

# Maximizing the Benefits of Regulatory Reform: Factors for Success

**Significance:** Building efficient regulatory structures is the pillar to create a business-friendly environment. Incentives to trigger investment and economic growth will produce better results if regulatory inefficiencies stemming from obsolete, unclear and badly designed regulations are significantly reduced. International experience shows that thriving reformers share similar underlying factors for successful regulatory reform.

**Analysis:** Although reform can entail short-term transition costs, the benefits of efficient regulation reform tend to be far greater in the medium and long term:

**Benefits.** International evidence shows that efficient and transparent regulations have a positive impact at macro and micro levels<sup>1</sup>:

- **Economic growth.** Regulatory reform has been estimated to increase the level of real GDP in several OECD countries, ranging from 1% in the US to 5 and 5 ½% in Japan, Germany and France<sup>2</sup>.
- **Export competitiveness,** supported by efficient trade liberalization reform, transformed Hungary and Mexico from inward-looking to successful export-oriented economies<sup>3</sup>.
- **Investment, both domestic and foreign,** responds positively to an effective regulatory framework that provides credibility and certainty to the private sector<sup>4</sup>. South Korea's FDI inflow increase resulting from regulatory reform was estimated at US\$36.5 billion between 1999 and 2003. Trade growth in Hungary was accompanied by a dramatic increase in FDI – during the reform decade Hungary attracted over one-third of all FDI in Central and Eastern Europe<sup>3</sup>.
- **Expansion of private sector activities.** The contribution of the Mexican and Hungarian private sector to the GDP reached nearly 90% and 85%

respectively by the end of the 1990s, higher than the ratio for many OECD countries<sup>3</sup>.

- **Increased labor productivity.** A study concludes that economic deregulation in five sectors increased labor productivity in OECD countries ranging from 0.5% in the US to 3.5% in Germany<sup>2</sup>.
- **Enhanced competition.** The opening of port operations to multiple parties in Uruguay increased firm productivity by 300%<sup>5</sup>. In Chile, deregulation of entry into the long-distance telephone market cut rates by 50%<sup>6</sup>.
- **Reduced business costs.** Inefficient regulation in port operation contributed to implicit tariffs of 5 to 15% on all Latin America exports<sup>6</sup>. A survey highlights that managers spent between 10 and 30% of their time managing process regulation, incurring costs in the range of 5 to 15%<sup>7</sup>.
- **Public goals** such as consumer protection and environmental quality can be reached through efficient reform. Modern regulatory reform focuses on the 'quality' of the regulation to guarantee that public policies are not compromised. Cutting costs and maximizing economic benefits while meeting public goods are the guiding principles in modern reform practice.

**Costs.** Regulatory reform can be associated with short-term job losses

and reduced government's revenues, though evidence shows mixed results:

- **Short-term employment losses** can occur in sectors with low levels of productivity and efficiency. However, there is evidence that early job losses can be compensated in the longer run as reforms breed entrepreneurialism and formal employment. In Hungary the job losses during the transition shock (1989-1992) were offset by the employment creation of a thriving SME sector by the mid-1990s<sup>3</sup>. In South Korea the 1998 deregulation was estimated to create more than one million new jobs between 1999 and 2003<sup>8</sup>.
- **Reduced government revenues** can occur when reform targets regulations created for revenue purposes (e.g. some business licenses). These license fees can be an important source of revenue for local governments. Yet evidence shows that reform aiming at streamlining licenses, eliminating those that are unnecessary or redundant, can have a pull effect on potential new users – e.g. informal firms – hence increasing the coverage of the revenue base. Local authorities in Kenya reported an increase up to 33% of revenues after the introduction of a single business permit<sup>9</sup>.

### Factors for successful reform.

Countries have taken different approaches to regulatory reform based on their intrinsic economic, social and institutional structures. There are however underlying factors that have contributed to reform success in most countries:

- **A supportive macro-economic environment.** In an unstable economic environment it is rather unlikely that the government will prioritize regulatory reform over macro-economic stability.

- **Political will** has been vital to the success of regulatory reform in Hungary and Mexico<sup>3</sup>. Political support resulted in clear mandates, allocation of resources and the creation of a dedicated reform agency staffed with by high-quality civil servants.
- **Anchoring reform to international agreements** has served as a stimulus for governments to tackle reform quickly. Trade agreements with the EU and NAFTA helped Hungary and Mexico respectively push their reform agenda<sup>3</sup>.
- **Adapting best practices to local conditions**. In Hungary international models were adapted using the existing legal and administrative frameworks to implement change<sup>3</sup>.
- **Creating an independent dedicated reform agency**. Ideally comprised of influential, skilled technocrats with direct access to the highest levels of policy making, this agency should have the authority to promote regulatory reform, to monitor progress, and to assess the quality and quantity of regulations using cost-benefit and cost-effectiveness principles. In South Korea the Regulatory Reform Commission (RRC) was created to maintain a consistent set of principles to control regulatory quality. In Mexico the government created executive units in key ministries to overcome entrenched resistance to reform<sup>3</sup>.
- **Designing and implementing compensation mechanisms**. Getting the support of interest groups opposed to reform may require a good mix of mechanisms such as compensatory resources for short-term losses, training for rapid relocation in the market place, and prior involvement of labor groups in the design of the reform process. Mexico is a good example of the efficient use of specific adjustment programs during privatization and trade liberalization, though fiscally expensive<sup>3</sup>.

**Challenges.** Countries that aim to reform are likely to find many obstacles – from a resistant bureaucracy to a weak institutional setting – that can either slowdown the reform process or simply bring it to a halt:

- **Picking the right reform model.** The top-down approach has had an impressive impact in several countries including South Korea and Mexico, though critics state that the lack of involvement of local governments in the implementation stages has often diluted the effectiveness of reform. The bottom-up approach has proved to have lesser impact as ‘quick fixes’ or isolated regulatory amendments may not trigger changes in the mind-set of the bureaucracy. Evidence shows that changes to individual regulations can be meaningless in over-regulated economies.
- **Linking reform to the broad policy agenda.** Radical reform could undermine popular support if it conflicts with other national policies, permitting opponents to question its legitimacy.
- **Building effective regulatory structures.** Regulations can be changed in a relative short period of time, but strengthening the regulatory institutions that implement reform and monitor the quality of regulations needs more time and requires the government’s continuous support.
- **Quick wins and long-term impact.** ‘Quick wins’ may be used for pro-reformers to gain momentum and sway skeptics’ opinion at early stages in the reform process. Yet governments should be aware that regulatory reform tends to produce results in decades.
- **Cost-benefit analysis and monitoring.** As each individual regulation has a cost-benefit balance, a government should be able to know the expected costs and benefits of its actions. Many countries, including Mexico, lacked a cost-benefit analysis prior to setting the reform agenda, leading to misperceptions of the impact of reforms in the monitoring phase<sup>4</sup>. A regulatory impact assessment (RIA) establishes the baseline and performance measures that can assist in later evaluation<sup>10</sup>.

## References:

- <sup>1</sup> World Bank, 2004. Doing Business in 2004: Understanding Regulations. World Bank and Oxford University Press: Washington DC.
- <sup>2</sup> Blöndal S., and Dirk Pilat, 1997. The Economic Benefits of Regulatory Reform. OECD Economic Studies No. 28, 1997/1, Paris.
- <sup>3</sup> FIAS, 2006. Case Studies on Reform Implementation Experiences: Regulatory transformation in Hungary, Mexico and South Korea. Draft for discussion. Washington DC.
- <sup>4</sup> Kirkpatrick C. and David Parker, 2005. Towards Better Regulation? Assessing the Impact of Regulatory Reform in Developing Countries. Paper prepared for the CRC workshop 22-24 June 2005, University of Manchester, UK.
- <sup>5</sup> Guasch J. Luis, 1996. Lessons for Port Reforms, in J. Luis Guasch and Leandre Amargos, eds., New Port Policies in Latin America and Caribbean. New Press: Barcelona.
- <sup>6</sup> Guasch J. Luis, and Robert Hahn, 1999. The Costs and Benefits of Regulation: Implications for Developing Countries, The World Bank Research Observer, vol. 14, no. 1, (February): 137-158.
- <sup>7</sup> World Bank, 1997. World Development Report 1997: The State in a Changing World. Oxford University Press: Washington DC.
- <sup>8</sup> Ha, Byung Ki, et al., 1999. The Economic Effects of Korea’s Regulatory Reform. KIET (in Korean)
- <sup>9</sup> Kelly R., and Nick Devas, 1999. Regulation or Revenue? Implementing Local Government Business License Reform in Kenya, Development Discussion Paper No. 723, Harvard Institute for International Development.
- <sup>10</sup> Jacobs, S., and Irina Astrakham, 2006. Effective and Sustainable Regulatory Reform: the Regulatory Guillotine in Three Transition and Developing Countries. Paper prepared at the World Bank Conference: Reforming the Business Environment: From Assessing Problems to Measuring Results, 29 Nov – 1 Dec, 2005, Cairo.

For further information, contact:

Manuel Albaladejo  
 fpd\_id@worldbank.org  
 Ph. 62 21 5299 3000  
 Fax. 62 21 5299 3111

Financial & Private Sector Development  
 World Bank Office Jakarta  
 Jakarta Stock Exchange Building  
 Tower 2, 13th floor  
 Jl. Jenderal Sudirman Kav 52-53  
 Jakarta 12190, Indonesia

Please visit our website:  
<http://www.worldbank.org/id>

This note reflects the views of the author and not necessarily those of the World Bank