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WHITHER BUSINESS REGULATION INSTITUTIONS AND PRIVATE SECTOR DEVELOPMENT

There is now widespread agreement that the institutional environment which regulates the context in which businesses operate is a critical (but not only) factor affecting entrepreneurial activity and hence economic growth. By institutional environment we mean the structure of laws, rules and regulations governing all aspects of economic activity.

The World Bank's *Doing Business 2007*, published on 6 September 2006, and the fourth report since its inception in 2003, provides interesting evidence of this by tracking indicators of time and cost to meet government requirements in business startup, operation, trade, taxation, and closure in 175 countries. The authors of the report argue that the report itself makes business easier for firms by suggesting that the mere publication of comparative data on the ease of doing business has inspired or informed 48 reforms around the world since 2003. But how clear is the ultimate target of the agenda on business deregulation, and how and at what pace should it be reached?

Surprisingly, Africa makes the top-three among reforming regions this year, after Eastern Europe and the OECD countries but ahead of Asia and Latin America. Two-thirds of African countries made at least one reform, and Tanzania and Ghana rank among the top 10 reformers. Admittedly, African countries also have the furthest to go. It takes 13 regulations and 113 days in Mozambique to set-up a business, but only 6 regulations and 10 days in the Netherlands. In another example, in Cote d'Ivoire registering property took 397 days in 2005. Reforms eliminated the need for governmental approval to transfer property, decreasing the time to 32 days. However, by comparison, it takes 9 days in Singapore and 2 days in New Zealand to register property, the two countries with the most business-friendly

regulation.

Few would object to improved and streamlined business regulation. Most firms will regard the time spent on complying with regulatory procedures as a waste of time. Too heavy regulation will raise barriers for private sector firms to move from the informal to the formal market. And the presence of too many unnecessary rules and procedures widens the scope for corruption and proneness to capture by a few interest groups and individuals.

Yet this is not the end of the story. Is less regulation *always* better? The simple answer to this is no. A key dilemma facing business regulation is to ensure an *optimal* level of regulation, not just a *minimum* level of regulation. To see this, one simply has to consider the following cases to realise that certain circumstances require more not less effective regulation: better regulations and procedures were required to regulate the accountancy profession after spectacular frauds at major companies in recent years, they were required to protect the commons from pollution, and to regulate natural monopolies preventing them from abusing their power, and finally to get better private property rights in lawless countries emerging from civil war.

The complex answer to whether less regulation is always better is also no. The literature on the economics of regulation and development is of little guidance in identifying the optimal level or sequencing of regulation: the evidence is country specific and says that optimal regulation is not predetermined but depends on specific conditions. It suggests that the market is likely to fail in the absence of regulation, but also that a country will lose its competitive edge with overly burdensome regulation in cases of government failure. So the ultimate target of the agenda on business deregulation is not clear.

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Nor is it clear how and at what pace this target should be reached. Concentrating the minds too much on studying the symptoms – business regulation – without a proper diagnosis of root causes may fail to identify the binding constraints to further investment and growth. The theme of this year’s *Doing Business* report is ‘How to reform’, and it provides a practical list of 4 steps to successful reform:

- Begin with simple administrative reforms that don’t need legislative changes.
- Cut unnecessary procedures, reducing the number of bureaucrats with whom entrepreneurs need to interact.
- Introduce standard application forms and publish ample regulatory information.
- Consider how regulations are administered.

These are likely factors when considering reforms, but they do not take account of the deep institutional and political determinants of reform. Such deep determinants include effective state-business relations (SBRs). The following measurable factors tend to be associated with effective SBRs

- an organised private sector vis-à-vis the public sector;
- an organised public sector vis-à-vis the private sector;
- an institutionalised mechanism for conducting state-business relations (SBRs); and
- a mechanism to ensure the absence of harmful collusive behaviour.

An effective SBR may lead to, and prioritise, reforms by suggesting a more optimal allocation of resources and optimal level of regulation. Preliminary research at the Overseas Development Institute for the IPPG programme has begun to measure what constitutes effective SBRs (see chart). It shows that factors associated with improved SBRs in sub-Saharan Africa lead to more streamlined administrative procedures (i.e. fewer regulations and time wasted when trading goods) and better business conditions.* African countries with factors associated with better SBRs – Mauritius, South Africa and Botswana – are included amongst the four highest ranking African countries for ease of doing business. Focusing on outcomes alone has parallels in the use of targets generally – the root causes need to be tackled.

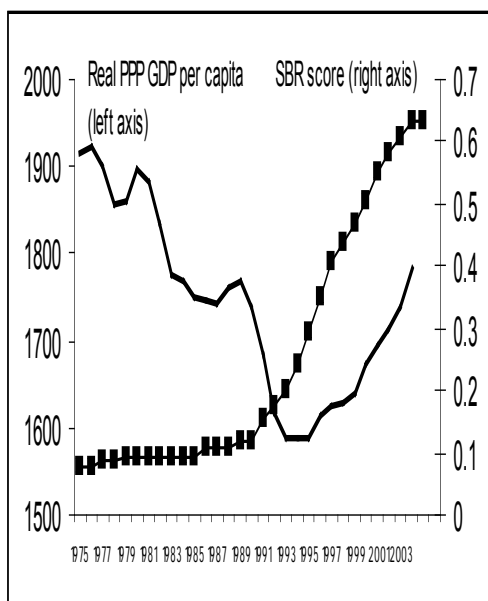
If, as the World Bank report argues, ‘what get’s measured gets done’, it becomes time to understand and measure the underlying political and institutional factors which shape reform of business regulations, including what constitutes effective state business relations, in addition to tracking business regulations.

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* ‘Measuring State-Business Relations in sub-Saharan Africa’, paper for the RPC on Institutions and Pro-Poor Growth

A LINK WORTH EXPLORING?

Average GDP per capita and SBR scores for Sub Saharan Africa



SBR measured on the basis of 20 countries*