

Regulatory policy transfer

Western views on regulatory reform have had a growing influence on governments in developing countries. Indeed donor organisations such as the World Bank and the International Monetary Fund have pressed such countries to adopt Western models on the assumption that this will benefit their economies. But it is now recognised that direct policy transfers often fail to produce the expected results. We argue that the impact of policy change is strongly affected by the political, legal and social context. Just because a policy works well in one country does not mean it will do so in another. Rather than simply apply a standard model, policy makers need to analyse their own situation and tailor policy to fit.

When policy transfers are not undertaken voluntarily but rather as a result of donor pressure there is a serious danger that reforms will exist mainly on paper and make little real difference. It is also likely that such an approach will underestimate or neglect the influence of the political context in determining a response to reform pressures.

The politics of regulation

Politics affects regulatory reform in many different ways. For example, privatisation and regulatory reform are more likely to occur in some sectors, such as telecommunications, than in others, such as the electricity and water sectors. We suggest this is because privatising telecoms has been found to be less risky and creates less political opposition.

A study of regulatory impact assessment in Sri Lanka found that regulatory weaknesses were due not only to a flawed institutional framework and the absence of a specific policy but also to unchecked poor governance. Regulatory agencies were easily captured by powerful interested parties – indeed it seemed that this

might have been deliberately built into the system. Although formal institutions of regulatory accountability existed, their main role appeared to be to hide the actual politicisation of the process.

Other studies, in the Philippines, indicated that, despite rhetoric about reforming the system of governance and public administration, reform actually legitimised and strengthened the traditional elite's continued dominance of government. Real democratic gains were less significant than the enlargement of funds to maintain congressional and elite support for government reforms. Privatisation and regulatory reform did have some success in improving services but also provided new opportunities for established elites to enrich themselves from public funds. Research concluded that further economic, social and political reforms would only be permitted as long as civil unrest was limited and the privileges of the traditional elite were not threatened.

The political situation can also affect whether regulatory reform is embraced rapidly or slowly. In the

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Arab world, where regulatory reform has been largely ignored until recently, authoritarian regimes face much less pressure from political competitors than do governments in Latin America, where reforms are widespread. It is suggested that, in the absence of political competition, regulatory reform loses much of its usefulness to the government. In other words we consider that the decision to reform is often driven by its political value (or the lack of it), or by donor pressure, rather than by whether reform contributes to social or economic welfare.

Law and economics

It is obvious (though often overlooked) that law affects economic transactions. For example if people do not trust the state to enforce contracts they will be less inclined to engage in trade. If it is very expensive to negotiate and enforce deals then economic growth

will suffer. Where there is not a lot of money to invest in the legal system it probably makes sense to devise rules that are relatively easy to apply and leave less room for discretion.

At one time under development was seen as a failure to adopt Western styles of liberal democracy including independent courts. However transplanting such models was not a success and the importance of the cultural and political environment was recognised. Efforts then focused on building strong states that could intervene effectively. But this approach also largely failed to deliver the promised economic growth. Instead it tended to reinforce the position of the political elite and the bureaucracy.

Following the collapse of the Soviet Union and the growth of privatisation in the capitalist economies came further attempts at legal reform. The

role of the private sector was seen as of increasing importance and new laws were needed to reflect this. The lack of 'good governance' was blamed for causing poor growth. Since donor agencies, on which developing countries were increasingly dependent, were reluctant to address the *political* aspects of governance they made loans and other aid conditional on *legal* reform. This time, rather than transferring standard models, they focused on basic essentials such as stable bodies of rules, known in advance and enforced by independent bodies and on basic property and contract rights.

However it has been observed that a legal system may have all these desirable qualities and yet still mask tyrannical or arbitrary government. Perhaps not enough attention has been paid to how law

Policy transfer - emulation or learning?

As well as sometimes happening in response to international pressure or the domestic situation, policy transfer can also spread horizontally by way of learning from, or simply copying, others. We analysed the spread of independent regulatory agencies across 19 Latin American countries to see how much it was influenced by what had happened in other countries or in different sectors within the same country. We also examined whether this was a process of learning from others' experience or whether it was merely copying or emulating reforms without also taking into account whether or not the effect of the reforms had been beneficial.

In Latin America, since the late 1970s, economic crisis coincided with a widespread transition to democracy. Under newly elected leaders, privatisation and regulatory reform went further and faster than in any other part of the world. Politicians were expected to deliver on their campaign promises of growth and employment and public support

for these new policies was relatively high. The spread of regulatory agencies is generally the most important indication of state reform. We identified and counted those agencies of the state that had been separated from ministries and so had some independence.

We found that the decision to set up such regulatory agencies did depend on previous such decisions. It was more strongly influenced by decisions in the same sector in other countries than it was by decisions in other sectors within the same country. To decide whether this behaviour could be better described as learning or as emulation we investigated whether better economic performance in other countries (in terms of economic growth, levels of foreign direct investment or private investment) affected the probability of other regulatory agencies being created. Our results were mixed but showed evidence of emulation rather than real learning. It is not that countries cannot learn but, especially in the economic, political and social conditions in Latin America, their capacity to do so needs to be

considerably enhanced before much improvement in their performance will be seen.

What we are seeing is a wave-like pattern of regulatory reforms being adopted. An innovator originates a bold reform which attracts the attention of other countries which, more or less blindly, follow the example. At this point it is the behaviour of others rather than local conditions that drives reform. In effect control is transferred to the group in general and the innovator in particular.

The results also indicated that the influence of international organisations and the US might be better understood in terms of the soft power of influential peers rather than direct coercion. We suggest that more attention should be paid to the power of ideas as they spread through networks of policymakers and other relevant communities. At the moment developing countries are essentially imitating the rich countries which are not only telling them what the solutions to their problems are but also telling them what their problems are.

actually works in practice – and especially whether it is effective in controlling the government itself.

Legal culture

All societies develop their own strongly-held views about what law is and how it ought to work. To understand how any legal system works it is necessary to look at how it has evolved over time. In many developing countries legal cultures imposed by colonisers have clashed with indigenous traditional law.

Western legal systems are predominantly of two types – common law and civilian. In common law systems, although many laws are passed by government, there is a long tradition of legal principles being established in court through the decisions of judges. Some argue that common law is better at dealing with unregulated economic activity because it is supposed to adapt more easily to changing circumstances. In civilian law systems, on the other hand, judges have been less independent and

have had less freedom to interpret the laws which are set down more fully by government. Civilian systems have separate courts and principles for public and private law.

When considering non-western legal systems, much attention is paid to how the colonisers organised their systems in their home countries. However in colonised countries these may have been modified either to suit the settlers' needs or by successive waves of colonisation. And, most importantly, we need to take account of the relationship between colonial and indigenous, mainly customary, law. This relationship varied according to how hard colonisers tried to impose their own legal systems. But, in general, they only interfered in local legal arrangements when they considered it essential in order to maintain their own power or to further the interests of the settlers.

Under indigenous law, family or kinship groups tend to be considered more significant than

individuals and decision makers have a lot of discretion. Often indigenous law has been flexible and adapted to the presence of the colonisers. It is important not to draw too much of a distinction between the informality of indigenous law and formal Western systems. Formal and informal systems co-exist almost everywhere though the balance between them varies. Economic growth may well have suffered when too much effort was made to formalise legal systems.

At independence, there was less legal change than might have been expected. For most people the replacement of the colonial powers by the ruling elite did not make a lot of difference. The new rulers had little incentive to revitalise indigenous law – after all they had done well under the existing set up. Also indigenous law was not seen as consistent with a strong state or with modernisation. Obviously major political change did lead to some institutional change but those in power could often avoid or ignore the formal law.

Towards intelligent policy transfer

Historically the industrialised nations achieved their current level of development through exactly the sort of strong, interventionist state policies that the current 'market led' regulatory reforms are fundamentally opposed to. The emergence of high growth states is as much to do with political change as institutional change. The challenge for donors and researchers is to identify political as well as institutional reform strategies. We need to learn to accept the realities of local political cultures that shape externally devised reforms, rather than being transformed by them.

As we have said, regulation cannot be separated from politics. It is a complex, interactive process. All those involved have needs and capacities and solutions arise from a mutually dependent relationship. Inevitably regulation operates within some sort of governance framework. The way public and private decisions are made, and by which institutions, shapes how regulation is created and implemented. Government also regulates itself. In the last two

decades, in the UK, regulation inside government has become as large an 'industry' as regulation in the private sector.

Policymakers should look critically at the notion of 'independent' regulatory agencies which is currently so heavily promoted. What does independence mean in a context where regulators and judges, for example, owe their positions to political patronage? Even in the UK, where the railways regulator was notably independent, he was quite unable to resist the regulatory decisions of the minister. Since privatisation and regulatory reforms are often concentrated in public utilities where there is a strong public interest factor it is hard to see how regulation can be really independent i.e. insulated from overriding political considerations.

When seeking to compare systems in different countries, it is possible to choose indicators of state capacity. For example, looking at tax revenue mobilisation and levels of tax evasion would give some information about implementation issues. The extent of regulatory capture has been measured

in terms of business people's perceptions of how widespread is the sale of government policies and laws.

But comparing national systems of regulation is difficult and beset with the problems of poor quality and missing data. Results are claimed at a higher level of sophistication than the data allows and often fail to provide useful information in the longer run.

In any case, because regulation is largely politically, legally and socially situated, it is difficult to make valid comparisons. This causes great problems for policymakers who want to make informed judgements about which regulatory reforms would suit their own situation best. At the moment attempted policy transfers generally reflect donor values and preferences e.g. structural adjustment, new public management and good governance. Policymakers urgently need good quality information on how the complex negotiated process of regulation works in other countries.

Licensing for better business set-up

Deciding what businesses to license, and for what purpose, has political implications, as does the decision whether to make licensing an integral part of the set up process, or independent of it. Developing countries tend to regulate the business set-up process more intensively than developed countries and this does not always produce benefits. There are two main types of controls when businesses are set up – registration and licensing. Registration involves businesses in providing information to the public authorities which simply keeps it on file. Under licensing the authority has to decide whether or not the applicant is suitable to carry out the business.

Set-up versus independent licensing

When a licensing requirement is part of the set-up process the business has to get the licence before it is allowed to carry out any activity. This is sometimes known as set-up licensing (SL).

However if licensing is separate from the set-up process then, before the licence is granted, the business can get on with any of its other activities for which a licence is not required, thus reducing costs due to delay. This is known as independent licensing (IL). Under IL the business can go through the set-up process at the same time as it is applying for the licence. This cuts down the time involved and again reduces costs. It can also benefit consumers by reducing the delay before new products or services are available to them.

For example in China, where SL has been widely used, businesses which want to start manufacturing pharmaceuticals cannot register the company until they have obtained a

drug manufacturers licence. In the UK, where IL is used, companies can register without a licence and decide for themselves when to apply for it.

Although they cannot start making drugs without a licence this system allows them to get on with the other activities involved in starting a business.

Licensing reforms

Some countries are reforming their set-up procedures. In Kenya, before 2000, businesses had to show that they had complied with public health and safety requirements before they could get a business licence. This caused many delays since there were few health officials available to carry out the required inspections. Since 2000, businesses no longer have to meet the public health and safety requirements in advance. Instead, inspections are carried out on an ongoing basis and if the business is not performing satisfactorily its licence can be withdrawn.

In the Chinese province of Hubei, reforms involved dividing businesses into two categories and imposing different licensing requirements on each. One group still had to obtain a licence before registration while the other could do so at a time of its own choosing. For example manufacturers of pesticides still had to get a licence in advance whereas those trading in seeds did not.

When businesses have to obtain a number of different licences to cover activities in different sectors, reforms have included allowing licences to be applied for simultaneously instead of one after another. Alternatively joint-licensing procedures can be used. This enables businesses to apply for and receive licences from a single agency

(‘one stop shop’). Under this system officials from the relevant different agencies meet and make a joint decision.

The politics of licensing

The existence of these kinds of reform show that some developing countries do recognise the extra costs that SL requires. However the reforms do not usually involve a complete shift to IL. Why is SL often preferred?

It is well known that many developing countries, due to lack of resources, have problems in enforcing regulations. As a result they often have large and growing informal economies. It might be argued that keeping licensing within the set-up process will mean that unlicensed activities will be more likely to be detected. But this ignores the fact that the extra costs involved in SL might encourage more businesses to avoid the whole process and join the underground economy instead.

Existing businesses may well prefer SL since the delay and extra costs involved protect them to some extent from competition from new businesses. Also, in SL systems any delay by the licensing agency will directly increase the business’s costs since the licence must be obtained before the business can start operating. This creates more opportunities for licensing officials to extract bribes. Where the distinction between politicians and bureaucrats is unclear, as in many developing countries, politicians may for similar reasons prefer SL systems. Therefore deciding to use independent licensing may involve challenging powerful interest groups.

This CRC Policy Brief draws heavily on the CRC Working Papers below:

No. 64. Minogue, M. *Regulatory Governance and the Improvement of Public Services*. 2004

No. 65. Ogus, A. *The Importance of Legal Infrastructure for Regulation (and Deregulation) in Developing Countries*. 2004

No. 61. Levi-Faur, D. and Jordana, J. *The Rise of the Regulatory State in Latin America: a Study of the Diffusion of Regulatory Reforms Across Countries and Sectors*. 2004

No. 69. Levi-Faur, D. *The Advance of the Regulatory State: Regulatory Reforms in the Arab World and Latin America Compared*. 2004

which are all available on the CRC web site at:

<http://idpm.man.ac.uk/crc/publications.htm>

And on the CRC Conference Papers

Zhang, Q. and Ogus, A. *Licensing Procedures in Developing Countries: Should They Be Part of the Set-up Process?* 2004

Minogue, M. *Apples and Oranges: Problems in the Analysis of Comparative Regulatory Governance* 2004

which are available on the CRC web site at <http://idpm.man.ac.uk/crc/sapapers.htm>

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