factors, such as human capital and country- and industry-specific effects, are accounted for.[7] The increase in the intensity of competition can enhance productivity by improving the allocation of resources and encouraging a stronger effort on the part of managers to improve efficiency. Cross-country evidence suggests that countries that extensively reformed their product market regulations also experienced an acceleration of multi-factor productivity over the 1990s, while other countries experienced a productivity slowdown or stagnation.[8]

Regulatory reforms can boost investment. For example, liberalizing entry can spur fixed investment in some industries.[9] Removing numerous regulatory barriers to entry in South Korea was estimated to boost FDI by over $26 billion over 5 years.[10]

Regulatory reform, if multi-sector, can boost labor productivity and create more jobs, even if jobs are lost in sectors that are forced to restructure due to higher competition. Increased competition in sectors stimulates employment through various channels. A growing number of studies show spill-over effects from product market reforms in employment and labor productivity.[11] Employment gains from liberalization policies are likely to be higher in countries that have rigid labor markets.[12]

The 2005 *Doing Business* report found that indicators of cost to business in the areas covered by the report seem correlated with higher rates of job creation.[13] However, rather than showing that cost-cutting in these areas can produce macroeconomic effects, the correlation might be due to the fact that countries regulate consistently, using a national style that is reflected in the Doing Business indicators. This would support the OECD's 1999 conclusions about the pro-competitive style of regulation in the United States. A group of researchers finds a strong correlation between regulation of entry into markets and the regulation of labor. As they explain this: "countries have regulatory styles that are pervasive across activities and shaped by the origin of their laws."[14]

In Australia, the total cost of regulation was put at 9 to 14 percent of GDP in 1986. The national competition reviews proposed in the "Hilmer report" (and some related reforms) were estimated to yield potential gains in real GDP of 5.5 percent as competition brought down prices and increased productivity.[15]

competitive, and where regulatory regimes are undeveloped, deregulation has usually produced negative results. This report does not review the evidence for the results of sectoral deregulation, which have been extensively reviewed elsewhere.

The key point of sectoral liberalization is that reducing regulatory compliance costs is not the key goal of the reform. Rather, the goal is to induce more competition in areas formerly characterized by monopolies or high barriers to entry. Regulatory compliance costs are usually higher in competitive markets than in monopolized sectors. The assumption made in these kinds of reforms is that the costs of more regulation will be outweighed by the benefits of more competitive markets.

3.2 Broad-Based Regulatory Reform Associated With Higher Growth and Productivity

Reducing direct regulatory costs is a common goal, but is not the only area of interest about the economic impacts of regulation. Stringent regulation can be associated with good market performance, if other fundamentals are right. This is reflected, among other indications, by the fact that some countries traditionally considered as heavily regulated perform well on the World Bank Group's *Doing Business* Indicators. The OECD's principles for quality regulation go beyond compliance cost to include other quality factors related to efficiency, such as consistency with competition and trade principles, transparency, ease of compliance, and flexibility, that seem likely to affect market incentives.

Good evidence suggests that a pro-competition policy stance of regulatory regimes can stimulate factor productivity through several channels. Openness and contestability of regulatory processes weakens information monopolies and the powers of special interests, while encouraging entrepreneurialism, market entry, consumer confidence, and the continual search for better regulatory solutions.[3] The welfare-increasing effect of regulatory regimes that respect or increase rather than reduce or replace the role of competitive forces is documented in economy-wide and sectoral cases.[4]

These findings suggest that a pro-competition regulatory style might be more important to long-term economic performance than a low-compliance-cost regulatory regime. The poverty-reducing effects of broad-based pro-competition and market opening reforms is not as well documented, but presumably reforms that increase market competition drive down consumer prices overall, and increase household income. Reforms that increase factor productivity might have negative effects on the poor working in sectors open to more competition, but positive effects on poor who consume those goods or services.[5]

3.3 Reducing Regulatory Costs Can Have Important Sectoral, Macroeconomic Benefits

Reducing the direct compliance costs of regulation—such as administrative burdens—has been the focus of many regulatory reforms. At a prominent international conference in Bangkok in 2006,[16] 18 of 23 papers focussed on cutting direct regulatory costs as the main reason for reform (5 papers mentioned reducing policy risks as also valuable). These kinds of reforms are also called "reducing regulatory burdens," "cutting red tape," and "regulatory relief." In part, these reforms are so prevalent because regulatory costs are highly visible and hence creating a positive political consensus in favor of reform is easier, and in part because cutting the cost of existing regulations is relatively easy and short term. Some regulatory compliance costs also have important dynamic effects, such as those costs imposed on starting up new firms, which might act as a barrier to entry, or costs imposed by licensing which might reduce market entry or innovation.[17]

Without considering regulatory benefits, regulatory compliance costs indeed seem economically relevant in all countries—business regulation can be as pervasive in Europe and the United States as in developing countries, and everywhere businesses attest to the difficulty of compliance. A range of cost estimates, each fraught with uncertainty, places the annual direct compliance costs of regulation at several percentage points of GDP, not including efficiency losses and dynamic effects (see Box 4).

These estimates are far from precise, but give credibility to the assumption that the opportunity costs of regulatory compliance costs are important at macroeconomic levels, even ignoring efficiency and dynamic effects. Costs of regulation seem even more important at the microeconomic level, due to high opportunity costs of firm-level resources. The disproportionate impact of regulatory compliance costs on small and medium enterprises (SMEs) has been repeatedly documented.[18]

It seems obvious that reducing the costs of regulation, while holding benefits equal, is a good idea, since the resources released can be used for productive investments, higher wages, higher profits, higher quality, or lower prices. All of these are desirable outcomes, particularly in countries with low investment rates and high poverty rates. Inserting regulatory cost reductions into input-output models suggests that large reductions in regulatory costs can have non-trivial impacts on job creation, investment, and ultimately, one-time boosts to GDP levels. The Standard Cost Model is an example of the kind of reform that aims to cut costs without affecting benefits.[23]

BOX 4

Cutting Regulatory Compliance Costs—Examples of Initiatives and Impacts

In **Kenya**, the potential impact (cost savings) of a comprehensive business licensing reform aimed at streamlining and simplifying licensing procedures has been estimated at 0.6 percent of GDP.

In **South Korea**, the OECD estimated that the value of gains to individuals of a one-year program to reduce the regulatory burden was an amount equivalent to almost 1 per cent of GDP, reflecting the opportunity cost of time.[19]

A study for the **U.S.** Small Business Administration[20] estimated that the annual regulatory burden for American companies is $1.1 trillion, or about 8 percent of GDP. Aggregate benefits, however, might be even higher. The central regulatory office estimated that the annual social benefit of major federal regulations from Oct. 1, 1995, to Sept. 30, 2005, was in the range of $94 billion to $449 billion. Estimated annual costs ranged from $37 billion to $44 billion.[21] The central office found that there is still ample opportunity to reduce regulatory costs without affecting benefits.

The Dutch Bureau for Economic Policy Analysis estimated in 2004 that a 25 percent reduction in the costs of administrative burdens would lead to a 1.7 percent GDP increase in Europe.

In the Netherlands itself, a 2003 "base line" measurement of administrative burdens estimated their cumulative costs at €16 billion annually. Reducing this burden by 25 percent would, it was estimated, boost GDP by 2.8 percent to 3.7 percent.[22] Interestingly, the Dutch government also found that many administrative requirements reduced program benefits. For example, in the health care sector, 24,000 people dealt with paperwork rather than caring for patients.

3.4 Simpler Regulatory Regimes and Due Process That Protect Property Rights Expected to Stimulate Bottom-Up Development

Inefficient regulatory regimes have been associated with a high cost of establishing, protecting and trading in property rights, which, according to a body of literature initiated by de Soto in 1989,[24] restricted credit and investment in many informal sectors of the economy. Regulatory reform aimed at reducing barriers to the establishment and protection of property rights, particularly property, was seen as a way to unlock hidden assets and unleash the entrepreneurial energies of the informal sector. Evidence proving this theory has not developed, apparently because property rights are only one of the many barriers to business activity in the informal sector.

While the true contribution of regulatoy reform and associated legal reforms in due process aimed at strengthening property rights is unknown, the value of creating strong property rights in key factor markets such as land seems appealing as part of a broader program of private sector development.

3.5 Impacts of Regulatory Quality Tools Difficult to Document, but Logical Connections are Apparent

Tools aimed at increasing regulatory quality by changing how regulation is developed, designed, and implemented are also very popular. RIA is now used in around 50 countries, and more are adopting the tool each year. Stakeholder consultation is as popular in regulatory processes as in other policy processes. Transparency in fiscal policy has long been a reform priority, but transparency in the development and content of regulations has also become a common reform, increasingly assisted by information technology (IT) tools. Use of alternative regulatory designs and other kinds of policy instruments to replace traditional "command" forms of regulation is increasing. Quality control processes and "challenge" institutions in government and outside are breaking down the damaging "information monopolies," "single-missions," and "policy silos" that often characterize regulatory institutions across the government.

These procedural reforms are only indirectly related to economic impacts, because they operate within complex policy processes driven by a wide range of incentives, mandates, capacities, and influences. Directly linking policy process reforms to final outcomes in terms of economic impacts of government action is not easy, and there are few good studies showing these links. However, OECD and other work has linked these kinds of reforms to common causes of regulatory failures, and has stated that better procedural safeguards should reduce the incidence of costly regulatory failures.[25] Another frequent argument is that procedural reforms are more sustainable than cost-cutting reforms, because they change the incentives, capacities and cultures of regulation that, without change, would simply make the same mistakes over and over again.

While the evidence is slim for the market impacts of regulatory governance tools, these reforms are logically linked to sustainable and longer-term changes in the "style" of regulation toward market competition and openness, transparency, and efficiency in reaching policy goals. Available evidence also suggests that, logically, regulatory governance tools could mitigate important constraints on economic development that have proven resistant to change by other means, including:

- making public policy more efficient by allocating national resources to higher value uses, by reducing the risk of policy failures, and by finding effective policy designs that respect market principles;
- lowering policy costs and barriers to market entry for firms, goods, and services, which in turn boosts foreign direct investment (FDI) and trade, increases the returns on participation in formal markets, speeds the uptake of new technologies and other innovations, and frees resources for other uses;
- reducing policy risks for market actors by increasing transparency in the design and use of policy and by involvement of stakeholders in shaping policies important to them;
- increasing the social benefits of economic activity by safeguarding public interests such as efficient management of environmental, safety, and health risks; and
- improving business security and market neutrality of policy by increasing accountability for policy implementation and results, and lowering corruption and vulnerability to capture of government functions.

Experiences such as those described above show that the risk of failure is high for some regulatory quality tools, but that success is possible with the right conditions and designs. The lessons from these experiences must be kept in mind when regulatory governance tools are implemented in developing countries. This issue is further addressed in Sections 6 of this report. For a further review of empirical evidence on regulatory reform tools, see footnote references.[26]

3.6 Regulatory Governance and Informality

One of the circumstances in developing countries that leads to questions about the relevance of regulatory governance is the presence of large informal sectors, which operate to varying degrees outside of regulatory regimes. What are the benefits of regulatory reform when as much as 90 percent of the economy is in the informal sector, as in much of Africa?

For some authors, informality is a rational choice when taxes and regulations are too costly. The link between regulatory reform and informality is direct: bring down regulatory costs and barriers to entry, and, when the returns from formality (such as secure property rights, legal protections, and better access to finance) outweigh the cost-savings from informality, informal firms will choose formality. Under this scenario, reforms that reduce regulatory costs and risks and their associated effects such as corruption would seem to be an ideal strategy to increase formality. Indeed, a review of the literature of informality by Djankov and his co-authors finds that "The most important determinants are the prevalence of burdensome and costly government regulations and the level and administrative complexity of taxation."[35] Others find indirect links with regulation through impacts on corruption.[36]

BOX 5

Impacts of Regulatory Governance Tools—The Case of RIA

There is positive and negative evidence of the impacts of RIA (most of which is from developed countries where the tool has been primarily implemented so far):

There is some negative experience about the value of RIA in OECD countries. According to the the National Audit Office, UK's RIA, after 20 years of history, had, by 2006, "not yet altered the way that Government thinks about regulation."[27] A study of RIA in 27 EU countries, finalized in 2008, concluded:

> *In almost all cases we have examined, there is a large gap between requirements set out in official documents and actual Impact Assessment practice. In most countries we found examples of both good and bad practice, but typically assessments are narrow, partial and done at a late stage. In many countries, a large share of proposals is not formally assessed or is assessed with a 'tick box mentality'.*[28]

There is also positive evidence. In the **European Commission**, four years after RIA was adopted, an independent evaluation found that 13 out of 20 RIAs had influenced policy proposals.[29] The European Commission itself reported in 2008 that RIA was inducing a cultural change as well as reducing unjustified regulations:

> *As part of a more general culture change, impact assessment has become embedded in the working practices and decision making of the Commission, and has changed how policy is shaped. Commission decisions on whether and how to proceed with an initiative are based on transparent evidence, stakeholder input and thorough analysis of options, including those of co- and self-regulation. In 2007, for example, the Commission stopped three planned initiatives on the basis of the impact assessments because they showed that EU action would not add sufficient value at this time.*[30]

Some countries that have just begun RIA have had positive results. In **Moldova**, a recent assessment found that new regulatory proposals decreased by 39 percent during the 11 months of 2008, compared to the same period of 2007, when RIA was not mandatory. The report states:

> *RIA Secretariat members believe the change is owing to the RIA, which started to prevent some of the unjustified regulations ....the main impact of RIA is changing the mindset of civil servants, who started to realize the principles of better regulation and main elements of RIA. It can be perceived already in discussions and debates with civil servants that they have become more knowledgeable and grounded in their arguments for regulations.*[31]

In **South Korea**, more than 25 percent of the regulatory proposals put forward in the year after legislating an RIA requirement (1998-99) were rejected by the Regulation Reform Committee.[32]

The **United States** Office of Management and Budget (OMB) reported in 2008 that the cost-effectiveness of federal regulations seemed to be increasing over time, that is, each dollar spent on complying with regulations produced more benefits:

> *The estimated benefits of major regulations issued from 1992 to 2007 exceed the estimated costs by more than four fold. The estimated benefits of major regulations issued over the last seven years exceed the costs by more than seven fold.*[33]

While OMB did not speculate as to why regulations became more cost-effective, the core instrument used in the federal government to assess the cost-effectiveness of policy options is RIA, combined with other "better regulation" tools such as independent quality control and stakeholder consultation.

There are many anecdotes in which RIA identified less costly regulations that would achieve results equivalent to more expensive alternatives. For example, the first proposal of the REACH regulation from the **European Commission** would have imposed €10 billion in costs on the European chemicals industry. After RIA stimulated a public debate about various alternatives, the regulation was revised to make it easier to comply, without significantly changing benefits. The final cost was €2 billion. The RIA cost the Commission about €1 million, producing a social return on investment of 10,000 to one.

A study of 15 RIAs by the **U.S. Environmental Protection Agency** showed that RIA increased net benefits to society from environmental regulations. Three of the RIAs showed that the net benefits from recommended improvements in the regulations would exceed $10 billion. The total cost of preparing all of the 15 RIAs studied was approximately $10 million. Thus, the EPA RIAs yielded a return on investment of 1,000 to 1. Four of the analyses studied showed how less costly regulations would achieve results equivalent to the more expensive alternatives. In two of these cases, the analyses showed that less costly alternatives would lead to greater reductions in environmental risk. The cost of RIA was low—on average, 0.1 percent of the compliance cost of a rule over five years.[34]

Complementing this view, others have written that cutting costs is only part of the solution, because governments also need to provide regulatory governance environments that are transparent, efficient, and low-risk. Bannock and Darroll wrote in 2007 that "...making the path from the informal to the formal sector easier to travel is not only a matter of reducing regulatory costs. It is also necessary to raise regulatory quality... Regulatory reform has much greater potential to improve the business environment for the broad spectrum of African enterprises."[37] If correct, the potential connection between the regulatory governance agenda and informality would be even stronger.

As of now, however, there is little direct evidence linking the use of regulatory governance tools (or any other reform) to reductions in informality. This has in part to do with the general methodological problems of linking process reforms to "impacts," but probably also because the results of frameworks of regulatory governance and "informality" programs have been poorly connected. In fact, since regulatory costs have trended sharply upward in most countries over the past decade, it is likely that regulation is contributing more to the informality problem, and hence that regulatory reform is becoming even more important element in tackling the "informality" challenge.

3.7 Conclusion

It is clear that regulatory governance is as much about increasing benefits as cutting costs, but that much of the emphasis in the developing world is on the latter. This chapter reaches four conclusions about the relationship between government regulation and market performance, and the relevance of the regulatory governance agenda to economic development:

First, government regulations that impose direct business costs often reduce economic performance, measured as business investment, employment generation, exports, and FDI inflows. Reducing direct regulatory compliance costs can create a one-time boost in performance at microeconomic and, depending on scale, macroeconomic levels. The potential benefits of regulatory reforms that reduce costs are obvious, in the most productive countries as in the least productive. Even where fundamentals are good, regulatory reforms that cut costs without cutting benefits can increase both government effectiveness and economic performance.

However, while cost-cutting might be the easiest of reforms, good results are not ensured. Not all attempts to reduce regulatory costs are effective in doing so. Even in the Netherlands, lauded as a "world leader" in administrative burden reduction, the concrete benefits for businesses are slow to emerge, and "some of the 196 simplification measures to reach the 25 percent reduction have only small benefits for businesses."[38] Cost-cutting goals have driven many reforms, in the hope that lower costs or faster procedures will change costs, risks, and commercial incentives to such an extent that businesses will become more innovative, competitive, and productive. For most of these reforms, the evidence of results in the market is slim. And, of course, the reduction in regulatory costs would have to be sustained, that is, eliminated costs should not simply be replaced by regulators once the reform is completed. Without such safeguards, cost-cutting, in itself, is likely to be weak in terms of sustainable effects.

Second, directly following the previous paragraph, if the reform also reduces barriers to entry, increases transparency, reduces regulatory risks, or otherwise increases competitive forces, the positive economic effects are longer-lasting and more powerful. That is, inducing competition is more important to sustainability than cutting compliance costs.

Third, the negative effects of high regulatory costs, risks, and entry barriers seem particularly relevant for developing countries where businesses compete in thin capital markets; face fierce price competition in export markets and pressures from low cost imports; confront competition abuses; face faulty due process with weak property rights; confront high regulatory risks due to nontransparent and captured policy processes; and compete with large informal sectors.

Fourth, while straight cost-cutting is likely to produce net benefits where regulatory quality is consistently very low, the regulatory governance toolbox seems logically relevant to sustainably cutting business costs and increasing competition by addressing the critical issues of institutions and incentives. Indeed, some of the results announced so far, such as in South Korea and the Netherlands, depend on regulatory governance tools such as cost assessment, central management of regulatory reforms, and stakeholder involvement to make and sustain real reforms. Given the endurable and entrenched regulatory cultures in many countries, regulatory governance reforms that directly change policy processes seem a necessary step to sustain reforms over time.

The potential benefits of regulatory governance tools do not necessarily mean that all of these tools have everywhere actually produced those benefits, either in OECD or developing countries. In many reforms, regulatory reform and the microeconomy seem to have been poorly linked. Many regulatory governance projects seem to have had no clear economic goal other than "improving the business environment." Institutional reforms have usually ignored incentives.

The mostly likely conclusion at this time is that a successful regulatory reform program in economic terms will probably include a mix of components, including cost-cutting aimed at one-time reductions in existing costs, and regulatory governance tools aimed at sustaining lower costs, reducing policy risks, improving resource allocation, and building a regulatory framework for socially beneficial growth. The relative ease (even if not the economic significance), of creating a supportive political economy for straight-forward regulatory relief and cost-cutting is proven, while the need for sustainable reforms to regulatory practices and cultures seems logically irrefutable, even if the political economy is less ready to support crosscutting, institutional, and longer term reforms.

This implies that regulatory reformers should move beyond what is immediately "doable" to what is actually "needed." What is needed, however, will depend on a careful analysis of the country context—not a simple transposition of an OECD relevant policy tool to a developing country as Chapter 5 will argue. Finally, the evidence reviewed here strongly suggests that time horizon and tools for successful reform should go beyond immediate results into the creation of sustainable practices.

Endnotes

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4 Building Blocks of a Regulatory Governance System

As indicated in previous sections, there is often a degree of "unease" among observers about the content of the regulatory governance agenda. Some find the agenda and its concepts too vague, some find them too broad and all-encompassing, even engulfing the entire policy process. "Insiders" often acknowledge that the agenda is complex, but believe that it reflects the real challenges of promoting good governance and economic growth. This section is an attempt to bridge these concerns by defining more clearly the major building blocks of a regulatory governance system.

This section argues that regulatory governance is accurately seen as a component of improving a country's governance capacities and of improving the policy-making process in particular, from the technical to the political dimensions of policy. The operational focus of regulatory governance is on the components of the policy process that produce, approve, implement, monitor, and revise laws and the many other forms of regulations.

This section also argues that a well-functioning national regulatory governance system is composed of four building blocks that are mutually reinforcing and interact in a dynamic way:

1. **Regulatory policy:** goals and content of a national regulatory quality policy
2. **Regulatory institutions and their incentives:** the administrative and political bodies and their staffing through which regulations are made, implemented, and adjudicated, and their quality controlled, at international, supranational, national and subnational levels. The institutions are driven by a host of different incentives.
3. **Regulatory quality tools and processes:** the administrative and political procedures through which regulations are conceived, proposed, drafted, assessed, consulted, adopted, implemented and monitored. These can be conceived as the "production process" for regulation.
4. **Regulatory and non-regulatory policy instruments:** the stock (existing regulations) and flow (new regulations adopted each year) of regulations and other policy instruments that work in parallel with classical "command" regulation or that replace such regulation. The policy instruments are outputs of the policies, institutions, and procedures.

The following sections present these building blocks in further detail. The functioning of each of these components together define the quality of the regulatory governance system.

4.1 Regulatory Policy—Goals and Content

Regulatory policy is defined above as an overarching political statement (meta-narrative) about how a state will wield its regulatory powers, apart from the content of regulatory policies specific fields (such as consumer protection or financial stability).

Almost all countries have statements in the Constitution about how governments will use their regulatory powers. However, these general powers and restrictions are not normally specific enough to reflect the political priorities of a specific government or to guide a government in its day-to-day decisions about whether and how to regulate. Adoption and implementation of a more defined regulatory quality policy, whether comprehensive or focused on specific quality aspects, is a fundamental component of the operation of the regulatory governance system. The national regulatory quality policy is the blueprint for implementation of regulatory quality standards through multiple policies, institutions, instruments, and processes. Amidst highly fragmented regulatory institutions, the policy functions much like a country's fiscal strategy that sets priorities, establishes standards for minimum regulatory quality, and ensures the sustainability of the governance approach (in this case, the regulatory function).

The regulatory quality policy, ideally, embraces a "whole-of-government" approach across institutions and policies. Constitutive elements of the regulatory quality policy should apply to all regulatory bodies in the system to create an orderly, coherent, and transparent regulatory system based on common concepts of quality. The "whole-of-government" perspective integrates interactive policy areas in the regulatory arena, such as trade, competition, environmental, industrial, and social policies.[1]

Government institutions resist new quality disciplines, especially those that limit discretionary activity that has grown up over decades. Regulatory policy is no exception. Two conditions are essential to sustaining the effects of the regulatory quality policy in the machinery and cultures of government:

- Regulatory quality policy must be adopted and supported at high political levels. Political leadership at the highest level—not only the head of government but also in the government and major political parties—is key to aligning policy objectives. Success in different countries is rooted in the degree of active political support for quality. Political support, even over changes of government, can be operationalized and sustained by empowering institutions or ministries as drivers of reform in the day-to-day turmoil of policymaking.
- Second, regulatory quality policy is sustained only if constituencies are built. Because of the strength of existing incentives to regulate in certain ways, regulatory administrations are very resistant to change, and fully capable of rolling back reform policies if attention is not sustained. This cannot be done only by a few political champions, but by mainstreaming regulatory quality policy into the expectations of citizens and stakeholder groups, such as business representation. Yet most such constituencies have, reasonably, become highly skeptical of the capacity of government to change how it regulates. Incentives supporting the status quo are very strong. Support by a broad base of citizens and businesses for the regulatory quality policy can be achieved, not necessarily by waiting for a crisis, but by linking regulatory quality to concrete and credible changes that produce improvements to the quality of life.

Linking regulatory governance to political priorities is a useful approach. Integration of Kenya's new regulatory quality reforms into the anti-corruption agenda, and Vietnam's linkage of regulatory impact assessment and stakeholder consultation to the World Trade Organization (WTO) agenda, are examples of mainstreaming regulatory quality. Building allies creates a virtuous circle—public support sustains political attention to regulatory governance, which produces more benefits and more allies. This process, which takes time, changes the political economy inside the government and builds incentives for the right kinds of regulation.

A potentially powerful tool to keep a regulatory policy high on the political agenda is to have an annual regulatory agenda presented by the government and discussed in a proper parliamentary session. This would provide "macro" political incentives to carry out the more detailed "micro" political work on details of the regulatory system, i.e. promoting a RIA system or carrying through targeted regulatory reviews in selected sectors. It could also help clarify the link between the regulatory and budgetary/spending agendas of a government.[2]

The substantive policy content of regulation is where countries differ the most, yet even here long-term trends are resulting in convergence of basic policies embedded in national regulations. The most obvious is the decades-long move away from using regulation to replace markets and, instead, using regulation to correct market failures. Also, trade and investment competition is driving a search for regulatory quality, in which highly inefficient regulations become more exposed and slowly reformed, resulting in a gradual convergence in regulatory design. The internationalization of products is also driving a convergence in risk management, which is of major importance to regulatory policy. International treaties on the environment, labor standards, food safety, and other areas are pushing regulatory regimes closer together.

Regulatory governance itself says little about the content of regulatory policy, except to counsel against those kinds of policies that have proven to be consistent failures, such as price controls in competitive markets. Governments will continue to adopt a wide range of regulatory goals depending on national values, history, priorities, and constraints. The role of regulatory governance is to speed up learning, inside governments and across borders, by installing disciplines that systematically identify failing options, and promote successful options. Regulatory governance should speed up convergence only to the extent that convergence is supported by evidence and experience as the best approach for that country.

4.2 Regulatory Institutions and Incentives

Institutions in the public and non-public sectors organize the activities that make up a national regulatory governance system. The number and type of institutions that are developing and implementing regulatory systems have increased over recent decades. The growth of environmental, safety and health regulation since the 1960s is well known, and new regulatory institutions have continued to proliferate in most countries to perform new regulatory roles, such as in the liberalized utility sectors, in new policy fields such as environmental protection, and for new technologies such as bioengineering and information technologies.

The institutional architecture for regulation varies across countries depending on legal, constitutional, political, and historical context. Regulatory agencies set up to deal with specific issues and economic sectors have attracted criticism for failing to strengthen their governance and capacities to avoid regulatory capture and regulatory failures. For example, highly technical regulation requires new capacities and expertise not normally found in ministries, and new regulations require enforcement and compliance strategies that far outstrip the resources and limits of traditional "policing" functions of 20th century inspectorates. Fragmented regulatory institutions are less capable of addressing problems that cut across jurisdictional lines, but increasingly such problems that ignore government convenience are the critical issues that need coherent and coordinated solutions. The current financial crisis is one example, as is energy policy.

There is little doubt that the institutions and instruments of the regulatory state continue to grow worldwide, in OECD and developing countries alike, and that regulation is used to allocate a large and probably increasing share of national resources. The growth of the regulatory state without commensurate disciplines and quality controls on its output is why OECD countries have invested so much in recent years on regulatory management strategies. Emerging and developing countries are perhaps 25 years behind the most advanced OECD countries in putting into place a management structure for the growing regulatory system.

Institutional change is needed at central government levels, too. Implementation of the regulatory quality policy normally requires new roles, located at the center government, for overseeing, coordinating, and monitoring regulatory policy and quality. Many countries have established oversight bodies to advocate and monitor regulatory quality. These institutions are charged with carrying out key roles such as ensuring that a "whole-of-government" approach is taken on key policy issues, acting as an advocate of quality regulation, and providing technical support to regulators applying new regulatory governance tools. These functions require resources and active political investment. Oversight bodies often challenge existing interests, inertia, and self-interest. They need to be credible when taking the reform agenda ahead, coordinating inside the administration and managing the regulatory system.[3]

But incentives in public administrations are rarely supportive of reform. The quality characteristics of a good regulatory governance system do not arise spontaneously—indeed, the incentives for quality are perverse in most regulatory systems due to fragmented government institutions, career incentives, short time horizons, revenue goals, risk aversion, and capture. The incentives of businesses that benefit from a distorted business environment to resist market reforms are well recognized. In parallel, the perverse incentives inside regulatory systems themselves have long been recognized in "public choice" theories of regulation.

Repeated evaluations have found that perverse incentives inside governments have stalled reforms. The World Bank's evaluation of the WBG's support to improving the investment climate concluded that "The implementation of reforms would get bogged down at lower levels of bureaucracy if incentives were not changed."[4] In his overview of business environment reforms in Asia, Mallon found that enduring incentives inside public administrations were reducing the success of reforms:

> *Public servants (at all levels) need to have incentives to facilitate private sector development, and be accountable for achieving tangible results in terms of increased business start-ups, investment and business employment. The best business environment recommendations mean little if the administrative system lacks the capacity and/or incentives to implement change. Better performance indicators and accountability are important in developing incentives, as are merit-based recruitment and results-based promotion policies for public service officials.*[5]

There are many examples from across the world. For example, in the United Kingdom, the establishment of Public Service Agreement (PSA) targets across the government were found to actually encourage regulatory behaviour, while incentives to consider the regulatory impact and proportionality of the proposal were found insufficient.[6] In many developing countries, regulations have fees attached. A high level official supporting impact assessment in the European Commission once asked, "Has anyone ever been promoted for deciding NOT to regulate?"[7] Record concluded in Malawi that "Given the need to maintain fiscal prudence, finance ministries in developing countries can often be reluctant to reduce red tape and restrictions on the private sector for fear of short term revenue loss."[8]

The incentives inside the public administration are both predictable and resistant to change. The regulatory governance agenda has—by changing the machinery of government inside the policy process—directly attacked the issue of incentives in the countries with the longest experience. For example, in the United States, RIAs that demonstrate that the agency has selected a good solution greatly increases the speed of policymaking, and reduces conflict in the system. The use of RIA and stakeholder consultation in several countries has broken through the information monopolies that permitted much "insider" behavior, and has generated stronger incentives for reasoned, evidence-based rules. But there is much work to be done here, with civil service reforms that go deeper than policymaking into salaries, skills, and professionalism. Few donor-supported reforms have explicitly dealt with incentives.

4.3 Regulatory Quality Tools and Processes

Regulatory processes encompass both the development of new regulations, the revision of existing regulations, and the implementation of existing regulations. A range of quality tools have been developed to improve the outcomes of regulatory processes. The three phases are discussed separately below. (For a more exhaustive presentation of the many regulatory quality tools and processes, see the the referenced BRG papers in the sections below).

Development of new regulations

Every government has a set of procedures to develop new regulatory instruments and revise existing procedures. In some countries, procedures for developing new regulations are extraordinarily detailed, requiring a step by step approach that is routine, orderly, and clear. Such procedures slow down policymaking, but protect systemic values such as the role of institutions, accountability, transparency, and substantive quality. In other countries, the legal/policy system is chaotic, and new regulatory instruments emerge unpredictably, moving ahead quickly or slowly due to the influence of supporters or opponents. Such systems permit rapid response to political priorities, but undermine systemic values such as transparency, quality, and predictability. They are at high risk of producing regulatory failures.

The goal among governments today is to increase the ability to react more quickly to problems, but to do so with higher quality policy instruments that are less prone to failure. These two objectives are not always coordinated very well. On the quality side, a range of tools have been developed to improve the capacities of regulatory processes to distinguish better regulatory policies and instruments from worse ones. The most common tools are RIA, stakeholder consultation, and benchmarking.

RIA is a flexible tool that helps governments makes better regulatory decisions based on information and empirical analysis about the potentital consequences of government action. Around 50 countries have now adopted various forms of RIA as a routine element in making new regulations. The aim of RIA is to ensure that better policy options are chosen by establishing a systematic and consistent framework for assessing the potential impacts of government action. The RIA process, when embedded in the policy process, trains decision-makers to ask and answer targeted questions, at the beginning of the policy cycle, about the need for and goals of regulation, and the possible consequences of government action. The many methods used in RIA—including benefit-cost, cost-effectiveness, and least-cost tests, and partial tests such as administrative burden and small-business tests—are simply means of giving order to complex qualitative and quantitative information about the potential effects of regulatory measures. RIA is not, however, about analytical precision. Even simple analysis based on qualitative information and stakeholder consultation can help identify better and worse options. The methods used in RIA are highly adaptable to a wide range of administrative capacities.

There is no single RIA model. The institutional set-up for RIA depends on legal, political, economic and social conditions. The methods used in RIA reflect the values and capacities of the regulatory system. However, good practices have been identified internationally.[9] Work is also being undertaken to explore how the general and internationally accepted RIA standards can be adapted to developing country contexts. Under the BRG Program, this focus is captured in a separate report on "RIA Light."[10]

Strangely, there has been as yet no global assessment of the impacts of RIA on economic or government performance. However, anecdotal evidence—positive as well as negative—exists on the impacts of RIA (see Box 5).

Stakeholder consultation is a regulatory tool used to improve the transparency, efficiency and effectiveness of regulation. Consultation is a structured, two-way flow of information between government and those affected by government actions that can be developed at any stage of the regulatory development, from identification of the problem to design of the instrument mix to evaluation of existing regulation. Consultation increases the quality of regulatory policies in different ways: by bringing into the discussion the expertise and perspectives of those directly affected by the regulation; by helping regulators balance opposing interests and identify unintended effects and practical problems; and by fostering interactions between regulations from various parts of government.

Consultation, if constructive and well structured, improves the quality of rules and programs, improves the legitimacy and credibility of government actions, and improves compliance, reducing enforcement costs for both governments and citizens. When government announces in a timely manner changes to regulation, affected parties can also adjust to changes.

Benchmarking against regulatory practices in other countries that are accepted to be of an acceptable quality is a frequent and low-cost device for checking the quality of new regulations. A large number of international comparative indicators on regulatory quality have made comparison easier. The risk is that benchmarking will lead to acceptance of models that are not appropriate in the national context. However, there is tremendous learning across borders about what kinds and designs of regulation work, and what does not work. Combined with context-specific quality tools such as RIA and stakeholder consultation, benchmarking can be a powerful tool for better regulatory design.

Revision of existing regulation

In revising existing regulations, governments almost always adopt a policy of monitoring and evaluation, but in practice find themselves outmatched by the sheer volume of regulation. The result is the accumulation of regulations over time that may go decades without evaluation. In the meantime, the original conditions that led to the regulation may have changed, and the regulation might have become irrelevant, or worse, actually damaging.

A paper written in the BRG program[11] assesses various approaches to upgrading the stock of regulation, including reforms linked to the *Doing Business* indicators, to using the Standard Cost Model, the "Guillotine Approach," staged repeal, as well as other tools. The paper concludes, "tools and approaches to review existing regulation can generate benefits quickly through relatively minor changes in existing rules. Where properly implemented, such tools can lead to positive results."

Large-scale reforms seem to work better than small-scale reforms, because they match the scale of the regulatory thicket facing businesses, and have the capacity to make meaningful changes to commercial incentives. A licensing reform in Kenya from 2007-2009 proposed to eliminate around 300 licenses and simplify another 300, the largest licensing reform in the history of the country. If the recommendations are all eliminated, potential gains to the business sector from lower compliance costs are estimated at 0.6 percent of GDP or $137 million a year.[12]

Implementation of regulations

When implementing regulations, most governments find problems with traditional methods of inspecting, licensing, and overseeing the actions of thousands or even millions of market actors, and even more daily transactions. Some of these problems have to do with capacities of inspectorates, who are over-stretched and too under-staffed to enforce the ever-growing body of regulations, and others have to do with costs to businesses, who deal daily with a bewildering jungle of regulations, procedures, inspectors, and administrative requirements. In fact, the discretion of inspectorates to decide which rules to enforce introduces an element of uncertainty into the regulatory environment that simultaneously reduces policy effectiveness and increases business costs. In this environment, it is no surprise that discretion and lack of transparency breeds corruption, and that corruption undermines compliance.

Governments are adopting a variety of new processes to increase certainty in regulatory compliance and to reduce transaction costs for both governments and regulated entities. The widespread adoption in Europe and outside of the Standard Cost Model approach, and the popularity of the *Doing Business* indicators, which are mostly based on business procedures, illustrate the frustration of businesses and citizens with inefficient, duplicative, and inconsistent procedures. Three examples of improving regulatory implementation are discussed below.

Transparency mechanisms and electronic dissemination: e-government tools are rapidly changing how the public accesses public information, including information on regulations. An increasing number of OECD and non-OECD countries are adopting electronic registers for laws and lower-level rules, including formalities and forms. A variety of registries currently in use are designed to accomplish a range of public policy objectives:

- improve access to regulatory information and reduce transaction costs for regulated entities;
- boost legal security;
- improve accountability of regulators by fighting discretionary abuses; and
- set the basis for continuous monitoring of a regulatory system or regime.

One of the main goals of these reforms is to collect and publish in a single site (in this case a registry) descriptive information on the stock of regulations. This information is presented in a standardized format and is accessible by the public, almost always without fees. The combination of setting up a regulatory registry with ICT and e-Government tools further improves access to the legal and regulatory framework by regulated entities.

The "centrality" of the registry—that is, the fact that all legal measures and their substantive information are available in a single source—reduces the transaction costs of businesses The centrality reduces the costs of searching and comparing different sources. This centrality is also crucial to reducing the costs of updating the registry, allowing the applicable legal measures to be maintained up to date. The legal value of the data in the registries ranges from purely informational to full legal security. Mexico, for example, requires that a formality in the registry be applied exactly as it appears in the registry, while most others give electronic registries only an informational value.

Transaction mechanisms such as one-stop shops. The one-stop shop (OSS) has been a popular idea, but more difficult in practice. Sader wrote in 2004 that during the 1980s, the concept of an OSS came into fashion as a vehicle to deal with administrative barriers to provide a more streamlined and investor-friendly policy environment. However, "the experience with the OSS concept is checkered and not particularly positive in many instances." The German Development Agency implied in 2006 that the one-stop shop had become another model that donors were airlifting into local situations without adequate understanding: "The mere introduction of "outside solutions"—often termed as best practice and resulting in just another "one-stop-shop"—is not sufficient, as external solutions must be developed further and fitted into the local context by local actors."[13] The picture in 2009 seems slightly more positive, at least where IT is involved. The OSS has proliferated, and most countries now use some version in business registration. The OECD also reported in 2006 that "There is evidence that many of the variations of the basic idea of one-stop shops have been successful in reducing administrative burdens on businesses and the general public.[14] The relevance for developing countries is that the OSS seem to be useful under some conditions, and that information technologies will increase capacities for regulatory governance services.

Inspections reforms that reduce the costs and uncertainties of regulatory inspections, while increasing their effectiveness at increasing compliance, are underway in many countries. There is little international consensus on best inspection practices, but a growing body of recommendations, case studies, and research is documenting methods of increasing inspections quality. Defining "quality" for an inspection system is not easy, because an inspection system is only one piece of a larger and complex legal system. At bottom, inspections are meant to improve compliance with clear rules in order to achieve desired policy results. But compliance alone is not a sufficient standard of quality. An IFC toolkit[15] proposes four quality criteria for an inspection system that:

- maximizes compliance with clear and legitimate government regulations by detecting and deterring non-compliance consistently and fairly;
- minimizes uncertainty and regulatory risks for businesses by operating transparently and under the rule of law;
- fights corruption by reducing the opportunity for abuse of discretionary powers; and
- minimizes costs to businesses and optimizes cost to governments by using resources efficiently to target the highest risks.

4.4 Regulatory Instruments

The type and quality of the regulatory and non-regulatory instruments used to reach regulatory policy objectives is another important quality component. A regulation is successful only if it changes incentives and therefore behaviors. Traditional regulation bases incentives on deterrence driven by the risk of penalties, but there are many other ways to change incentives in the market and in society. Governments in both OECD and developing countries are using today a wider and wider set of policy instruments, both regulatory and non-regulatory, to achieve goals.

The instruments range from very prescriptive regulatory interventions to tools such as various degrees of self-regulation. Some of these alternatives are familiar to most countries, OECD and developing alike. For example, the comprehensive tobacco control regime recommended by the United Nations combines 10 different instruments.[16]

Different instrument mixes can have very different effects. The OECD has for many years examined instrument mixes in environmental policy and found there are a number of good arguments for using a mix of instruments.[17]

There is little doubt that the skill of regulators in a country in identifying and designing efficient mixes of instruments can greatly affect the benefits and costs of regulation. Designing an effective instrument mix requires a set of regulatory governance skills, such as regulatory impact asessment.

Endnotes

1. For examples of stand-alone regulatory policies, see for example those developed by the UK and Dutch governments, available from www.berr.gov.uk and http://www.rr.nl
2. See for example the work on regulatory agendas in Canada developed by Bruce Doern at http://www.policyresearch.gc.ca/page.asp?pagenm=2009-0014_06
3. The role of and experiences with central regulatory reform units is explored in detail in a separate paper under the BRG Program. See www.ifc.org/brg
4. World Bank (2006). *Improving the Investment Climate: an Evaluation of World Bank Group Assistance*. Washington.
5. Raymond Mallon. *Creating Better Business Environments for Enterprise Development; Asian and Global Lessons for More Effective Donor Practices*. Asia Overview Paper, Asia Consultative Conference, Bangkok, 2006.
6. UK National Audit Office (2007). Evaluation of Regulatory Impact Assessments 2006-07, Report by the Comptroller and Auditor General , HC 606 Session 2006-2007 | 11 July 2007.
7. Private conversation with Scott Jacobs.
8. Richard Record (2007), *Lessons from Malawi's Experience Attempting to Reform the Business Environment*, Presented at the Africa Regional Consultative Conference on the Business Environment, Accra, Ghana, 5—7 November 2007.
9. OECD (1997), Regulatory Impact Analysis: Best Practices in OECD Countries, OECD, Paris. The good OECD practices cover a range of issues: maximize political commitment for RIA, integrate RIA as early as possible in the decision-making process, use RIA for existing and new regulation, communicate RIA results, use a flexible methodological approach, develop and implement data collection strategies, allocate responsibilities for RIA program carefully, train the regulators, to involve the public extensively, and target RIA efforts to the most important regulations.
10. See www.ifc.org/brg
11. See www.ifc.org/brg
12. Independent evaluation of Kenya's business licensing program commissioned by the World Bank Group Investment Climate Advisory Services (ICAS) (not published).
13. GTZ (2006). Facilitator's Manual. Local Red Tape Reduction To Improve the Business Climate. Version 1.1: 20 June 2006.
14. OECD (2007). *Cutting Red Tape: National Strategies: Policy Brief.* January. Paris.
15. IFC (2004). *Good Practices for Business Inspections: Guidelines for Reformers.*
16. The instruments are (i) higher taxes (excise); (ii) smoking bans (workplace, places open to the public), (iii) advertising bans (direct, point of sale, indirect), (iv) bigger, stronger warning labels; (v) packaging restrictions (descriptors, colors); (vi) product regulation (TN ceilings, ingredients); (vii) cessation programs (industry funded); (viii) youth smoking prevention programs and laws; (ix) counter-advertising and restrictions (denormalization), and (x) litigation (internal document disclosure). Source: Japan Tobacco Inc, private communication with Scott Jacobs.
17. "First and foremost, many environmental problems are of a "multiaspect" nature—in addition to the total amounts of releases of a certain pollutant, it can, for example, also matter where emissions take place, when they occur, how a polluting product is applied, etc. Secondly, certain instruments can mutually underpin each other—as when a labelling scheme enhances the responsiveness of firms and households to an environmentally related tax, while the existence of the tax help draw attention to the labelling scheme". Source: OECD (2007), *Instrument Mixes for Environmental Policy*, Paris

5 Regulatory Governance in Developing Countries: Application and Experiences

This section discusses the application of regulatory governance tools and approaches in developing countries. It does so by first putting forward the "traditional" arguments for and against applying these tools and approaches beyond OECD countries. There is no parallel debate about whether these tools are appropriate in OECD countries, since there is already wide acceptance of their necessity. The section then summarizes a review of (the limited) actual experiences in developing countries, including case studies and reviews carried out as part of the BRG Program. Section 6 discusses the implications of this analysis and reviews if and how developing countries should invest more in regulatory governance tools.

5.1 Concerns About Capacities and Relevance

The relevance of the regulatory governance framework to development is sometimes questioned, particularly when needs such as building roads and hospitals seem more urgent. Some have stated that the regulatory governance framework is a "rich country luxury" that developing countries should postpone until they get the fundamentals of governance and markets right. Given the difficulty of sustainably reducing the overall costs of bad regulation, the long period needed to change highly resistant governance practices, and the lack of evidence of results in some countries, investments in these kinds of reforms seem better spent elsewhere. Others argue that firms operating in developing countries have adapted to the distortions and costs of regulation, and therefore these impacts are not critical constraints on growth and firm performance. Others argue that the real constraints on growth are often non-regulatory, such as in the capacity of firms to transit to the formal sector and to seize opportunities for growth, and that regulatory reform is useful only when carefully designed to fit the constraints and capacities of businesses in that market.

5.2 Scenarios of Doing Nothing

Others believe that experiences of countries in transition to a market-based economy persuasively demonstrate that poor regulatory practices are a powerful drag on all other development efforts. They believe that regulatory reform offers a needed strategy for managing the economic and social risks of restructuring and more intense competition, while correcting pervasive distortions and inefficiencies that reduce the incentives of companies in domestic markets to compete and innovate. They point to the fact that the concepts and tools of regulatory governance have been developed over 25 years in at least 30 countries, and that a large body of evidence has accumulated in countries with very different levels of income, institutions, and reform contexts that shows the robustness of the concepts to a wide range of situations. Because modern concepts of regulatory reform balance public protection with the performance of economic actors, recent regulatory reforms are claimed to affect not only the *quantity* of growth, but the *quality* of growth in countries that must balance economic and social goals in the rapid changes of economic restructuring. Finally, they argue that the main constraints on development today are microeconomic in nature, that regulation is a primary microeconomic tool of governance, and therefore any bottom-up development strategy based on firm-level performance must include the practices and policies of regulation to succeed.

Waiting for regulatory governance can be costly, in this view, because regulatory reform is an overarching governance reform affecting all other reforms. In this view, regulatory practices will magnify the successes of other policy reforms or, conversely, reduce or even nullify their benefits. It is unlikely that a country has developed an effective state, competitive markets, and strong regulatory governance separately, or sequentially—they surely all develop together, whether coordinated or uncoordinated.

5.3 Context Matters, But Developing Countries Show Regulatory Problems Similar to Those in OECD Countries

It may surprise some that, even in very different legal cultures and development phases, regulatory failures follow common patterns across countries. All over the world, many regulations cost too much, deliver too little, serve narrow interests, and survive beyond their useful age. They also have interactive effects that reduce benefits and amplify costs, fail to keep pace with rapidly changing social needs, markets, and technologies, and are implemented unpredictably. Business surveys show the same kinds of complaints about regulations, whether the business is in Kent, New York, Limpopo, or Zhejiang, although the frequency might differ. Each government exhibits its own unique mix of regulatory problems, but the basic problems are well-documented and repetitive across the world. This suggests that regulatory failures are based in common structural elements of regulatory systems, and, positively, suggests that solutions that work in one country should be considered to address similar problems in other countries.

It is that similarity of regulatory problems that enabled consensus in the 1990s and 2000s around regulatory quality standards across the extremely different regulatory cultures, and that drive much of the internationalization and regulatory reform dissemination today.[1]

For that reason, regulatory management tools and systems seem relevant and badly needed in developing as well as developed countries.[2]

Despite the similarity in regulatory problems, it also clears that country context matters for the results of regulatory reform. The evidence suggests that the economic benefits of regulatory reforms are indeed highly determined by context.[3] This logic suggests that, while the reform tools might be similar, the real effects of those tools on national economic performance depends on the specific conditions in each country. The question is whether developing countries would show greater or lesser effects than OECD countries. Arguments go both ways.

Some have suggested that, since effective institutions are crucial in the success of regulatory governance, countries with weaker institutional capacities would gain less from these reforms. On the other hand, evidence also suggests that countries that are further from "good practice" have more to gain from regulatory reforms. We cannot reach a definitive conclusion, but no one advocates that OECD solutions be shifted wholescale to developing countries. A reasonable response to this challenge is to ensure that the national regulatory policy adopts only those tools and solutions that are well adapted to local conditions.

5.4 Potential Impact of Regulatory Governance Higher in Developing Countries

It is a reasonable assumption that the gains of reform are greater where inefficiencies are higher. The potential impact of efficiency-producing reforms is likely to be more significant for developing and transition countries undergoing rapid transitions to market-led growth than for developed countries. This is not because developing countries regulate more than developed countries, but because they often regulate against the market. They also implement more poorly, and economic restructuring in their economies is proceeding more quickly, increasing the costs of outdated regulatory policies. Many developing countries relied for decades on development strategies of heavy government intervention and protection. Today, they are hampered by a heavy legacy of outdated and archaic rules and regulatory habits dating back decades, much of which represent governing and economic policies that have evolved or been abandoned. Another reason is that when regulations are implemented through governance systems where the rule of law and public sector performance are weak, they can produce a business environment that is high cost and high risk, whatever their policy content.

In developing and transition countries where regulatory environments create high barriers to market entry and competition, moving to market-friendly regulation seems to significantly add to growth performance, as in the case of China and India.[4] Regulatory reforms in South Korea that eliminated almost half of government regulations that created barriers to trade and investment were predicted to boost real GDP growth by 8.57 percent over 10 years.[5] Least developed countries, particularly in South Asia and Sub-Saharan Africa, have the least business-friendly regulations covered by the *Doing Business* indicators, and therefore presumably the most to gain from regulatory reform.[6]

Another common argument for why regulatory reform is more important in developing countries is the *Doing Business 2005* finding that rich countries regulate less in the areas covered in the *Doing Business* report. The report concluded that regulatory costs are higher in developing countries. However, this argument does not seem correct when the totality of regulation is considered. The finding is probably an artifact of the narrow range of regulations measured in the indicators. Regulatory costs for businesses arising from stringent social regulations and relatively high compliance rates are probably much higher in OECD countries than in most developing countries. The argument that seems more persuasive is that the quality of regulation and its implementation in developing countries is lower than in OECD countries, and so regulatory reform would produce higher benefits.

Another argument is that faster regulatory adaptation is more valuable in the fast-changing market environment in developing countries. The quality of government regulation is even more important during the difficult transition from state-led to market-led growth strategies. In such transition periods, legal and regulatory regimes grow rapidly, in most cases without quality controls and mechanisms to ensure that the new and larger regulatory bodies and higher volumes of regulation actually achieve their goals at acceptable costs. The expanding regulatory state, containing a mix of market and interventionist policies and cultures, can either support or hinder investment and growth.

Finally, the importance of regulatory governance tools for improving the effectiveness of government policy in areas such as risk management should not be neglected. A national regulatory reform strategy is far more than a defensive strategy to prevent abuse of regulation—it is also about the effective use of regulation to carry out public policies. In many countries, development has raised concerns that important quality issues have been neglected, and that there has been widespread failure of regulation to effectively protect consumers, human health and safety, environmental quality, worker standards, and other public interests. In all of these areas, regulation has become the dominant tool of governance around the world. The only realistic way for governments to effectively respond to these concerns is to build an effective and modern regulatory system that can design and implement regulatory governance.[7] Hence, the challenge is not to regulate less as a general strategy, but to regulate better where regulation is needed.

It is also likely that regulatory reform strategies focusing on "cutting red tape" are not politically attractive and sustainable over the medium to long run. Political programs with a more positive message focusing on regulatory benefits and quality can be easier to use as a platform for the permanent task of improving a country's regulatory performance.[8]

5.5 Reviews of Experiences and Results

Two reviews of developing country experiences with regulatory goverance reforms were prepared as part of the BRG. This section reports on the main results of the reviews.

Expert papers about reform experiences and results

The first review analyzed regulatory reform results as reported by experts and policymakers in 43 papers at two conferences of the Donor Committee for Enterprise Development: a 2006 International Conference in Bangkok, Thailand, and a 2007 International Conference in Accra, Ghana.[9] The review and approach was motivated by the assumption that donors, policymakers, consultants, and other stakeholders would use the opportunity to present noteworthy results and experiences.

Our review focused on how results of regulatory governance reforms were evaluated and reported, and whether those results supported the recommendations to carry out the same reforms in other countries. The review did not go further into the issue of whether, having documented results, the reports established a causal relationship between the reforms and results.

At the Bangkok Donors Conference and Accra Donors Conference, 43 papers dealt with business environment reforms relevant to the regulatory governance agenda. Almost all of these papers were prepared by either the people who financed the work or people who delivered the work, and so the authors presented mostly success stories. The selection of papers was done using a peer-review process with prior defined criteria. It is interesting to summarize how these papers presented results.

- Of the 43 papers, 26 concluded that a specific reform in a specific country was successful in improving the environment for business performance. Of the 26, only 12 presented any specific evidence to support that conclusion. Of the 12, six of those presented intermediate outcomes of reforms such as the number of procedures eliminated or the number of days saved, rather than final outcomes such as effects on businesses. Only six of the 26 papers claiming success presented any evidence of actual business impacts (the causality of those impacts is a question not clearly addressed in most of the six). Most of the other 14 papers that claimed success based their conclusions on evidence that the reforms were proceeding according to an action plan, without evidence of results.
- Of the 43 papers, a majority, 33, concluded that the reforms discussed were so successful that they should be applied generally in other countries. However, such a recommendation would require the most rigorous of evidence. Of these 33, only seven presented any evidence of results in terms of impacts on market actors of the recommended reform. Three other papers used intermediate outcome indicators, such as the number of days reduced or number of regulations.
- Only two of the 43 papers concluded that the reform studied was ineffective. This astonishing success rate is likely due to self-interest (authors were mostly people who financed or implemented the projects).
- Six papers did not state conclusions because the reform was still underway.

Table 1: Summary of Results Reported in 43 Papers on Regulatory Reform

	Number of papers out of 43
Papers claiming that specific reforms were effective:	26
Of these, without any evidence	14
Of these, with intermediate or business-related outcome level evidence	12
Papers claiming that reforms of this kind should be used in other countries:	33
Of these, without any evidence	23
Of these, with intermediate or business-related outcome level evidence	10

Several kinds of evidence were used to measure results of these projects. Table 2 below shows, out of 13 total papers with some kind of evidence, the type of evidence. Some papers used multiple kinds of evidence, so the total adds up to more than 13. It is interesting that only 2 papers out of the 43 papers reported results as economic outcome data in specific sectors affected by reform. This kind of targeted data, if it occurs on a logical time schedule, seems persuasive that reforms actually produce market results. User surveys of affected businesses also seem a reasonable approach.

Table 2: Claims of Success in Regulatory Reform- Evidence Provided

Type of evidence	Number of papers out of 13
Statistical economic performance	1
Anecdotal	1
User surveys	2
Case studies	3
Economic outcome data in specific sectors affected	2
Other project specific information collection (unspecified)	1
Benchmarking with similar reforms in other countries/regions—not project specific	4
Citation to general research on similar reforms—not project specific	3
Intermedaate outcome level results (number of procedures reduced, fewer days for paperwork)	6

However, most of the papers resorted to evidence not specific to the actual project (benchmarking with similar reforms in other countries/regions or citation to general research on similar reforms) and to intermediate outcome indicators (number of procedures reduced, fewer days for paperwork). These latter kinds of intermediate outcome indicators represent a kind of reasoning in which it is already assumed that certain reforms will produce market benefits.

These findings are supported by other studies. A 2004 review of the DFID activities in the enabling environment concluded "Current evaluation and progress reports offer scant information to determine impact and there is a clear need to strengthen monitoring and impact tracking aspects of enabling environment,"[10] and the situation seems not to have improved. A 2006 review of 10 years of FIAS experience with reducing administrative burdens found almost no documentation of the impacts, but some results in intermediate outcomes of reform programs:

> *"The impact of FIAS work in producing tangible benefits in the market is poorly documented and is likely to be considerably less than desired due to implementation weaknesses in client countries. FIAS work has had, however, impressive results in mobilizing and stimulating reform capacities that were blocked by lack of information or the paralyzing dynamics of interest group politics. Almost every client country where FIAS has worked used the FIAS review to launch a process involving inter-ministerial initiatives and new forms of public-private dialogue. Client countries appear to take action on an impressive 50 percent of FIAS recommendations, and some 20 percent appear to be adopted in law within the three years after FIAS reports are published. Yet not everyone benefits. A significant portion of FIAS clients suffer from failed reform efforts and lack of sustainability."*[11]

The question is what kind of results analysis is needed? Most experts seem to support a kind of book-end approach—better bottleneck diagnostics at the beginning and better market impact evaluations at the end. Mallon[12] calls for more and deeper initial diagnostics of bottlenecks unique to each economy, before designing business environment reforms. He also calls for donors to "ensure frank, independent evaluation of major donor programs... Independent peer reviews (especially of methodology) would help ensure credibility of the evaluation studies." He advises that "Internal evaluations can be seen as an opportunity to prepare promotional material aimed at sustaining program activities"—but it is clear that internal evaluations were, in fact, often used in the conference papers to support claims of success. The FIAS review concluded that "Institutionalizaton of results monitoring" would be useful, since "Results monitoring that is integrated into the reform process from an early stage seems to sustain political and bureaucratic attention to the reform process."

Five Case Studies of Regulatory Reform in East Africa

A second review examined the regulatory reform capacities and how design features and capacities had influenced reform outcomes in five East African countries: Kenya, Uganda, Tanzania, Rwanda and Zambia. The review generally demonstrated the relevance and potential of regulatory governance tools and approaches, and identified key constraints in getting results from these tools. The review reached several conclusions.

First, the challenges facing each of the five countries when they introduced good regulation practices were far more extensive than those facing OECD countries. Most of the OECD countries already had well-developed legal and policy-making systems with qualified and experienced civil services and with established and long-standing relationships between various levels of government. Good regulatory practices could be grafted onto systems that were already functioning reasonably well, yet the OECD experiences have shown that system-wide regulatory reform is a long-term project measured in years or even decades. However, as already noted, each of the East African economies reviewed is involved in a wide range of challenging reforms that is being introduced at the same time—civil service reform, e-government initiatives, decentralization and devolution reforms, anti-corruption programs, legal and judicial reforms, land reforms, and general improvements to the macroeconomic and microeconomic environments facing businesses.

Managing these programs and ensuring coordination between them, so that they are supportive of each other, has not been easy in any of the countries. The addition of new approaches to policymaking, derived from a "good regulation" agenda, does not appear to make the task any easier. A clear consequence of the broad and interlocking nature of reforms is that substantial efforts are needed to widen the range of ministries that actively champion regulatory reform and to develop a capacity within government to provide guidance to the reform process in the long term. In particular, it would be beneficial for the countries to establish an overall regulatory policy as a coordinating role: currently, none of the five governments have developed explicit overarching regulatory policies, in spite of the fact that regulatory reform has been part of overall reform for several years. The investments in regulatory reform could yield more payoffs with a more consistent and coordinated strategy, and that is the point of the regulatory policy.

Second, a great deal of attention must be paid to "getting incentives right" within a regulatory reform program. A "campaign" approach can be sustained for only a relatively short while. In each of the East African countries, regulatory reform has been championed at the highest political levels, up to and including the president. This has signaled the general seriousness of the governments in pursuing reforms. However, the actions of leading decision-makers within the government have not matched the public commitment to regulatory reform. A commitment to evidence-based decision-making and consultation with all stakeholders that is introduced into individual regulatory areas has to be supported by clear and broad adoption of such an approach by the champions themselves. In the case of Uganda, incentives for lower-level staff in the ministries to promote the regulatory reform agenda are significantly weakened by the fact that, in several high-profile cases, the evidence-based decision-making process was replaced at crucial times by purely political considerations.

Moreover, commitment at the highest political levels has to be supported by sustained and consistent follow-up activities at the policy and technical levels. Again in Uganda, the impetus for regulatory reform is seriously weakened by the failure of the Cabinet to institutionalize and provide resources for a Better Regulation Unit. This appears to have reduced enthusiasm in lower-level agencies and staff for regulatory reform in their own areas of responsibility. In Tanzania, the Better Regulation Unit has so far become more of a project management facility geared to procurement, financial reporting, and donor reporting for a range of specific regulatory reform areas, rather than being resourced to provide expertise, incentives, and skills for the development of a better regulation system.

In addition, incentives for regulatory reform should be part of broader public sector and civil service reforms, including anti-corruption and e-government, that are geared to improving the quality of public services and the responsiveness of civil service staff and processes to the population's needs. In Kenya, the government introduced a performance contract system for ministries that required the ministers and permanent secretaries committing their agencies to specific performance standards and deliverables. To date, little progress has been made in "disaggregating" these deliverables to lower levels of the ministries. In addition, the extent to which this performance contracting can be relied on to improve the quality of regulatory performance is unproven.

Third, the countries in East Africa continue to face challenges in building institutions for regulatory reform. Kenya, Uganda and Tanzania have established "Better Regulation Units" that are formally given responsibility for promoting better regulation procedures in general and for introducing regulatory impact assessment methods in particular. There are proposals under consideration within the Rwandan and Zambian governments to do the same. As indicated, these institutional developments are hampered by the fact that the BRUs have been given other responsibilities, as in Tanzania, or have not been resourced at levels commensurate with their responsibilities, as in Uganda. Perhaps too much has been expected from these units, given that they have not been supported by active political support that can continually reinforce the government's strategic commitment to reform.

Fourth, efforts to introduce RIA methods have not proceeded smoothly. The one area where progress has been made in all five countries is consultation procedures. These procedures were introduced for reforms well beyond the regulatory arena—all five countries have, for example, produced long-term "vision" statements involving intensive and inclusive consultations within government and with business and civil society groups. Much work remains to be done in including groups that do not have ready access to the government and in educating all parties in how to conduct consultation, but the principle of consultation that is an essential element of RIA is accepted and is being implemented.

Less progress has been made in the area of analysis of options and cost benefit calculations. The entry point of regulatory reform has been licensing systems in all the five countries (in the case of Tanzania, the entry point has been wider, involving land and labor regulations also), and RIA as a technique has not been broadly applied. The effort to measure costs has been limited to application of the Standard Cost Model, where calculations have been possible to date only through use of heroic assumptions. Efforts to introduce RIA in Uganda and Tanzania were characterized by a large gap between good RIA practice and what is feasible in a data-poor economy. Feasible techniques for developing or approximating data have not been introduced. What is missing has been a step-by-step strategy for moving towards best practice, without raising the bar too high in the short-term and thereby discouraging application of RIA techniques. Such a strategy is necessary to support the role of RIA in framing the policy options and allowing effective discussion among interested parties.

Finally, the experiences of the five countries, insofar as they have completed regulatory reform projects, suggest that monitoring and evaluation components should be designed at the beginning of the reform, both to ensure creation of a baseline against which the reforms can be evaluated and also to provide a framework for development of relevant information for more effective cost-benefit calculations in future programs. Care is needed in designing monitoring and evaluation frameworks that are geared to determining how reforms actually affect efficiency and effectiveness, rather than geared to monitoring information that is required by donors supporting these programs. The information gathered from the papers presented at international conferences suggests that most monitoring is indeed mostly an exercise designed for internal progress reports.

5.6 Conclusion

Is regulatory governance a luxury or a necessity for developing countries? In answering this, it is valuable to note first that, in any case, regulatory reforms already run through many sector and policy reforms in developing countries, and are already heavily influenced by OECD experiences. This was noted in the review of East African countries. Many of these policy or sector specific reforms—such as utility reforms, company law, business registration, environmental policy, judicial reform, and trade policy—incorporate aspects of regulatory governance, such as building new institutions or building new capacities in regulatory staff, based on principles of effectiveness, efficiency, and transparency. Similarly, the Doing Business agenda is focused on reducing the costs of several process-specific indicators. Stakeholder consultations are planned on a variety of specific projects and reforms. Hence, on the broadest level, the question is moot. Some levels of regulatory governance reforms are needed and many are already advanced (the bottom-up approach). It might be useful, however, to better inform these individual projects with the tools and lessons from regulatory governance in general to ensure their sustainability. The lessons from East Africa show that better coordination through a general regulatory policy might improve results.

The question should be more precisely phrased as: ***Should developing countries adopt and implement a government-wide program of regulatory governance?*** This is reform on a bigger scale, requiring more political and administrative reforms, than the individual sector and policy-specific reforms. Hence, such systemic reform is more costly, and more prone to failure. Can a government proceed with a bottom-up approach, rather than take on regulatory governance as a government-wide matter? It is clear that reforms that are too small and uncoordinated do not have much effect on the commercial environment of private firms, and so there is a limit to the bottom-up approach. But perhaps a big and coordinated bottom-up approach might work. However, a coordinated approach seems to resemble a regulatory policy, that is, regulatory governance. So the difference between effective bottom-up and top-down approaches might not be so different in practice.

The question posed in the preceding paragraph, though, supposes that the right answer is either "yes" or "no." However, the right answer seems to be more nuanced. Hence, the question might be again rephrased: ***What kind of regulatory governance strategy would produce the best results in a particular developing country?*** This question seems the right question, because it allows us to respond to the country context without supposing a general answer that is equally applicable to all countries.

Can we answer the question at all? It is clear that many reformers are over-promising results, or, more precisely, promising results without knowing if they are over or under-promising. Evidence linking particular regulatory governance reforms to changes in market performance or to government policy effectiveness is thin in OECD countries, and practically absent in developing countries. Even for easier reforms, such as cost-cutting, the direct evidence is slim. One reason for this is the difficulty of such analysis as previously described, but the main issue is the lack of effort by reformers to integrate monitoring and evaluation into program design. There is ample room for more investment in evaluation in order to learn from reforms. Weak evaluation means that countries might be doomed to repeat the same mistakes over and over, based on the same incorrect advice from international donors.

But the available evidence supported by logic allows us to propose an answer. It seems clear that some preconditions apply to systemic reforms, such as a political economy that can push reform against strong resistance, and a center of government capable of implementing cross-government reforms. These preconditions can be better identified to determine where systemic reforms have a good chance of success. But these conditions can be found in a great many developing countries that have adopted difficult reforms: fiscal management, anti-corruption, decentralization, market-opening, and transitions to market-led growth. Indeed, as Kenya and Vietnam demonstrate, these other reforms can lead naturally to regulatory governance reforms as a practical way to implement the changes already promised.

Hence, one possible conclusion is that regulatory governance is not a stand-alone reform, but can be seen as a means of implementing other major policy commitments such as opening markets and creating jobs. The kind of regulatory governance that works best in a developing country is the kind that allows the government to deliver on its priority commitments for change. This answer deflects charges that investments in regulatory governance take resources away from other important reforms, and demonstrates that investments in a targeted program of regulatory governance actually increase results from other important reforms. Indeed, it could be argued that regulatory reform is an integral part of establishing effective governments and markets.

Another possible answer is found in the review of East African countries. Some systemic reforms, such as consultation, appear to be either easier or more adaptable than other reforms, such as RIA. Perhaps a sequenced approach that focuses step by step on a multi-year program, as defined in a national regulatory policy, would be better than the current scatter-shot approach, where some reforms from OECD countries are adopted and others are not, without clear rationale. Again, like the preconditions, a clearer sequence and the relation of specific tools to specific outcomes would help reformers design a more context-specific program.

Endnotes

1. See for example the 1995, 1997 and 2005 OECD principles for regulatory reform, and similar principles endorsed by all APEC countries in 1999.
2. A counter-argument heard in response to earlier drafts of this paper is that OECD countries can operate regulatory reform programs because they have strong governance capacities, which some see as a pre-condition for regulatory reform. Countries without strong governance will fail at regulatory reform. This argument is certainly right in part, because reform is more difficult when governance is weaker. But this argument presents a kind of simple binary view of the world in which some countries are able to reform, and others are not, while the true picture is much more of a range in which different mixes of reforms fit a range of governance capacities. That complexity is what this report tries to capture.
3. For example, the OECD has argued that the overall effects of regulatory reform depend on the size of the different shocks and the adjustment potential of the economy. The impact of productivity gains on output and employment depends, in principle, on how efficiency improvements translate into higher wages. According to this view, the economy-wide effects of productivity, employment, wage and profit shocks depend on the degree of real wage flexibility in the long run.
4. Crafts, Nicholas (2006), "Regulation and Productivity Performance." *Oxford Review of Economic Policy*, Oxford University Press, Vol. 22, No. 2, p. 197.
5. Byung Ki Ha (1999), *The Economic Effects of Korea's Regulatory Reform* (in Korean), KIET, Seoul. (in Korean).
6. Djankov, S., McLiesh, C. and Ramalho, R. (2006). *Regulation and Growth*, World Bank, Washington, March.
7. This paragraph is from a forthcoming (2010) book on regulatory reform, The Practice of Regulatory Reform, by Scott Jacobs, to be published by Edward Elgar.
8. Ladegaard and Djankov (2008). *World Bank Group Review of the Dutch Administrative Simplification Programme: Follow-up Monitoring and Analysis*, Washington DC.
9. The Donor Committee for Enterprise Development is a gathering of many of the funding and inter-governmental agencies working for sustainable poverty alleviation through development of "the private sector." See http://www.enterprise-development.org
10. DFID. 2004. A Review of DfID Activities in the Enabling Environment, p. 7.
11. FIAS (2006).
12. Raymond Mallon. *Creating Better Business Environments for Enterprise Development; Asian and Global Lessons for More Effective Donor Practices*. Asia Overview Paper, Asia Consultative Conference, Bangkok, 2006. He recommends that "Donors should cooperate to ensure coordinated efforts to provide substantive analysis of BE issues, rather than each donor funding separate (and less substantive) country studies."

6 Looking Ahead: Should We Invest More or Less in Regulatory Governance Tools?

This section brings together the findings of the report to try to answer the threshold queston of if and where to "invest"—politically and financially—in regulatory governance reforms. The section also examines possible reasons that results of many regulatory reforms are unclear, non-existent or not measured.

What can we expect from continued investment in regulatory governance? The set of reforms to governing instruments, procedures, policies, and institutions that are, collectively, grouped as "regulatory reform" is still developing as a strategy of development. As understanding of the nature of the regulatory environment has deepened, reforms have become progressively broader, more institutional, and longer-term, that is, more difficult, and less suitable for small and short-term projects.

Experiences with applying these tools are mixed but it is disappointing that we do not yet have clear evidence of their value in developing countries. Regulatory reform is, in this sense, in the mainstream of Private Sector Development (PSD) reforms in that there is general disappointment with most PSD results in developing countries.

Yet donors invest large sums. The OECD estimated in 2006 that its donors spent about 15-20 percent of official development aid on efforts to support improvements in the business environment at the macroeconomic, enabling environment and enterprise level.[1]

As investment in regulatory governance continues, it is time to ask for better evidence of results. The last decade has seen an increasing exposure of regulatory governance tools to developing countries. More rigorous assessment of what has been learned will enable us to draw tentative conclusions and recommendations on whether developing countries should invest more or less in these tools. In other words, have reformers just "talked the walk" without doing the policy work required? Or did they actually "walk the talk" only to find that the regulatory governance strategies are inferior to other development strategies in generating growth and development?

Donors, for their part, exhibit great enthusiasm for more business environment reforms involving regulatory reform. Almost all of the papers presented at the last Accra Donor conference in 2007 concluded with "lessons learned," even if there is no evidence of results, and almost all of these lessons advise the reader to generalize from a single country or a single reform and to carry out similar reforms in other countries. Many of these "lessons" are of dubious value. It might be advisable to stop writing about "lessons learned" until we have really learned.

As discussed below, the lack of evidence of results is a constraint on designing the next generation of regulatory governance reforms. Some kinds of regulatory reforms—such as producer and consumer reactions to liberalization and re-regulation of the "public" utilities—are extensively studied, and results are fairly well known. Yet the links between many specific regulatory reforms and regulatory governance tools, on the one hand, and the response of firms in the market, on the other, are unclear, as is the link between specific regulatory reforms and the efficiency and effectiveness of government. Even where there is good data from OECD countries, the extrapolation to developing countries has been challenged, due to the different impacts that institutions, markets, and other contexts might have on determining the results of different kinds of regulatory arrangements.

Hence, while there is broad agreement on the need for some kind of regulatory reform, the economic results of specific regulatory reforms, while sometimes spectacular, are too often disappointing or at least unsubstantiated.

Another question is whether regulatory reforms, even if they are successful as measured by the micro-indicators of the reform project itself, are meaningful, that is, do they sustainably improve the business environment so that firms perform better, or improve the performance of government in protecting public interests? Hence, even when success in meeting reform goals is claimed, the value of the reform might still be questioned.

This section examines some possible reasons that results of many regulatory reforms are unclear, either non-existent or not measured. Possible reasons include: incorrect conceptual frameworks, incorrect reform designs, ineffective implementation strategies, poor application of evaluation and monitoring methods, and unavoidable risks during the experimentation in the development phase of an emerging discipline.

1. The concepts and tools in the regulatory governance framework seem to be relevant to developing countries but application requires more attention to context.

The previous section concludes that regulatory governance reforms are likely to be relevant to developing countries when they are linked to other government priorities, when certain preconditions are in place, and when the design of the reform is context specific. It is not, however, possible today to resolve this debate definitively, partly because regulatory governance involves a range of different cost-cutting, competition-inducing, institition-building, and good governance reforms, and each kind will be supported or critiqued with its own body of evidence. Some reforms will be supported by evidence, and others will not. Some reforms will likely work well in some situations, and others in different situations. Hence, there will never be a global answer about regulatory governance. The likely answer is, "It depends...." The next question is, "On what?"

There is insufficient evidence to substantiate that most regulatory reforms have actually improved firm-level performance or government effectiveness. More and better-designed evaluation and monitoring, particularly of the results of cost-cutting reforms and regulatory governance tools, is needed to document results and sustainability. This point is discussed in more detail below.

Most observers can probably agree that some regulatory reforms are producing better results than others, and that it is worthwhile to know more about which is which, and their conditions for sustainable success, so that future investments are progressively better targeted, designed, and more cost-effective.

2. Application of the concepts and tools of regulatory governance, even when accepted as relevant, is not well enough understood by governments and donors. As a result of poor design, some reforms are vulnerable to failure.

Even if the concepts of regulatory governance are relevant and well-supported for developing countries, designing an effective reform program that is both feasible under tight time and resource constraints, and sustainable in changing enduring regulatory practices, is extremely difficult.

Three kinds of errors in the design phase seem to be prevalent.

First, the size and complexity of the regulatory system are not always understood or appreciated. Many times, reformers define the regulatory problem as one of too many regulations or regulatory costs that are too high, and then develop a list of bad regulations or procedures to improve or eliminate. Once the list is addressed, the reform is considered to be a success.

But this kind of reform produces limited results. These "listing reforms" focus entirely on regulatory *instruments*, which are the product of the regulatory *system*. The fact that these regulations emerge from a system that is fully capable of replacing them and has enduring incentives to make even more in the future, is frequently missed. This mistake is akin to tackling fiscal reform by cutting the costs of

BOX 6

Focus on Systemic Approaches to Reform

Excerpts from papers presented at the Asia Regional Consultative Conference, "Creating Better Business Environments for Enterprise Development - Asian and Global Lessons for More Effective Donor Practices," November 2006, Bangkok

- "Losers from reform will resist reform at all stages. Broad-based support needs to be actively sought to address this resistance... Measures need to be introduced and institutionalized to improve quality control over new regulatory and policy documents."—*Raymond Mallon. Creating Better Business Environments for Enterprise Development; Asian and Global Lessons for More Effective Donor Practices*.
- "These returns tend to be neither quick nor telegenic. To maintain the necessary momentum for regulatory and administrative reforms and to fend off populism from pressure groups, donors have to engage on a long-term basis and to support all stages of the reform process. In the past, donors too often went for the "easy option."—*Ulla Keppel, Le Duy Binh, Julius Spatz. Streamlining Business Registration and Licensing Procedures: Experiences from the Philippines and Vietnam*
- "Some administrative improvements can be made even within the most constraining legal frameworks. However, good practice is to make a comprehensive overhaul of the law, as was done in Vietnam."—*Le Quang Manh, Bui Anh Tuan, Nilgun F. Tas (2006) Lessons Learned in Sustaining Business Registration Reform in Vietnam*
- "OSS reform needs to be complemented with broader regulatory reform at local and national levels."—*Liesbet Steer, Business Licensing and One Stop Shops in Indonesia*
- "Development can only take place if the different action levels - the enterprise level issues, the sector specific business environment and macro framework - are being seen in a systemic relation."—*Peter Richter. Value Chain Promotion and Business Environment Reforms: Experiences from Sri Lanka*
- "Market-oriented reforms become sustainable reforms only when they were institutionalized into the machinery of government and constituencies for change were mobilized and included in policy processes. Reforms were more successful when governments built progressively wider networks of reform-minded institutions through the public administration."—*Scott Jacobs, Broad Reform of the Business Environment: Drivers of Success in Three Transition Countries and Lessons for South Asia*
- "Any regional economy is shaped by a variety of different aspects which all impinge, in one way or the other, on the potential for local employment generation. If these aspects are addressed in an isolated, standalone manner, one may not be able to remove all growth barriers and unleash the economy's full potential."—*Rolf Speit, Chambers of Commerce and Industry as Key Drivers of Change for Local Business Reform? Methodology and first Experiences from Mongolia.*

a few line items in the budget. Where reforms touch only instruments, the reforms cannot address the root causes of regulatory failures.

The regulatory governance agenda is based on the notion that complex systems are self-correcting, and only by changing the rules inside the system can its behavior be changed.[2] The fundamental regulatory reform challenges faced by most governments are rarely marginal or related to very specific rules and regulations. The problems are often related to deficiencies imbedded in institutions and administrative practices.

Even where the systemic nature of regulatory failure is accurately perceived, the regulatory reform agenda covers such a wide range of problems that seem so deeply entrenched in government that, as noted above, reformers often pick "low hanging fruit" and hope that good practices are institutionalized later. There is little evidence that such easy pickings lead to hard reforms. This is not a new conclusion. The World Bank's 2006 evaluation of its own work on the investment environment found that "Modest, piecemeal efforts have been less successful than a comprehensive set of reforms." As evidence accumulates, the reform community seems to be swinging away from easy and short-term reforms to more systemic regulatory governance reforms (**Box 6**).

Second, a problem in the design phase is the over-use of other-country models that are exported to the reforming country. Regulatory reform is mostly an institutional reform that is highly contextual. Because the principles of good reform design tailored to a specific context are not well enough developed in this field, reformers sometimes choose a country program that seems successful and imitate it without adequate understanding of its preconditions. This practice has been roundly discouraged in development, but can be seen in regulatory reforms.

Third, the time period allowed for reform is sometimes unrealistic given the cultural and institutional issues to be addressed. Some reforms, such as a pilot RIA project, are purely technical and can be accomplished in short order. But others, such as mainstreaming RIA in policy processes, cannot be effective without changing longstanding behaviors and deeply entrenched incentives, and combatting inertia and outright resistance. Most donor projects for regulatory governance are 2-4 years, which is time enough to sell and implement new ideas, and to finalize focused reforms, but not time enough to integrate new behaviors into institutions, or to sustain change.[3] Pilots are often seen as precursors to wider reform, but time horizons of projects sometimes do not allow pilots to be exploited over the medium-term.

There seems to be considerable uncertainty about the appropriate timeframe needed to get good results. Of the 20 papers dealing with some aspect of the regulatory governance agenda at the 2007 Donors conference in Accra, two-thirds did not present any clear timeframe for when recommended reforms might produce results.

These kinds of problems can be viewed either as "teething" problems that are natural in the development of innovative reform strategies, or as evidence of the inherent difficulty and undesirability of the regulatory governance agenda.

3. Even if regulatory governance reforms are well designed and conceived, implementation of these reforms on the ground is difficult, resource intensive, and often ineffective.

Implementation failures might explain much where reform results are disappointing. Implementation is hard work, and the most risky stage of reform because it involves a wider group of institutions, some of which might not fully accept the change. Sustaining the influence of reformers and political champions during a lengthy implementation phase is difficult, as is mobilizing the resources needed to get the job completely done. Because of the inherent institutional character of many regulatory failures, and the prevailing culture of regulation that lies behind enduring regulatory practices, implementation of reforms can be quite difficult, controversial, and resource intensive.

It is here that recommendations are most often made. Reports on reforms often call for the need to sustain public-private dialogue, institutionalize change, mobilize allies, maintain political interest, and so forth.

However, implementation remains a continual challenge, and there is no generalized framework that demonstrably improves success. Some reform programs are not consistent in timeframe, strategy, or resources to implement sustainable regulatory reforms. Others work valiantly, but are reversed by strategic behavior among interest groups who prefer the status quo. In general, the role of incentives in the old and new systems is not adequately analyzed in reform strategies. At the prominent international conference in Bangkok in 2006,[4] only 5 of 23 papers on issues relating to regulatory governance mentioned incentives in the public sector as an issue, and most of those only in passing. Hence, new procedures are usually placed on top of old and contrary incentives, surely a recipe for disappointment.

4. Evaluation and monitoring of regulatory reforms should be built in from the very beginning.

Methods to assess the impacts of regulatory governance on growth and development are either not well used or not well suited to these kinds of projects. At the project level, there is little data even about reforms completed in the past few years. This is in part a result of poor program design and in part a lack of rigor in reporting on results.

Another reason for the lack of good evaluation data for the regulatory governance agenda in developing countries is that the goals of reform are too narrowly drawn by conventional databases. In fact, the regulatory governance agenda pursues a variety of goals important to development—macroeconomic, microeconomic, intermediate reforms, good governance, and the rule of law, cf. Section 3. There seems to be a range of relevant challenges with developing better indicators on each of them, cf. Annex 1.

It would seem a minimal expectation that projects to improve regulation would have an evaluation component built in from the very beginning, with clear performance indicators and measurement techniques.

5. RIA is hard to implement, but holds promise as an effective tool to embed a more empirical and transparent decision process in the policy machinery of government.

It is nearly impossible to regulate well if the consequences of government action are not understood in advance, and that is the main purpose of RIA. RIA mandates have been adopted in various forms in at least 50 countries, with more every month. A recent addition is Vietnam, which began a new RIA regime in January 2009 that should eventually produce some 400 RIAs each year.

Some believe that experience is demonstrating that useful RIA can be done almost everywhere if the techniques are clearly understood and adapted to suit the policy priorities, and capacity and information constraints, of the government. Others believe that RIA is so difficult, evidenced by the fact that even most OECD countries are struggling to improve the quality and relevance of their RIAs, that developing countries cannot hope to implement useful RIA, and should abandon the idea.

The question that must be asked is this: If not RIA, what? How can governments get control of their regulatory systems to instill a higher level of quality, however defined?

There is no question that RIA is hard to implement. Integrating the use of RIA in a policy-making process that lacks elements such as good consultation procedures, a culture of openness, and an understanding of how to use empirical analysis in policy processes is challenging, because it ultimately becomes a top-down reform. So far, results in most countries have been more disappointing than successful. However, the same could be said of many governance reforms, such as adoption of modern budgeting systems. Most agree that even weak budgeting systems are better than no system at all.

RIA is new to most countries, and it is clear that time is needed. RIA is a transformational reform, that is, it aims to affect how regulators think about their role, introduce new actors into policy procedures, and foster more open and competitive policy dialogue that, in the long run, is intended to improve the quality of regulatory content, design, and implementation. RIA is a policy process requiring a cultural shift in the perception of policymaking towards a significantly more transparent and empirically based approach than used in most countries. The impact of RIA in changing information and power structures also means that it is one of the most resisted of reforms.

Several issues merit examination. First, the design of RIA programs sometimes seems to emphasize the precision of analysis rather than the role of RIA in fostering better use of information and public debate to improve regulatory decisions. The debate about cost-benefit analysis often presents an academic view of RIA based on complex analytical methods that bear little resemblance to RIA as it is actually done even in the most advanced RIA countries. The practice of RIA almost always involves a practical mix of qualitative and quantitative information, and good qualitative information is always preferable to highly uncertain quantitative data.[5]

If RIA is seen merely as an analytical method that must produce precisely quantified impacts, it will surely fail, and indeed that is not the criterion for successful RIA in even those countries that have the longest experience with this process. The question is how to design a RIA system that examines the right issues, uses qualitative and quantitative methods that are feasible, fosters transparency and consultation, and systematically distinguishes worse options from better options.

6. The institutional arrangements needed to promote regulatory governance reforms cannot be divided into "rich" and "poor" methods.

One of the main arguments made for why reforms that have been successful in OECD countries are not relevant to developing countries is that institutional capacities are different. This argument can be rebutted only with good evidence of results of regulatory governance tools in different administrative environments in countries at different stages of economic development. To some extent, this evidence is already available, since OECD countries exhibit a wide range of development phases, legal arrangements, and institutions, and the OECD principles have been applied in non-OECD countries as well. But the OECD range, while wide, does not stretch to all developing countries.

Development of an institutional strategy is a critical part of the regulatory governance agenda, since, in a regulatory system, it is the institutions that are the main determinants of the quality of outputs (regulations and implementation). Hence, the main variable of interest for effective and sustainable change is the incentives, capacities, and relationships among institutions.

OECD countries provide a general framework for some institutional reforms. The OECD agenda is a very flexible tool that has been implemented in many different ways across the highly varied national situations in the OECD. Both among OECD countries and developing countries there are very different governance capacities. Rather than a bright line between OECD and developing countries, there is a considerable overlap in governance capacities between countries at different phases of institutional development. As the adoption of modern budgeting methods across the world shows, governance techniques cannot be divided into "rich" and "poor" methods. And, as implementation of the OECD agenda demonstrates, country-specific adaptation is needed for developing countries as much as for OECD countries.

For example, one of the lessons validated by many successful regulatory management systems is the benefit of a "single unit" or regulatory oversight body at the centre of government, usually located in the Prime Minister's Office, the Ministry of Finance or as a semi-independent statutory body within the Executive. The advantages of a dedicated body spearheading regulatory reform across the whole of government are predicated on an assumption of clearer accountability structures and stronger incentives for the officials working in such units.

A strong regulatory oversight body seems to have clear advantages compared to many other or looser arrangements to drive the regulatory reform agenda with the executive. However anecdotal evidence suggests that other institutional arrangements may provide the same kind of day-to-day leadership of reform within government, but with a more flexible involvement of different officials from a number of key agencies. This set-up could come in the form of task-forces with representation of key ministries or virtual units within one ministry drawing upon different staff on a part-time basis depending on the task requirements. Among the possible advantages of a more "networked" approach to leadership of a government's regulatory reform agenda are a higher degree of reform ownership with more officials.

7. Transparency mechanisms can be used more effectively to create incentives towards better regulatory practices.

Transparency mechanisms such as consultation and publication of RIAs are among the most powerful tools to discipline policymakers towards greater compliance with principles of regulatory quality. If promotion and improvement of transparency mechanisms are to boost the results of regulatory governance reforms, more careful work and evaluation is needed in this area. Experience indicates such mechanisms should play a more prominent and early role during regulatory governance reforms, possibly at the expense of other tools.

One of the most impressive achievements of the *Doing Business* indicators is the power of information in defining a problem and mobilizing action. Many reforms today are focused on providing better information both to businesses and to government through mechanisms such as media, public-private dialogue, publication of information, new IT tools such as e-registries, and other means.

These information strategies are claimed to improve the business environment. However, while the role of information in launching and sustaining reforms is a subtheme in many case studies, there is as yet no clear framework for what information is most useful, and when and how it is used.

Each of these seven conclusions could be disputed, and further nuanced, but together they present a manageable challenge to transforming regulatory governance into a practical and valuable toolkit for developing countries. None of the challenges and solutions is unfamiliar to reformers in developing countries. The basic solution to improve the results of regulatory governance reforms is the design of a step-by-step systemic reform that addresses the scope of the regulatory "problem" but in its sequencing and pace is realistic in the context of the implementing government. Comprehensive and broad-based reforms may appear a first-best solution but require significant inputs in terms of political will and reform resources. Lacking those inputs in the short-term, reform might be more successful with an initial targeting of high-priority regulatory regimes with visible and short-term benefits for key stakeholders. This could be incorporated into a clear and deliberate strategy to institutionalize and incentivize good regulation practices over the medium term. Regulatory governance reforms in developing countries are unlikely to be as successful as advocates hope, or as impractical as critics claim, but the centrality of regulation to so many development agendas means that regulatory governance in some form is unavoidable. With better concepts, design, implementation, and evaluation, there is substantial potential for getting better results out of these investments.

Endnotes

1 OECD (2006). *Promoting Private Investment for Development: the Role of ODA*, Paris, p. 12.

2 The links between regulatory governance, New Institutional Economics, and New Public Management should be obvious here.

3 The OECD has argued that donors 'need to change the way they do business if they are to be effective in supporting improvements in the business environment. In particular, OECD argues that internal systems should not work against staff pursuing longer-term and riskier interventions. OECD (2006). *Promoting Private Investment for Development: the Role of ODA*, Paris.

4 Asia Regional Consultative Conference, "Creating Better Business Environments for Enterprise Development - Asian and Global Lessons for More Effective Donor Practices."

5 Jacobs has called current RIA methods "soft benefit-cost analysis" because qualitative and quantitative information are presented together. Scott Jacobs (2006). *Current Trends in Regulatory Impact Analysis: The Challenges of Mainstreaming RIA into Policy-making*, at www.regulatoryreform.com/Publications-Reports.htm.

Indicative Challenges for Regulatory Governance Indicators

The goals of regulatory governance fall into five categories, cf. Section 3 of this report. The status and challenges of establishing governance indicators on each of them is briefly discussed below.

1. Macroeconomic: Many of the indicators attempt to correlate patterns of regulation with economic indicators across countries. These indicators measure the total effect of many regulations, rather than the outcomes of a reform project. Surprisingly, there are few attempts to correlate changes in national regulation with national economic performance over time.

2. Microeconomic: For individual projects, impacts might be seen more precisely and more quickly in the specific businesses or activities that were affected. However, very few evaluations of regulatory governance have looked at impacts at sector or firm levels. Firm-level surveys might be a good method for this, as might measurements of firm activities. A good example of the latter method in linking intermediate reforms, such as easier property registration, with actual enterprise behavior, is in the *Doing Business 2007* report, which said that Argentina experienced a 47 percent increase in investments after properties were formally registered. However, since context matters, the same result might not be seen in other countries using the same reform, which emphasizes the importance of project evaluation, rather than assuming results. An evaluation method presented at the Accra conference by UNIDO[1]—an "investment monitoring platform" designed to "facilitate monitoring the dynamics of investor activities, at the national, regional and sub-sector levels"—seems better suited than general indicators to assess impacts of specific regulatory reforms.

3. Intermediate results, such as fewer licenses or lower business costs. Commonly used measures in OECD countries, such as through the Standard Cost Model, or in developing countries, such as measures used by Doing Business, are to measure intermediate impacts such as fewer regulations and faster procedures. These measures are a step, or two, removed from actual business performance, and sometimes their relevance to actual commercial incentives is unclear. In particular, attempts to reduce the number of items—regulations, licenses, steps—without accounting for actual cost-savings to businesses is suspect, since it is easy to chop down a few bushes without creating a path through the jungle. However, such measures are easier to measure. The BRG program has stressed the need for good baseline measures: "Good Business Enabling Environment (BEE) baseline measurements must be linked to what governments can effect through their policies, they must be representative or at least indicative of the business environment, easy to communicate, and technically feasible."[2]

4. More effective government policies: In developing countries facing unacceptable risks of human health and safety and the environment, the benefits of the regulatory governance agenda could include better policy outcomes. Simplifying and streamlining regulations would also have an impact on public policy outcomes by improving compliance rates in the business sector. The same is true for anticorruption impacts of the agenda. The social benefits of these kinds of impacts could be very large, and the social costs of inappropriate deregulation and regulatory cost-cutting could also be large.

5. Good governance, dialogue, and political economy: Some regulatory reforms are aimed at building the capacity of governments to address investment environment problems facing the country through stakeholder dialogues and democratic processes. For example, in Nigeria, investment climate reforms were designed to address "a breakdown in public-private trust" during the "transition from military to democratic governance."[3] Other reforms are aimed at reducing opportunities for corruption, which should, in theory, increase returns to investment for honest firms, making formality more attractive.[4] Yet this area should be approached cautiously, since many "governance" projects aimed at "fostering public-private dialogue," to use a popular example, have had no discernible results in actually improving market conditions.

6. Democracy and rule of law: The regulatory governance agenda might also be evaluated in terms of its effect on strengthening the institutions of democratic governance—respect for law by both state and society, empowering democratic processes such as stakeholder participation, improving accountability for performance, and so forth. The institutional aspects of these reforms might have a value beyond short-term effects on regulatory costs.

Endnotes

1. UNIDO (2007) *Using firm-level survey data to monitor and enhance the effectiveness of technical assistance to improve the business environment in Africa*. Investment Promotion Unit, United Nations Industrial Development Organization, Vienna, Austria.
2. Tony Polatajko (DFID) and Peter Ladegaard (FIAS) (2007) *Regulatory governance for Growth (BRG) - Improving the Governance Framework for Investment Donor Committee for Enterprise Development.* Presented at the Africa Regional Consultative Conference on the Business Environment, Accra, Ghana, 5–7 November 2007.
3. Peter Mousley and Catherine Masinde (2007) *Business Environment Reform in Nigeria. Design and Implementation Experience 2002-2007,* Paper Prepared for the SME Donor's Committee Conference on "Creating Better Business Environments for Enterprise Development" Accra, Ghana, November 5-7th, 2007.
4. Researchers differentiate between the economic impacts of corruption that is organized to reduce uncertainty, and corruption that adds to investment risk. The latter tends to have strong adverse impacts on economic growth. See Chapter 7 of World Bank (2006) *An East Asian Renaissance. Ideas for Economic Growth*. Washington DC., reported in Mallon (2006).

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December 2009, Pre-Release copy