The Efficacy of Regulation in Developing Countries

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January 2003

United Nations

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I. Introduction

The receding role of direct state intervention, coupled with a consensus on private sector-led growth and development, has led to a reduction in economic regulation of industries. Most developing countries have undertaken liberalization and privatization as a first step toward free market regimes, though progress has been uneven. At the same time, whereas the promised benefits, in terms of economic growth, have been considerable, these have been limited to a few countries. Why has deregulation not worked for all?

This paper presents the argument that for economic deregulation to be effective, it must be set within a holistic regulatory framework which supports the efficient functioning of free-market enterprise.

The objective of this paper is to obtain a better understanding of the extent and type of regulation in developing countries and the surrounding policy, institutional, and legal environment within which an economy functions. Using data from recently conducted surveys about regulatory constraints on private sector firms, the paper presents a comparative analysis of 30 economies grouped according to their level of economic development. To put the regulatory burden into perspective, the paper subsequently constructs quantitative indices to measure the policy and institutional constraints on the overall 'enabling environment' which are an important determinant of the efficient functioning of the markets. In doing so, it identifies key areas where states need to design high-quality regulation.

II. Why deregulate?

All states regulate. From rules and laws governing trade, banking, and education to hazardous material, health standards and so on, the state rules on what will be produced, how it will be produced and often who will be the beneficiary of what.

The focus on the linkage between regulatory issues and economic growth is relatively new. The globalization of the world economy, associated with the transnational revolution in information, technology and trade in the past two decades, has ushered in a strong emphasis on models of sustainable economic development based on free-market enterprise. The importance of competitiveness and competition in the global market place has led to a need for establishing the incentive and regulatory framework which would provide the enabling environment for the market forces to thrive.

An efficient and competitive private sector forms the basis of the current development paradigm for achieving sustainable economic growth. Liberalization and deregulation provide the necessary environment for the private sector to function efficiently. Deregulation or re-regulation aims at improving competitiveness and efficiency by ensuring that the free-market principles are not distorted. Deregulation seeks to stimulate competition, protect consumers against monopolies and create an enabling environment for greater competitiveness in the domestic and the global market. Economic deregulation supports development by removing barriers to entry, reducing regulatory and administrative burdens on businesses, creating new business opportunities that support employment generation, and fostering opportunities for greater trade and investment.

The economic benefits of deregulation and regulatory reform are substantial. In Europe, labour productivity grew twice as fast in those manufacturing sectors most affected by competition-enhancing reforms of the Single Market Programme, compared to other sectors.[1] The benefits are not limited to a

[1] The OECD Report on Regulatory Reform. http://www.oecd.org/EN/documents/0,,EN-documents-2-nodirectorate-no-4-no-2,00.html

sector but are economy wide. According to the OECD, the formation of the Single European Market increased European Union's (EU's) income by an estimated 1.5 per cent from 1987 to 1993.[2] For individual countries, the projected benefits of deregulation range from 0.3 per cent of GDP for Germany to 5.5 per cent for Australia.[3]

A. Regulatory reform in developing countries

Most developing countries have adopted liberalization and privatization as the cornerstone of the strategy for private sector development. Issues of regulatory reform in the developing countries have ranged widely from deregulation or re-regulation (to improve existing regulation) in some, to establishing new regulatory structures and mechanisms, in others.

Most deregulation and regulatory reform has taken place at the sectoral level. In many developing countries electricity, telecommunications, transportation, agriculture and banking have been subject to economic deregulation in the form of reducing or dismantling barriers to entry or exit, streamlining licensing and tariff laws, and price and wage controls. Liberalization and deregulation in the utilities sector in the developing countries have led to both efficiency gains and lower consumer prices. For example, deregulation of the entry into the long-distance telephone market in Chile cut rates by 50 per cent. In several Asian and Middle-Eastern countries (e.g., Egypt, Jordan), deregulation and greater private sector participation in telecommunications have led to increased competition and lower consumer prices. Within the framework of regulatory reform, liberalization and deregulation should be seen to be the first steps towards a regulatory reform.

However, the extent and form of regulation has differed from country to country**.** Moreover, where successful, regulation has been complemented by others reforms aimed at enhancing the efficiency of the private sector, and overseen by the regulatory body. For instance, evidence from South Asia indicates that even though sectors in different countries have deregulated at differing speeds, establishment of effective regulatory agencies with clear roles, autonomy, accountability and transparency have been conducive to establishing more effective regulatory governance.[4, 5] Lessons of experience suggest that where institutions are weak, the key to a successful regulatory reform is to focus the regulatory agenda and adapt the available tools to fit the institutional capability of the country.[6]

Though many developing countries have made considerable progress in the reform of economic regulation systems in the last decade, the increasing globalization of trade, finance and technology has given rise to significant challenges in this area. Most economies have witnessed the swift growth of private sectors, a dramatic increase in foreign capital flows and rapid evolution of financial markets and instruments; however, some have found it difficult to align economic governance strategies to the changing global realities. Economic regulatory frameworks, as formulated and applied so far, have not always stimulated adequate participation in economic development activities.

Strategies for successful deregulation for the developing countries focus on defining the macroeconomic context for an effective regulatory regime, enhancing the quality of regulatory institutions and the

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[2] Ibid.
[3] Robert Kahn. 'Reviving Regulatory Reform: A Global Perspective'. AEI-Brookings Joint Center for Regulatory Studies. Washington D.C., 2000. p. 12.
[4] Asian Development Bank. 'Private Interests vs. Public Good: Governance Dimensions of Regulatory Frameworks for Private Sector Infrastructure Development'. http://www.adb.org/Documents/conference/Seminar_Governance/default.asp
[5] Regulatory Governance is the state management of the process of liberalization, deregulation and regulatory reform. It encompasses traditions and institutions by which a state exercises its authority for achievement of the goals.
[6] 'The State in a Changing World'. The World Bank World Development Report, 1997. p. 71.

capacity of the state to design high-quality regulation. In this context, measurement of the burden of regulation becomes a first step.

III. The measurement of state regulation

Regulation is the set of laws, decrees, rules, practices or government formalities which govern the political economic and social domain. *Economic or market regulation* is that subset which governs economic transactions and interactions between the various stakeholders in a market place. These focus on setting prices (e.g., for electricity); and entry into the market place, i.e., business license regulation; and financial regulation which regulates the conditions for banks and financial intermediaries, such as the exchange rate regulation.

In the decade of the 1990s, issues of trade and investment, access to World Trade Organization (especially as they related to reducing tariff and non-tariff barriers) diversification of the economic base, and of sustaining and promoting exports led most countries around the world to reduce the burden of sectoral economic regulation and strengthen free market regimes. However, as states reduced the burden of economic regulation, many imposed regulation to promote social policy goals, with considerable costs to the economy. *Social regulation* aims at correcting market imperfections and improving environmental, and health and safety standards as the means to enhancing welfare. Led by the United States of America, there was a substantial rise in social regulation all around the world, but most notably in the developed countries. For example, in the United States of America the costs of social regulation tripled from $80 billion in 1997 to $267 billion in 2000.[7]

Whereas effective economic and social regulation aim at improving economic efficiency and promoting social welfare, nevertheless all regulation, imposes costs. These take the form of management of the regulatory compliance and are termed *process or administrative regulation*.[8] The paperwork cost of regulatory compliance can be substantial. For example, of the total $542 billion in regulatory costs in the United States of America (9 per cent of GDP in 1991 dollars), $189 billion were the costs associated with the paperwork and implementation of regulations.[9]

A. Data and methodology

To measure the extent of regulation, recently available data from the World Bank Business Environment Survey (WBES) 2000 dataset was employed. The WBES surveyed over 10,000 firms in 80 countries from 1999-2000. The Survey asked 40 core questions with several subsets of questions within each of the six thematic areas. The thematic areas were quality and integrity of public services; rules and regulations; bureaucratic red tape (including corruption); predictability of policy; financial sector services and corporate governance; and general constraints affecting business enterprise functioning. For example, the Survey asked firms to rate the extent to which tax regulation affected the growth and operation of their business, whether labour laws were a major factor affecting their business operations, and so on.

For this paper, a subset of data specifically related to the regulatory constraints was extracted for 30 countries from the World Bank dataset. The variables related to regulation encompass business licensing, custom regulation, labour regulation, foreign exchange regulation, environmental regulation,

[7] 'What is Regulation?' Regulation.org. http://www.regulation.org/whatisreg.html

[8] Robert Kahn. 'Reviving Regulatory Reform: A Global Perspective'. AEI-Brookings Joint Center for Regulatory Studies. Washington D.C., 2000. p. 7.

[9] Thomas Hopkins. 'Costs of Regulation: Filling the Gaps' Report prepared for Regulatory Information Service Center, Washington D.C., 1992.

fire regulation and tax administration regulation. Individual responses by firms in each country were tabulated and transformed into country indices. The '*index of regulatory burden*' was arrived at by assigning relative weights. Another subset of data was employed comprising several policy, institutional and political environment variables to proxy for the enabling environment. A similar *index of* '*enabling environment*' was constructed.

A high score indicates a high burden of regulation, while the opposite is true for a lower score.

The countries are grouped as low, middle and high-income countries according to their level of economic development and based on their GDP/capita. According to the World Bank classification, low-income countries are defined as having a GDP/capita of less than \$760; middle-income \$761-9,360; and high-income more than \$7,960. The choice *within* a group is arbitrary reflecting i) maximum coverage across regions; and ii) an attempt to include a country with the least number of void data entries.

A word of caution in interpreting the data.

First, although the sample size is large as is the set of countries surveyed, the scores are likely to inherit a bias stemming from the country-specific cultural context. The use of common criteria provides comparability across countries, but the ratings still depend on the interpretation of the criteria and the subjective perception of each respondent. For example, a response regarding corruption will reflect the prevalent cultural perspective of what is considered corruption.

Second, the answers to survey questions are the views of entrepreneurs about the quality and effectiveness of government regulation and institutions in their own country. As such, inherent among them is a value judgement.

Third, the survey questionnaire does not allow for the difference between 'no regulation' and 'effective regulation'. In both instances, the score or the perceived burden of regulation would be low but the source of this perception could be widely different. For example, if a country's score on fire regulation appears to be a 'low constraint' on business effectiveness, it is unclear if this because there are not many fire regulations in place to comply with or that such laws are devised and managed so effectively that the burden is minimal. Another explanation could stem from a systemic acceptance of avoidance of such regulation in the country concerned.

Fourth, the survey cannot capture the impact on responses stemming from differences in political regimes which may constrict the ability and perception of respondents. It is conceivable that in some countries the attitudes towards policy instability, corruption, or street crime may be downplayed.

Notwithstanding, the survey is the most comprehensive set of data which allows for a firm level of comparison of constraints on businesses across a large number of countries worldwide.

B. The extent of regulatory burden

Table 1 below presents the quantitative results of the measurement of the extent of regulation by country. Columns 1-7 show the country scores by sector. The index of 'regulatory burden' is presented in column 8.

Table 1. The measurement of regulatory burden

	Business License	Customs	Labour	Foreign Exchange	Environment	Fire	Tax Administration	Index	Rank
Weight	0.2	0.2	0.2	0.1	0.05	0.05	0.2		
Low-income countries									
Armenia	1.65	1.82	1.14	1.84	1.62	1.24	3.48	1.946	4
Azerbaijan	2.02	2.11	2.03	2.02	2.06	2.16	3.17	2.282	12
Cameroon	1.98	2.72	2.39	2.39	2.00	1.78	3.50	2.545	26
Cote d'Ivoire	2.09	2.78	2.14	2.20	1.85	1.87	3.44	2.497	23
Ethiopia	1.47	2.54	1.74	2.47	1.48	1.45	3.10	2.164	7
Ghana	1.82	2.38	2.16	2.34	2.17	2.08	2.85	2.287	14
India	1.92	2.51	2.82	2.22	2.26	1.81	2.91	2.456	21
Indonesia	2.32	2.14	2.02	2.34	2.03	2.27	2.93	2.330	16
Kenya	2.33	2.57	2.15	1.57	1.84	1.66	3.26	2.394	17
Madagascar	1.96	2.77	1.79	2.39	2.10	1.77	3.60	2.458	20
Pakistan	2.81	2.86	2.69	2.44	2.41	2.25	3.29	2.808	29
People's Republic of China	1.84	1.82	1.70	1.63	1.70	1.64	2.43	1.887	3
Thailand	1.97	2.37	2.56	2.31	2.33	2.19	3.22	2.481	22
Average	*2.01*	*2.41*	*2.10*	*2.17*	*1.99*	*1.86*	*3.17*	*2.245*	
Middle-income countries									
Argentina	2.35	2.32	2.95	1.39	2.04	1.98	3.68	2.599	27
Brazil	2.73	2.61	3.46	2.51	2.35	2.18	3.88	3.014	30
Chile	2.28	2.00	2.47	1.77	2.69	2.02	2.73	2.309	15
Egypt	2.20	2.71	2.36	2.20	2.15	2.17	2.80	2.449	19
Estonia	1.44	1.66	1.72	1.13	1.73	1.67	2.88	1.822	2
Georgia	2.05	2.09	1.86	1.57	1.89	1.78	3.69	2.278	11
Hungary	2.13	1.76	1.96	1.40	1.90	1.61	3.47	2.180	8
Malaysia	1.88	2.00	2.26	1.93	1.96	1.72	2.14	2.033	5
Uruguay	2.10	2.44	2.42	1.24	1.70	1.77	3.56	2.402	18
Venezuela	3.09	2.86	2.97	1.89	1.82	1.98	3.13	2.790	28
Average	*2.23*	*2.25*	*2.44*	*1.70*	*2.02*	*1.89*	*3.19*	*2.246*	
High-income countries									
Canada	1.84	2.01	1.82	1.74	1.80	1.56	3.04	2.084	6
France	2.57	2.00	2.55	2.03	1.98	1.99	3.57	2.538	24
Germany	2.15	2.16	2.84	2.02	2.49	2.36	3.33	2.543	25
Sweden	1.59	2.01	2.73	1.63	2.23	1.74	3.13	2.254	10
Singapore	1.30	1.47	1.82	1.38	1.38	1.40	1.99	1.593	1
UK	1.92	1.90	2.59	1.83	2.43	2.01	3.00	2.286	13
US	2.07	1.87	2.32	1.69	2.55	2.28	2.95	2.253	9
Average	*1.92*	*1.92*	*2.38*	*1.76*	*2.12*	*1.90*	*3.00*	*2.144*	

Note: A low score indicates less regulatory constraints, while a high score indicates more regulatory constraints. Scores range from 1-4 with 1 = regulations 'no obstacle' and 4 = 'major obstacle' to the operation and growth of business.

Source: Data from *The World Bank Business Environment Survey 2000 dataset.*

The aggregate average burden of regulation is the least among the high-income countries on a comparative basis and increases progressively as income per capita declines. Chart 1 depicts this comparative relationship graphically. For individual countries as well, the extent of regulation is generally lower in high-income countries. There appears to be an inverse relation between regulatory incidence and income per capita. This is due to the fact that the high-income countries have deregulated economic industries to a greater extent than others. A lower score also indicates that the perceived constraints on businesses in high-income countries are less. In other words, the regulatory framework is more efficient. It should be noted that these scores focus on the regulatory burden stemming from the entire regulatory process and not just the laws. As such, they capture the efficiency of regulations as well and not just the impact of their magnitude. For example, it is conceivable that two countries, A and B, may have identical regulation governing a sector, but the systemic implementation in country A is far superior to that in country B. In such a case, the regulatory burden score in country A will be far less than that in country B.

Across all countries, tax administration is the greatest constraint (Chart 2). The average scores of all countries rate tax administration and regulation as a moderate or major constraint. For the other categories, economic regulation is a greater burden in low and middle-income countries, whereas high-income countries have more social regulation. As expected, business licensing, customs and foreign exchange regulations are more of a constraint on low and middle-income countries, while environment, labour and fire regulation are the major impediment among the high-income group. This reflects the greater openness of economies in the industrialized countries. As the level of economic development increases, the role of the state shifts from direct production of goods and services to deregulation and liberalization. The overall objective of the state, then, is to provide an enabling environment for an efficient private sector and promotion of social policy goals. The analysis suggests that the higher the level of economic development, the lower the burden of economic regulation and the greater that of social regulation.

Aggregate scores hide wide differences between countries in terms of their regulatory burden. The last column is a rank ordering of the countries on the basis of their regulatory burden index. Singapore rates the first and Brazil the last. The United States of America and Sweden rate 9 and 10 respectively. France and Germany rate 24 and 25, respectively. The People's Republic of China, Armenia, Malaysia and Canada rank above the United States of America. Brazil and Pakistan rank order the last two implying the greatest regulatory burden among the 30 countries shown here. A comparative picture of low and middle-income countries is presented in Chart 3 and Chart 4, respectively. The variation in individual scores not only further reinforces the belief that a higher level of economic development is associated with less economic regulation but also more social regulation. The United States of America ranking of 9 is not surprising due to a more complex and detailed level of legal regulation in place than in other high-income countries. Kagan argues that compared to other industrialized economies, the United States of America regulatory system has a high degree of 'adversarial legalism' characterized by 'complex and lengthy procedures, high costs associated with the judicial process; frequent requirements of recourse to the judicial system; delays in administrative decision making and more uncertainty and unpredictability.'[10]

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[10] Robert Kagan. 'How much do national styles of law matter'. In 'Regulatory Encounters, Multinational Corporations and American Adversarial Legalism'. University of California Press, Berkeley, 2000, Chapter 1.

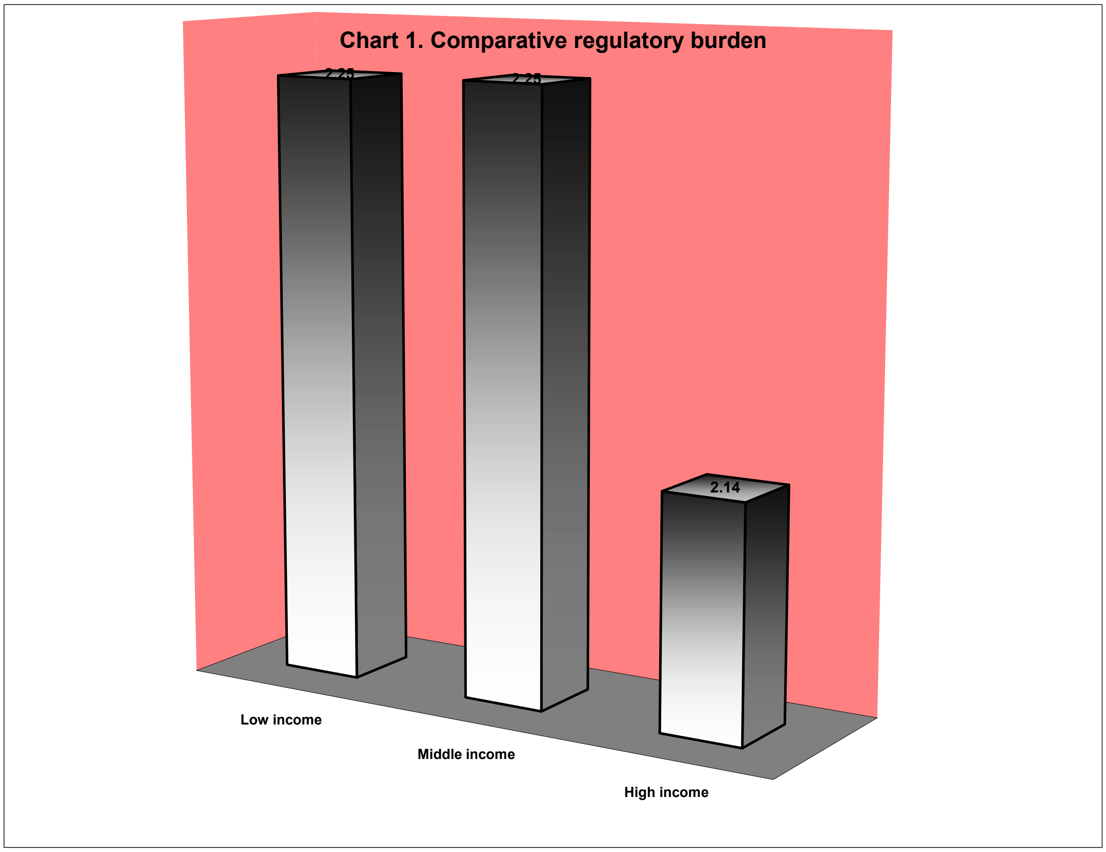


Chart 1. Comparative regulatory burden

Chart 2. Regulatory burden by sector

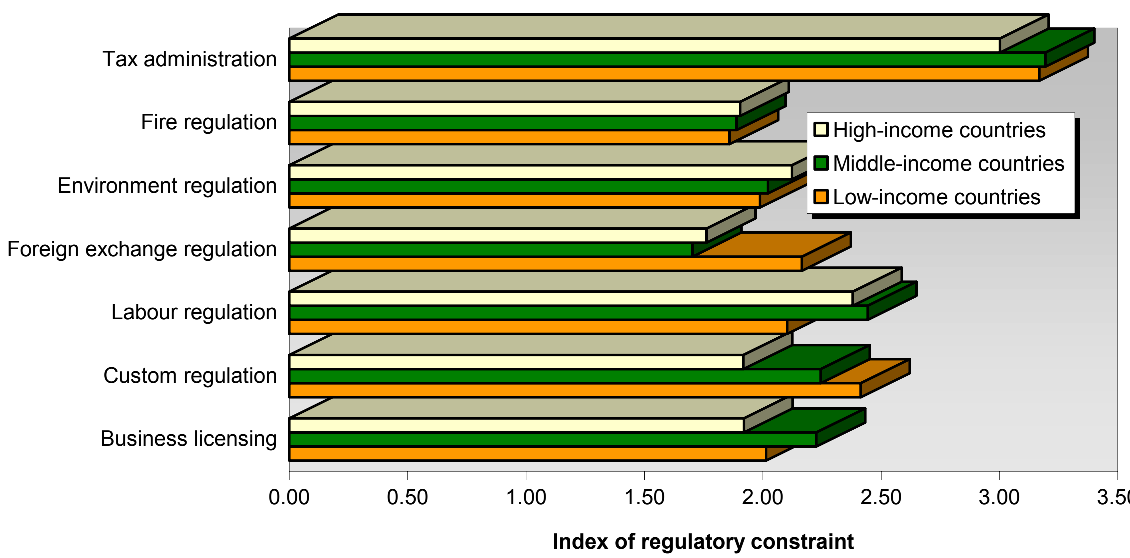
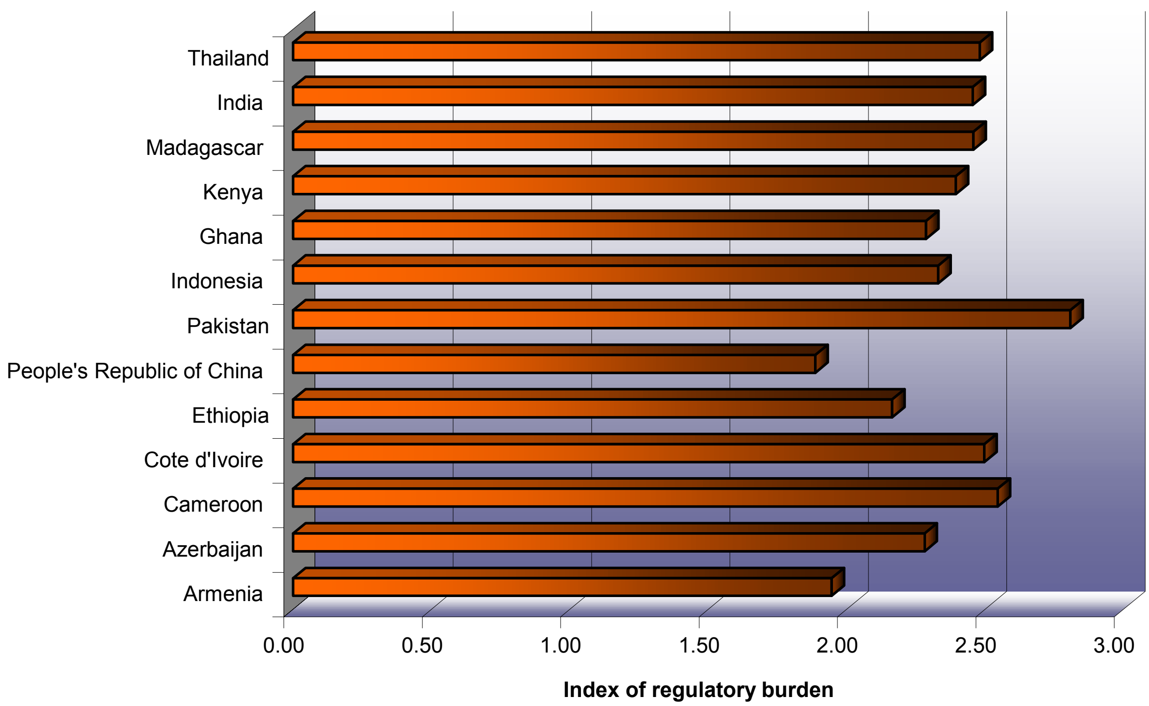


Chart 3. The extent of regulatory burden in low-income countries



C. The political economy of regulatory reform

Liberalizing the regulatory environment has a powerful impact on income and welfare. However, the magnitude of these effects depends, among other characteristics, on the domestic 'enabling environment' which should be conducive to the efficient functioning of the market.

The efficacy and extent of regulatory reform is a function of the level of the economic, political and institutional development in a country. Whereas the cornerstone of the new development paradigm is a private-sector led growth strategy, the challenge to deregulate and reform becomes unique in developing countries which may have a lack of a rule of law and property rights, weak judicial institutions and ineffective or non-existent commercial codes and bankruptcy laws. Moreover, state management of the regulatory reform process is not always free of political constraints. Government interference and corruption impact on private sector firms by increasing business risks and costs.

In an interdependent global economy, deregulation and regulatory reform need to be complemented by other factors. Good regulatory regimes provide for an effective interplay of a host of economic, political and social factors which together impact upon the efficiency and efficacy of the market. Macroeconomic stability, access to infrastructure, an effective rule of law and enforcement of property rights, stability and security, and transparency and accountability are all important factors which ultimately impact the efficiency of transactions in a market place. Policy stability reduces the uncertainty and risk from business decisions; transparency and accountability. As a whole, the legal, institutional and policy framework provides the setting for the economic and social regulation to be effective. Legal regulation encompasses property and contractual regulations setting quality standards and establishing criteria governing fraud and discrimination.

The benefits of globalization and free trade are unlikely to trickle down unless de-regulation and regulatory reform are complemented by other policy and institutional reforms which together constitute the 'enabling environment'. Stable and outward-looking regimes are more likely to adopt policies geared towards a laissez-faire approach to the market. As such, they aim towards reducing the burden of regulation.

To put the efficacy of regulatory governance in a holistic perspective, data on an additional nine variables in the Survey was tabulated. The economic and social variables selected for this exercise were those which would most closely proxy for overall enabling environment. These are access to: financing, infrastructure constraints, policy instability, inflation, exchange rate fluctuations, functioning of the judiciary, corruption, street crime, and organized crime. These were then assigned weights to arrive at an *Index of enabling environment* for comparative purposes. Table 2 presents the index of 'enabling environment' for the 30 countries.

Table 2. Measurement of the enabling environment

	Financing	Infra-structure	Policy instability	Inflation	Exch-ange rate	Street crime	Organ-ized crime	Corrup-tion	Effective-ness of Judiciary	Index of Enabling Environ-ment	Rank
Weight	10%	10%	20%	10%	10%	10%	10%	10%	10%		
Low-income countries											
Armenia	2.64	1.79	2.94	2.84	2.79	1.81	1.52	1.90	1.47	2.264	15
Azerbaijan	2.83	2.27	2.37	2.57	2.29	2.24	2.37	2.76	2.37	2.444	19
Cameroon	3.09	3.44	2.08	2.02	2.33	2.95	2.38	3.39	Na	2.376	16
Cote d'Ivoire	2.91	2.44	2.89	2.49	2.06	3.27	2.32	3.29	Na	2.456	20
Ethiopia	3.06	3.08	2.40	2.33	2.52	1.60	1.50	2.56	Na	2.145	12
Ghana	3.21	2.74	2.26	3.35	2.48	2.31	2.48	2.68	Na	2.377	17
India	2.55	2.77	2.84	2.87	2.48	1.99	1.90	2.80	2.01	2.505	21
Indonesia	2.86	2.36	3.10	3.14	3.36	2.66	2.55	2.63	2.20	2.796	27
Kenya	2.79	3.57	2.90	2.72	1.83	3.10	2.99	3.46	Na	2.626	24
Madagascar	3.17	3.06	2.67	3.18	2.32	2.77	2.27	3.35	Na	2.546	22
Pakistan	3.27	3.08	3.50	3.12	2.91	2.87	2.94	3.29	2.60	3.108	29
People's Republic of China	3.35	1.96	2.27	2.28	1.79	1.80	1.72	2.03	1.56	2.103	11
Thailand	3.11	2.81	3.48	3.36	3.63	3.52	3.73	3.47	2.13	3.272	30
Average	*2.99*	*2.72*	*2.75*	*2.79*	*2.52*	*2.53*	*2.36*	*2.89*	*2.05*	*2.634*	
Middle-income countries											
Argentina	2.99	1.92	3.10	2.01	1.81	2.47	1.90	2.62	2.33	2.425	18
Brazil	2.69	2.15	3.48	2.70	2.94	2.74	2.42	2.49	2.54	2.763	26
Chile	2.41	1.89	2.60	2.15	2.53	2.45	1.84	1.87	1.99	2.233	14
Egypt	2.91	3.23	2.98	2.72	2.74	2.64	2.49	3.15		2.584	23
Estonia	2.52	1.62	2.57	2.39	1.81	2.17	1.61	1.85	1.70	2.081	10
Georgia	3.25	2.22	3.02	3.43	2.77	2.53	2.63	1.84	1.92	2.663	25
Hungary	2.65	1.58	2.63	2.62	1.59	1.80	1.65	1.91	1.29	2.035	9
Malaysia	1.32	1.79	1.95	2.29	1.93	1.74	1.58	1.85	1.69	1.809	4
Uruguay	2.74	2.01	2.64	2.12	2.42	2.11	1.21	2.12	1.92	2.193	13
Venezuela	2.57	2.35	3.64	3.47	3.14	3.27	2.69	3.03	2.72	3.052	28
Average	*2.61*	*2.08*	*2.86*	*2.59*	*2.37*	*2.39*	*2.00*	*2.27*	*2.01*	*2.404*	
High-income countries											
Canada	2.07	1.39	2.12	2.16	2.02	1.30	1.28	1.31	1.43	1.720	3
France	2.62	1.81	2.07	1.97	1.79	1.80	1.40	1.60	1.73	1.886	6
Germany	2.54	1.84	1.58	1.86	1.69	1.55	1.64	1.84	2.07	1.819	5
Sweden	1.90	1.54	2.46	1.69	1.77	1.53	1.27	1.18	1.32	1.712	2
Singapore	1.86	1.35	1.47	1.56	1.82	1.20	1.29	1.25	1.51	1.478	1
UK	2.27	1.61	2.22	2.20	2.25	2.03	1.41	1.29	1.55	1.905	7
US	2.28	1.83	2.00	2.22	1.63	2.15	1.51	1.84	1.78	1.924	8
Average	*2.22*	*1.62*	*1.99*	*1.95*	*1.85*	*1.65*	*1.40*	*1.47*	*1.63*	*1.778*	

Note: A low score indicates less regulatory constraints, while a high score indicates more regulatory constraints. Scores range from 1-4 with 1 = regulations 'no obstacle' and 4 = 'major obstacle' to the operation and growth of business.
Source: *The World Bank Business Environment Survey 2000 dataset.*

The low and middle-income countries fare less than the high-income group of countries. (See chart 5). Indicators of macroeconomic stability, inflation, and exchange rate volatility are much higher in these countries. Five out of 13 low-income countries in the sample also rate inflation as a major constraint.

The rule of law as gauged by the responses to 'efficient functioning of judiciary' indicates most low and middle-income countries rated it a much higher obstacle than their high-income counterparts. The aggregate average of street crime, organized crime, and corruption are all higher than in the developed world.

Most notably higher are the scores on political stability and security in low and middle-income countries – important factors for business investment decisions. Individual country responses indicate policy instability to be a major constraint in Pakistan, Indonesia, Madagascar, Thailand, Argentina, Brazil and Georgia.

The last columns in Tables 1 and 2 rank the countries according to their regulatory burden index and the enabling environment index. It is interesting to note the change in the rank of several countries. Most notably, France and Germany which ranked a low 24th and 25th according to their regulatory burden rank, due to their considerable social regulations, improve their ranking substantially on the enabling environment index, ranking 6th and 5th respectively. The same is the case of Sweden, Canada, Uruguay and United Kingdom. On the other hand, the People's Republic of China, which ranked a high 3rd on the regulatory burden, indicating a low regulatory burden, declines considerably to 11 when ranked according to the enabling environment index, reflecting greater constraints in terms of access to financing, inflation and policy instability. Armenia, Azerbaijan, Ethiopia, Estonia, Indonesia, Kenya, Thailand, Georgia, and Egypt, all of which scored well in terms of the regulatory burden, reversed their rankings when ranked according to the enabling environment index.

Chart 4. The extent of regulatory burden in middle-income countries

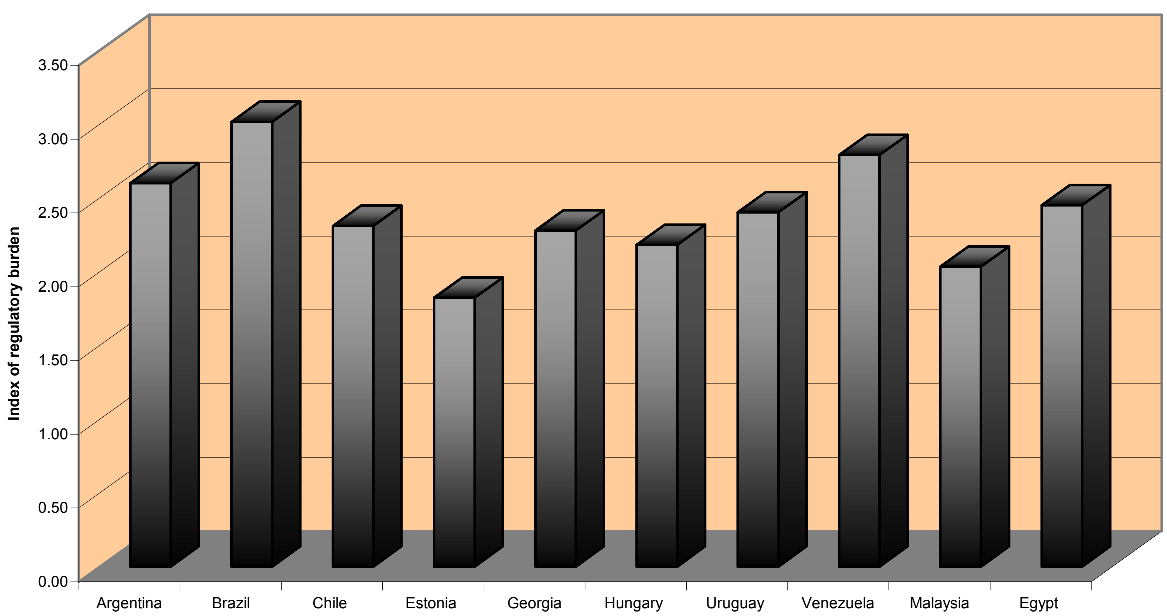
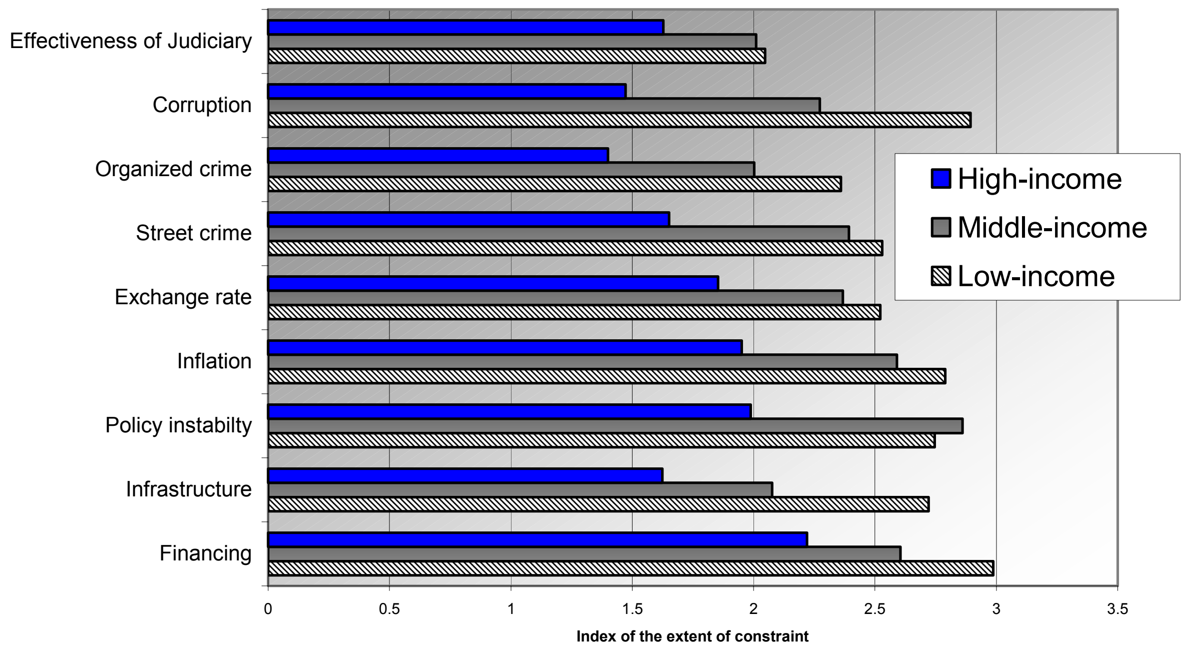


Chart 5. The enabling environment in selected countries by income group



IV. Economic growth and regulatory regimes: is there a link?

In spite of the growing importance of regulatory reform, the process is slow, especially in the developing countries. Significant efforts have been made by many developing economies to pursue regulatory reforms and to become more integrated into the global economy; however, many countries are still experiencing disappointing economic growth rates, which, consequently, adversely impact on the poor.

A first step in organizing the diverse results from tables 1 and 2 is to compare the levels and trends in major economic variables across groups of countries to explore the relationship between economic growth and the regulatory framework: Is a low regulatory burden associated with a higher-income growth and a more ‘open’ economy? Is an open economy sufficient for producing high rates of growth? Where greater burden is evident, is it just a reflection of a less open policy regime or are there other factors which are necessary for deregulation to be effective?

Several noteworthy trends are apparent from the classification in table 3. High-income countries all appear to have sustained economic growth rates for the decade of the 1990s. They also exhibit a high degree of ‘openness’ of the economies (except for the United States of America); a low level of economic regulatory burden; and a highly conducive ‘enabling environment’ for private sector to function. These developed countries were among the first to liberalize and deregulate their economies. Sustained economic growth appears to be associated with the level of economic development, openness of the economy, low burden of economic regulation and a conducive overall enabling environment.

From among the developing countries, China and Malaysia, which were among the highest achievers in terms of per capita growth rates for the period 1990-2000, support this thesis. The high average rate of growth in China (9.2%) and Malaysia (4.4%) went together with an open trade regime (44% and 201%

respectively); a low regulatory burden (3 and 11 ranking respectively); and a conducive enabling environment (11 and 4 ranking, respectively). The second group of countries exhibiting this pattern are India, Indonesia and Thailand among the low-income countries and Chile in the middle-income group. All four countries undertook regulatory reform in the last decade and achieved a relatively open trade regime (India 53%; Indonesia 62%; Thailand 107%; and Chile 51%, respectively). The first three also form a group with the next highest growth rates in the low-income group and much higher than the 1.2 for the low-income group as a whole. Most of this growth appears to have been contributed to by the liberalization and opening up of the economies rather than a reduction in the extent of regulatory burden or an improvement in the supporting enabling environment, both of which remained constrained in all four countries, especially in Indonesia and Thailand.

Table 3. The Regulatory environment and economic growth

	GDP/capita (PPP 2000)	Trade/GDP (%)	Regulatory burden Ranking	Enabling Environment Ranking	Average GDP growth rate/capita 1990-2000
Low-income					
Armenia	2,559	62	4	15	-2.5
Azerbaijan	2,936	60	12	19	-7.3
Cameroon	1,703	36	26	16	-0.8
Cote d'Ivoire	1,630	76	23	20	0.4
Ethiopia	668	Na	7	12	-0.1
Ghana	1,964	91	14	17	1.8
India	2,358	53	21	21	4.1
Indonesia	3,034	62	16	27	2.5
Kenya	1,022	47	17	24	-0.5
Madagascar	840	25	20	22	-0.9
Pakistan	1,928	33	29	29	1.2
People's Republic of China	3,976	44	3	11	9.2
Thailand	6,402	107	22	30	3.3
Middle-income					
Argentina	12,377	18	27	18	3.0
Brazil	7,625	19	30	26	1.5
Chile	9,417	51	15	14	5.2
Egypt	3,635	19	19	23	2.5
Estonia	10,066	150	2	10	1.0
Georgia	2,664	35	11	25	-12.4
Hungary	12,416	132	8	9	1.9
Malaysia	9,068	201	5	4	4.4
Uruguay	9,035	29	18	13	2.6
Venezuela	5,794	40	28	28	-0.6
High-income					
Canada	27,840	76	6	3	1.9
France	24,223	47	24	6	1.3
Germany	25,103	56	25	5	1.2
Sweden	24,277	70	10	2	1.6
Singapore	23,356	295	1	1	4.7
UK	23,509	44	13	7	2.2
US	34,142	21	9	8	2.2

Note: PPP = Purchasing power parity
Source: GDP per capita and GDP/capita growth rates from UNDP Human Development Report 2002, pp.190-193; Trade/GDP from the World Bank World Development Indicators database, April 2002. http://devdata.worldbank.org/data-query/SMResult.asp

The opposite of this thesis is also true. Low economic growth rates are associated with a closed and burdened economy. Several countries in both the low and middle-income groups display negative or low growth rates. Economic growth for the past decade averaged –0.9% in Madagascar, -0.8% in Cameroon, a much lower rate than before 1.2% in Pakistan, and 1.5% in Brazil. This was associated with relatively closed economies with trade/GDP ratios in the range of 19-36% and a high burden of regulation in a less than favourable enabling environment. Three of these four countries were in the bottom 5 when ranked by regulatory burden. Cameroon ranked 26th, Pakistan 29th and Brazil 30th on the regulatory burden index. Brazil ranked 26th and Pakistan 29th on the enabling environment index, while Madagascar was 22nd and Cameroon 16th.

Another group of countries which could barely muster positive growth rates or suffered negative ones, are mostly the Central and Eastern European countries and a few others (Ghana). This is considered the outlier' group of countries which do not follow this hypothesis of association between economic growth, openness, and regulatory regimes. In this group, major political and economic reforms, including liberalization and deregulation, have been recent enough not to be fully captured in the growth rates and which are, in many cases, still in the process of reform.

Another notable insight from the analysis is that openness of an economy by itself may not be associated with higher income growth unless the domestic regulatory environment is also supportive of free trade. Countries such as Cote d'Ivoire (76%), Venezuela (40%), and Kenya (47%) have relatively open economies. However, Cote d'Ivoire ranked 23rd and 20th on the regulatory burden index and the enabling environment index; Kenya 17th and 24th; while Venezuela ranked 28th on both. These domestic constraints on the efficient functioning of the markets were reflected in their low growth rates which averaged 0.4% for Cote d'Ivoire, -0.6% for Venezuela, and – 0.5% for Kenya respectively for the period 1990-2000.

The above analysis suggests an association between economic growth, openness of the economy and the regulatory regime, including the political, institutional and legal regulatory framework. This is, however, not to say that these are the only factors affecting the overall economic growth. Outliers which do not conform to this pattern suggest that other factors such as the level of social development (literacy and education; health) and political development would have a bearing on sustainable growth. This may help to explain why some countries with a low openness of the economy but a substantial regulatory burden still managed to average a respectable growth rate.

V. Conclusions

The current slowdown of the world economy has exposed aspects of economic governance that need strengthening to meet the demands, and reap the benefits, of an increasingly integrated world economy. Whereas a strengthened regulatory framework across a broad spectrum of policy, administrative and institutional issues is now widely accepted as a key factor in rebuilding domestic and international confidence, much needs to be done. It is of vital importance that states aim at improving the mechanisms and processes governing the market place. The basis of an effective economic policy framework in developing countries is building and supporting the development and maintenance of an effective and efficient economic and regulatory environment conducive to efficient private-sector activities.

The new role of the state must focus on building regulatory regimes within the context of its constitutional, economic, legal and political systems. Establishing a well-functioning system of market institutions with clear and transparent rules, effective checks and balances and strong enforcement mechanisms is the cornerstone for a good regulatory framework. The existence of an appropriate and effective legal and regulatory framework is a key factor in successful efforts to promote the private sector and achieve sustainable economic growth.

The analysis in this paper indicates that whereas the move towards greater deregulation and regulatory reform in developing countries is an important step towards private sector growth and development, it is unlikely to generate the full potential of benefits of unless complemented by legal, policy and institutional reform which together provide the enabling environment.

To achieve the benefits of globalization, a holistic approach to deregulation and regulatory reform is necessary for achieving sustainable economic growth. This is the new challenge of effective regulatory governance for the states.

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