

Regulation and Deregulation

Timothy Besley, LSE

Growth in India and the World

Delhi

December 2006

Issues and Motivation

- There is a lot interest in regulatory issues and the impact of regulation on growth and development
- A regulation is usually defined as “a principle, rule, or law designed to control or govern conduct”
- Regulation is generally pro-active
 - relies on an effective bureaucratic structure overseeing its design and implementation

- Regulation is generally seen as an alternative to a tort-based system of affecting private sector behaviour.
- This "Coasian" view seems the role of government as providing an effective court system, establishing property rights and then letting private contracts/litigation "regulate" behavior.
 - Social networks are also important as an alternative to formal legal structures
 - But relying on networks often create entry barriers

Issues and Motivation (continued)

- The dominant paradigm in economics until recently focused on the benefits of regulation in fixing market failures
- BUT this view has been revised in two important ways:
 - need to see regulation as supporting markets
 - need to focus on how regulations are chosen and implemented.

- There is an implicit critique of the type/nature of regulation that has been employed in many countries (rich and poor)
- Two main critiques of regulation:
 - selectivity of areas to be regulated
 - implementation of regulation – corruption and capture

- In many places deregulation is now seen as key component for improving economic performance
- India examples include:
 - labour regulations
 - licensing arrangements

- It is frequently argued that injudicious regulation is responsible for rigidities and low levels of growth.
- But this is pretty difficult to establish given the current state of knowledge
- That said, there is now a lot more effort focused on trying to quantify the extent/nature of regulations and to assess the impact of regulations on various aspects of economic performance in India and elsewhere.
- Probably the best-known effort on a global scale is the World Bank doing business project which looks across countries.
- But there have been efforts also to look at these issues on a more disaggregated basis in India.

Remainder of the Talk

- Background conceptual discussion
- India's global position
- A more disaggregated picture
- Some brief discussion of public-private partnerships (if there is time)

Background

- Interest in regulation has grown on the back of two agendas:
 - Practical
 - Academic

Practical Developments

- The latest 25 years has seen a global trend towards deregulation
 - It has been linked to (but is distinct from) the privatization agenda
 - * it is related to a generally greater commitment to creating effective market economies.
 - Measures such as “size of government” do not seem to have mirrored this trend.

Practical Developments (continued)

- This has been an important part of India's recent economic history.
 - delicensing has been a key development
 - less clear how far this has gone in other spheres.
 - public-private partnerships for infrastructure are a related development.

Academic Developments

- Debates about regulation are inseparable from two other wider debates:
 - (Law and economics) the effectiveness and resourcing of court systems.
 - (Political economy) the effectiveness/benevolence of administrative intervention.

Tort versus Regulation

- Key issue: Should government use direct administrative intervention to affect behavior or pass broad rules and leave it up to the courts to enforce outcomes,
 - The latter is the “Coasian view” but it clearly relies on swift and effective court systems for it to be viable option.
 - Deregulation will leave a vacuum if there is no effective tort system to fall back on
 - Even if the court system is efficient, administrative intervention may still be easier and fairer

Political Economy

- How effective will direct intervention be?
 - Power of sectional interests in passing rules.
 - Corruption/inefficiency in administering those rules.

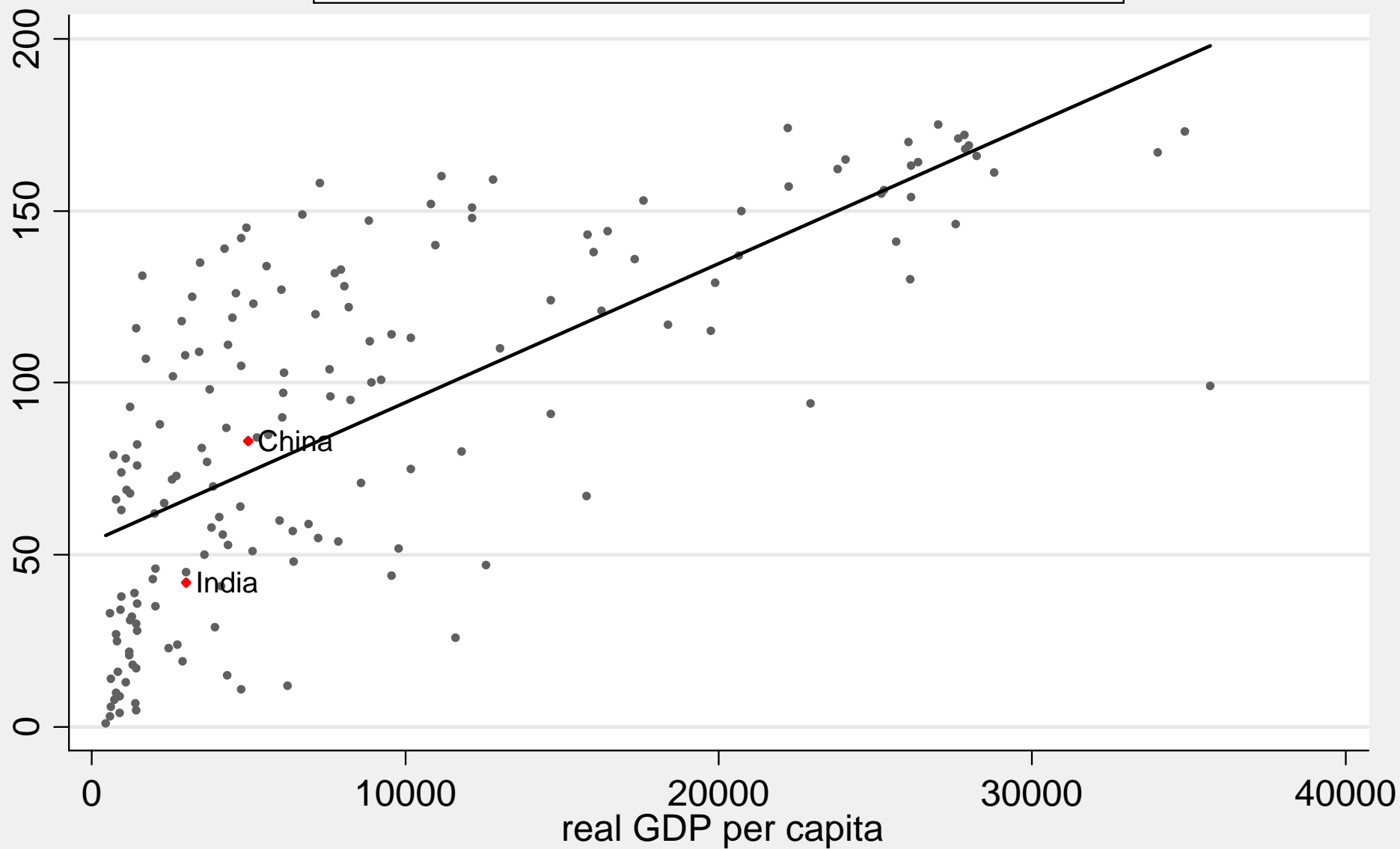
Where does India stand?

- Regulation – there are still many challenges ahead.
- Courts – serious issues of delay and under-resourcing of courts.
- BUT: how far is all this of real consequence?

India's global position

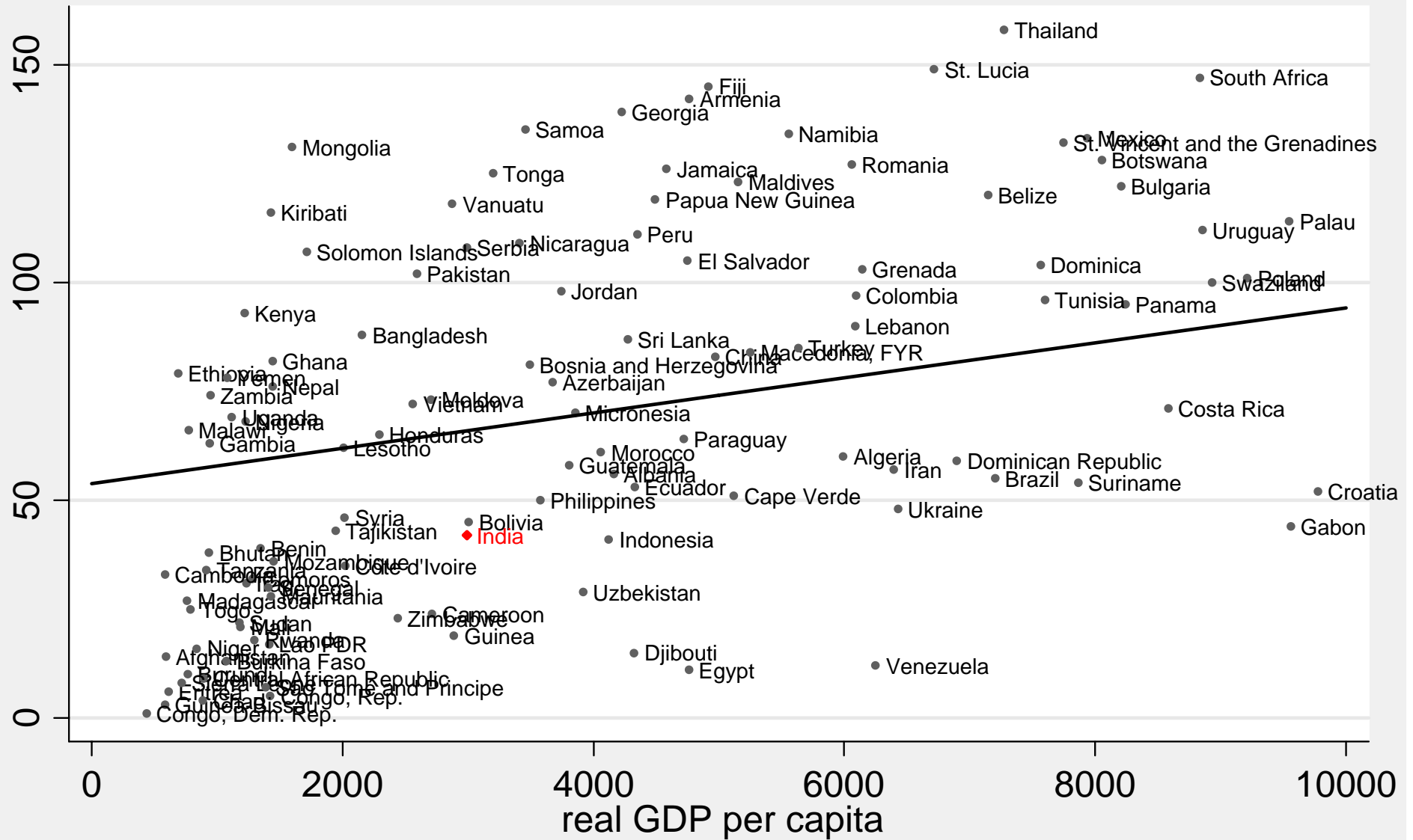
- The World Bank *Doing Business* data provides a way of benchmarking India's position on a variety of indicators
- I will look purely at the rank measures
 - these are built up from a variety of underlying measures with an effort to construct these on a comparable basis internationally.
 - there are issues about how these measures are constructed and this should be taken as a caveat.

• Ease of Doing Business - Rank (reversed)



Data: World Bank 'Doing Business'(2006), Penn World Tables (2003)

• Ease of Doing Business - Rank (reversed)

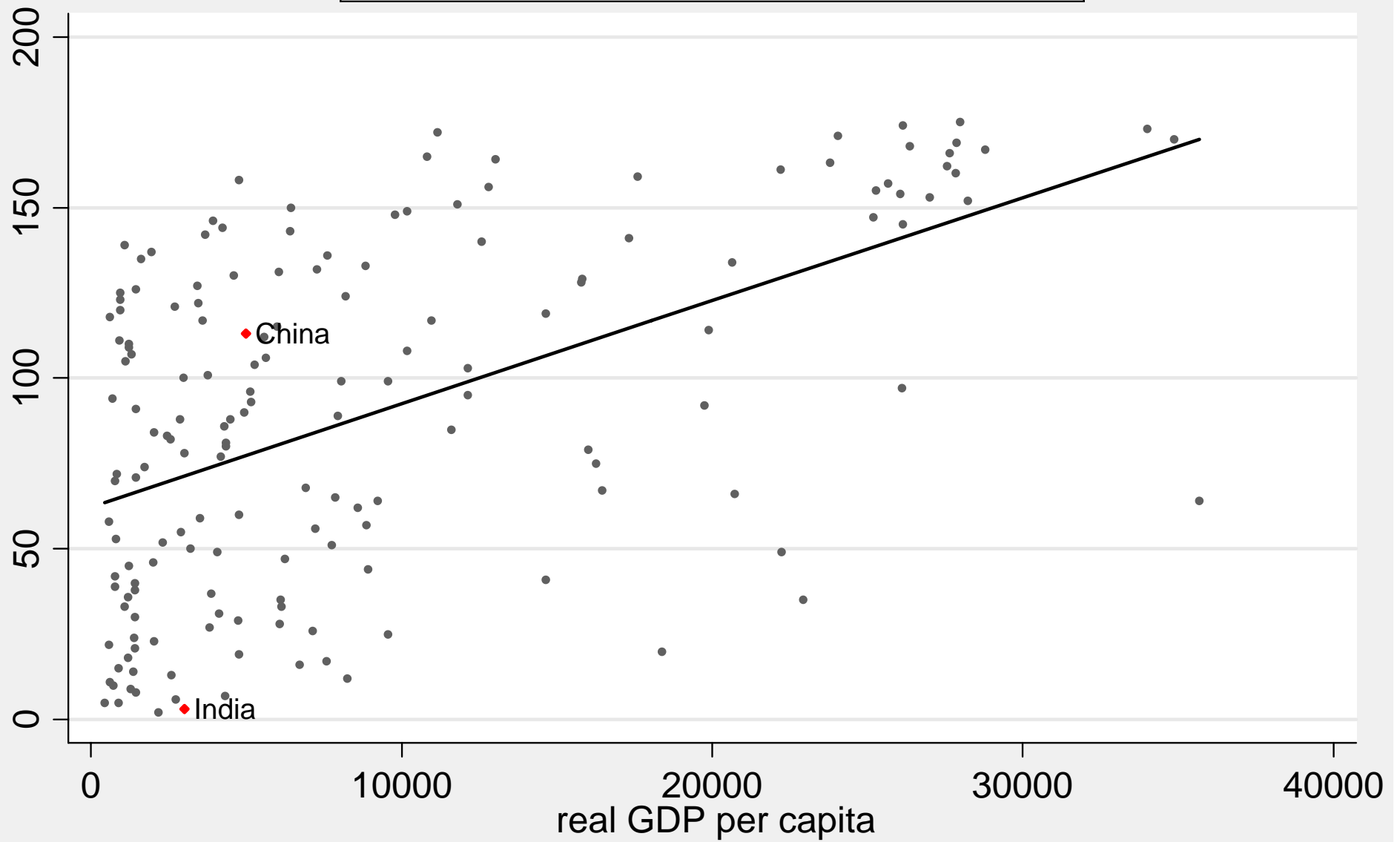


Data: World Bank 'Doing Business'(2006), Penn World Tables (2003)

India's global position

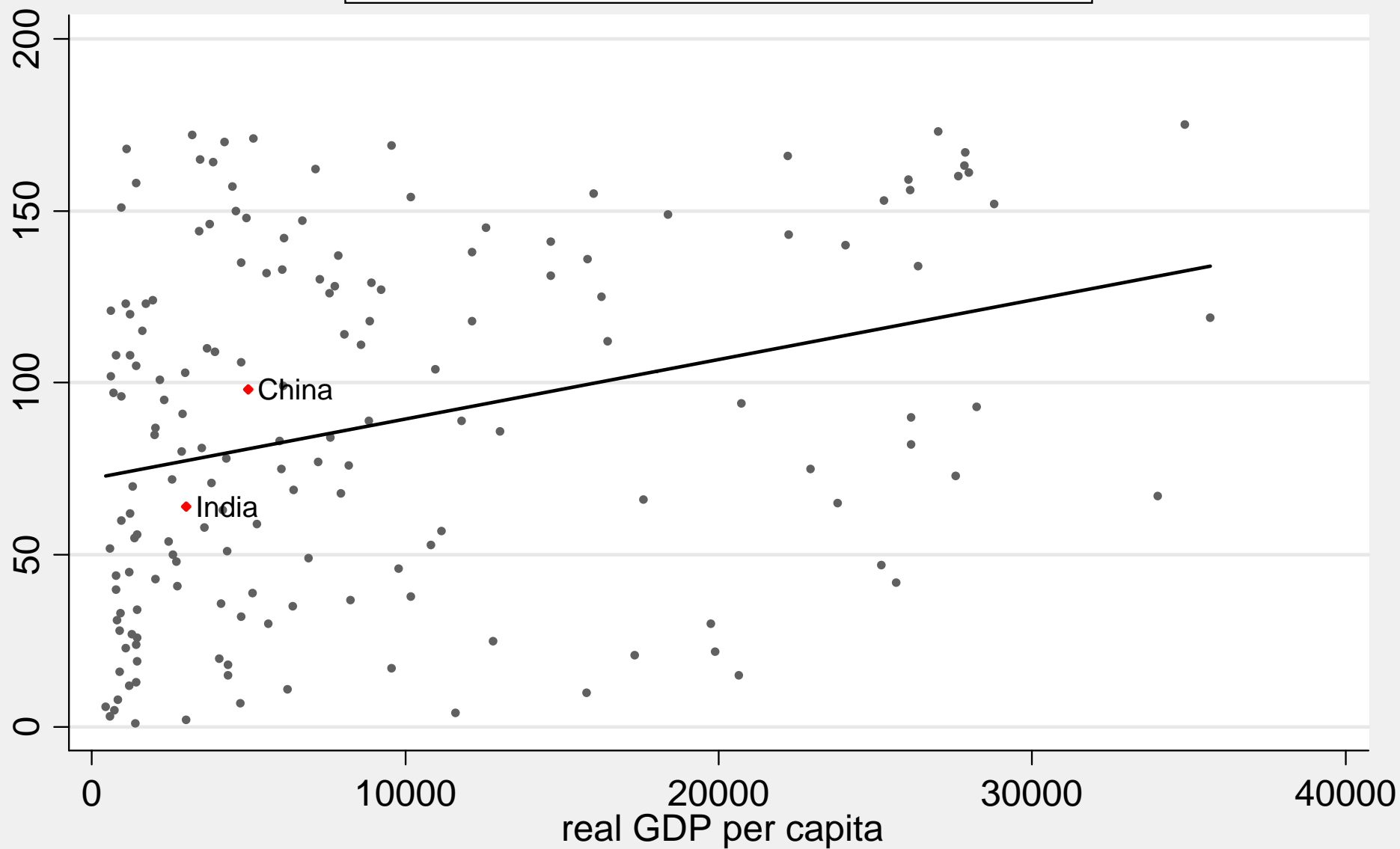
- India does score somewhat poorly on a number of dimensions including
 - measures related to court effectiveness
 - labour regulations
 - export regulations

• Enforcing Contracts - Rank (reversed)



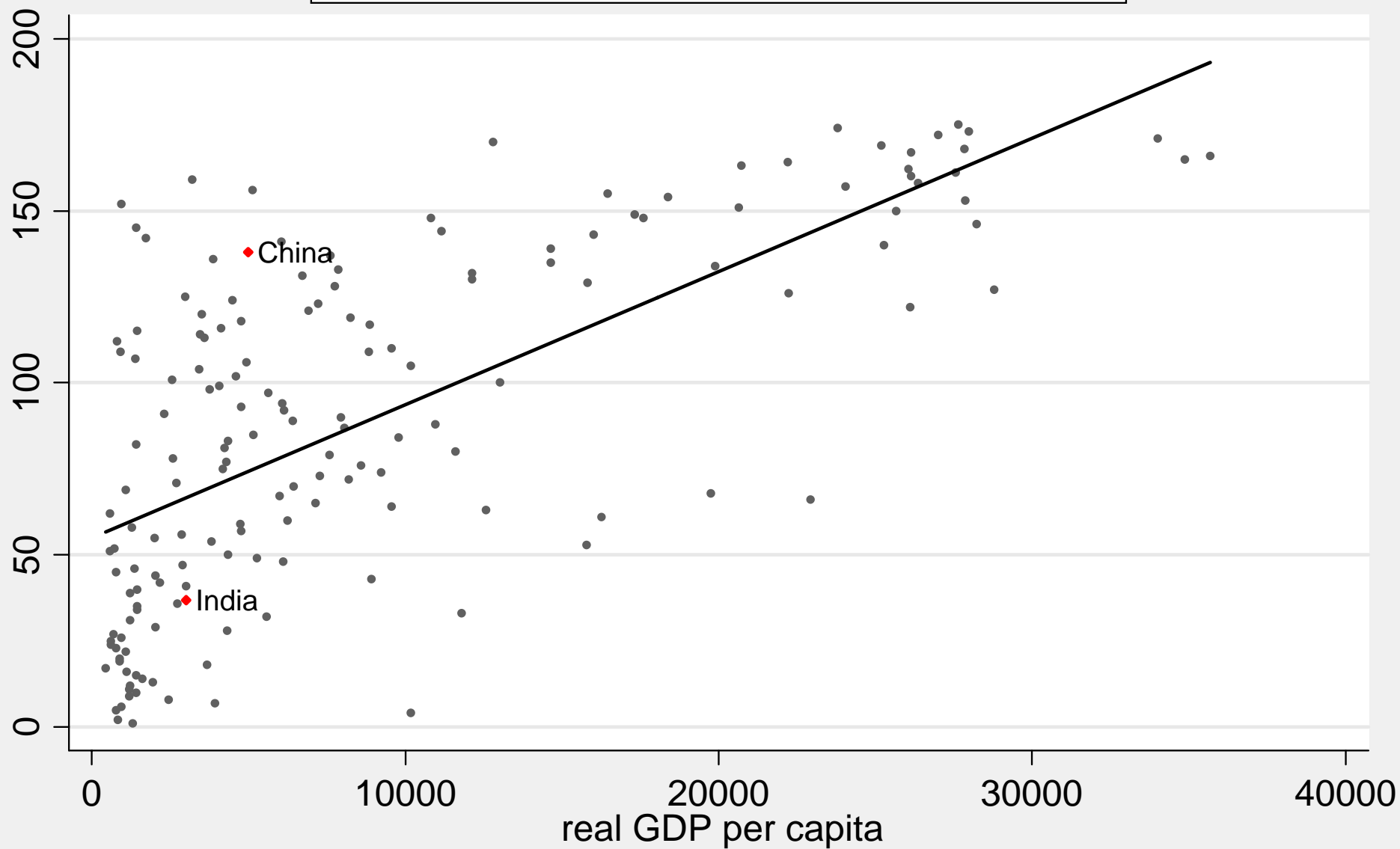
Data: World Bank 'Doing Business'(2006), Penn World Tables (2003)

• Employing Workers - Rank (reversed)



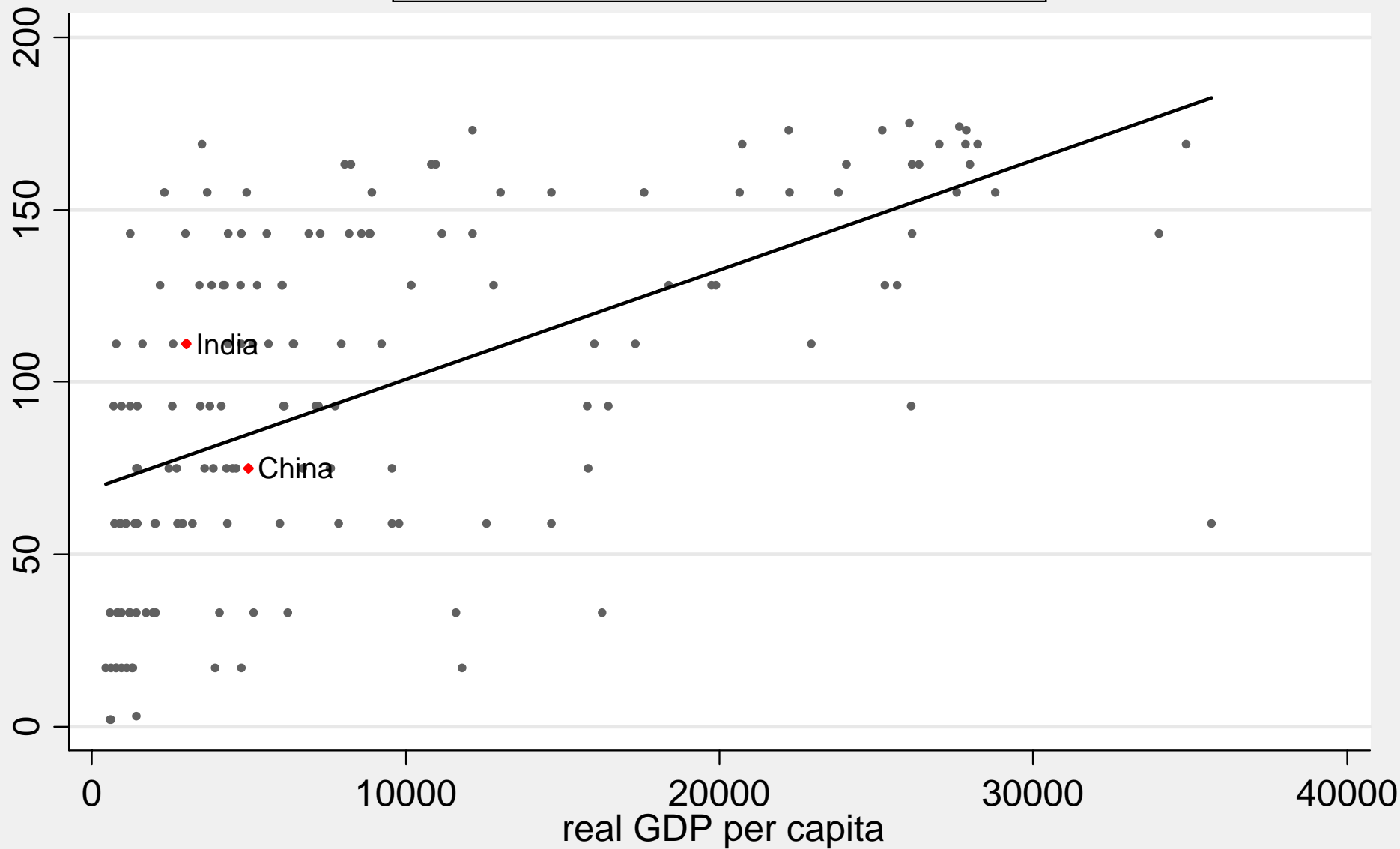
Data: World Bank 'Doing Business'(2006), Penn World Tables (2003)

• Trading Across Borders - Rank (reversed)



Data: World Bank 'Doing Business'(2006), Penn World Tables (2003)

• Getting Credit - Rank (reversed)



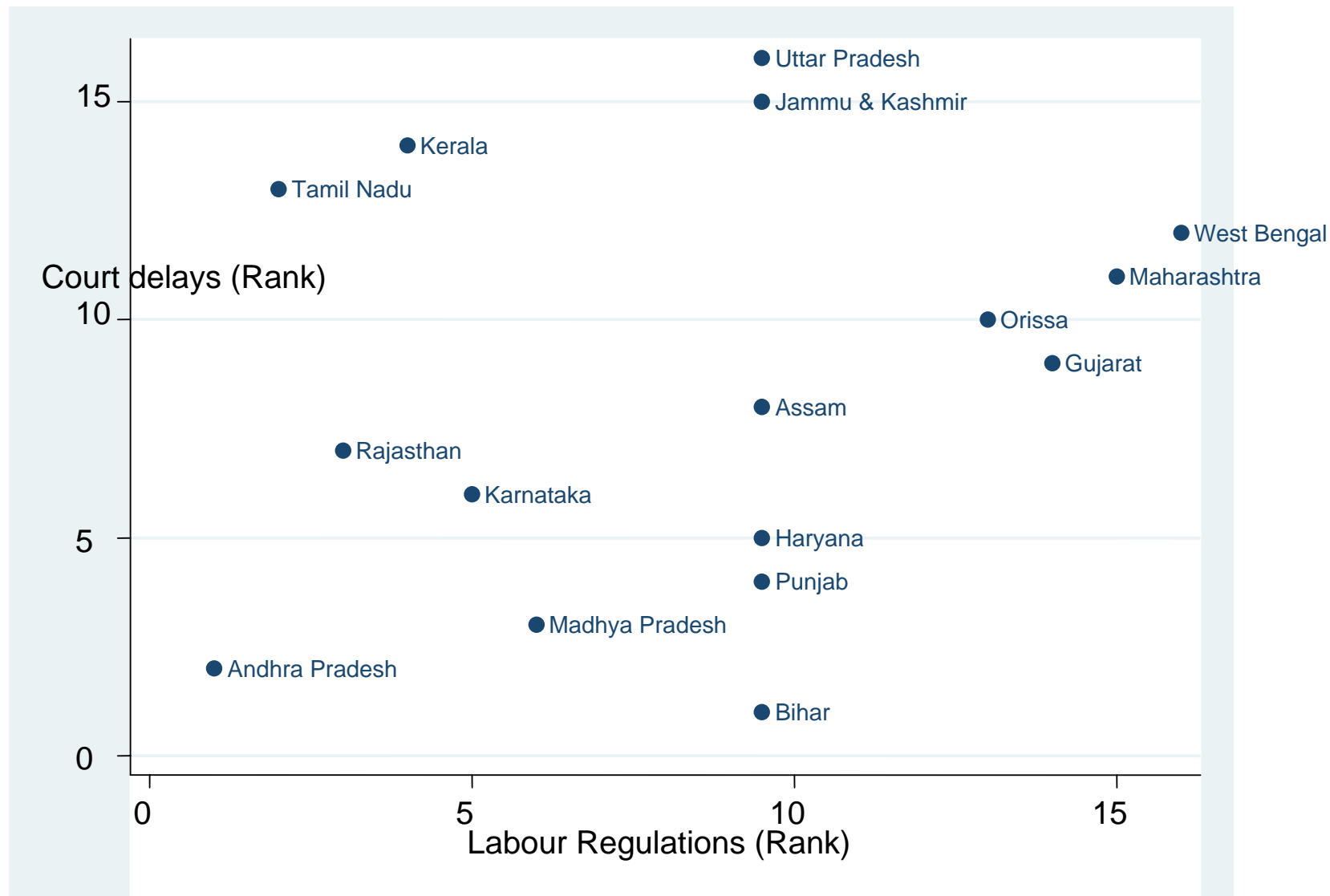
Data: World Bank 'Doing Business'(2006), Penn World Tables (2003)

What can we take away from this?

- It is certainly not credible to draw causal inferences from regulation to economic performance
- In fact, from a methodological point of view, it is next to impossible to use such cross-sectional variation to learn much.

Disaggregated Evidence: Indian States

- One interesting source of variation to exploit is cross-state variation in policies across Indian states
- How to find meaningful measures of regulatory policies is, however, an issue.
- I will discuss three lines on this:
 - labour regulations
 - court delays



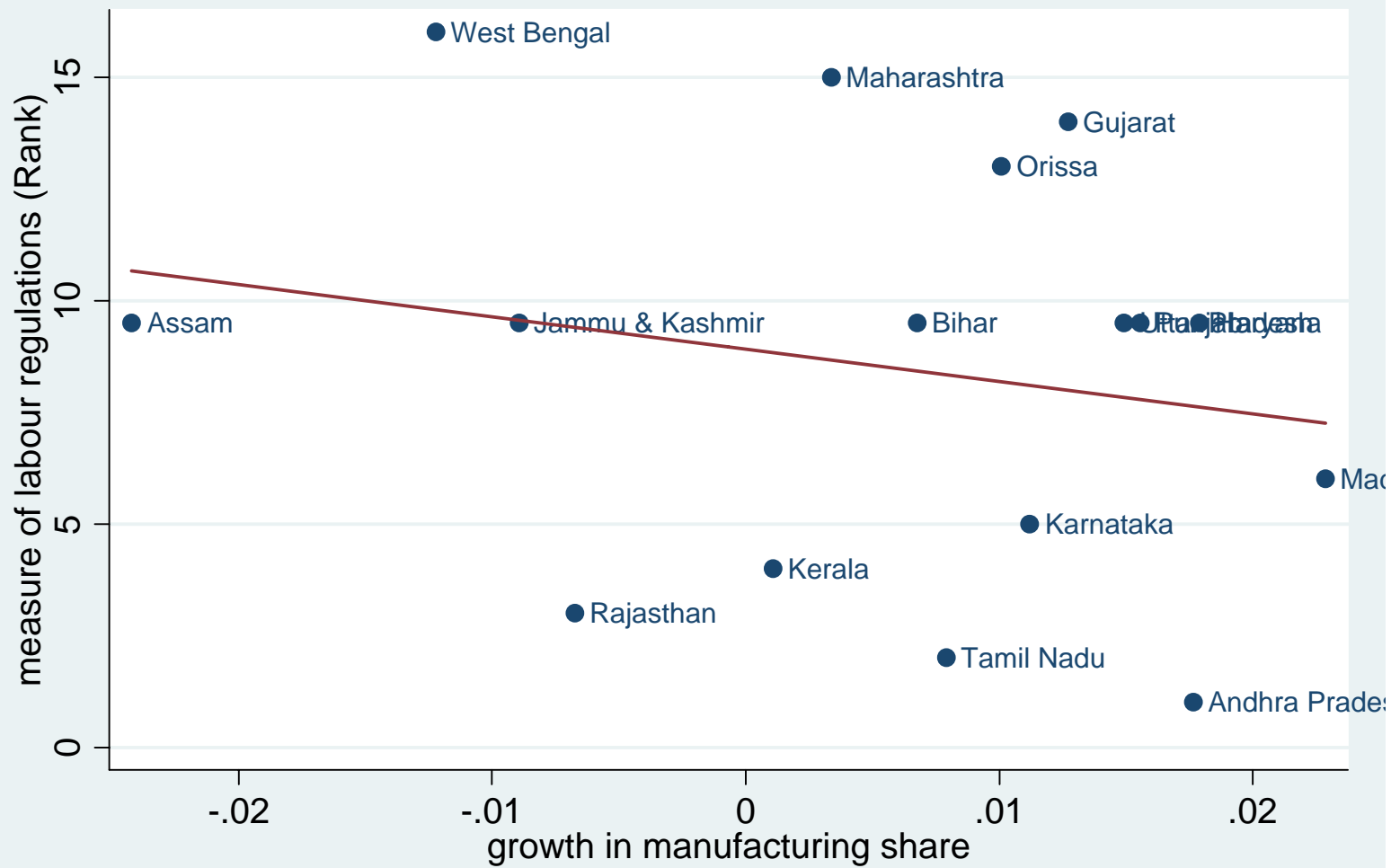
Issues

- Given that there is both time series and cross-sectional variation, it is possible to subject the data to rather more demanding tests
 - controlling for fixed characteristics of states
 - controlling for macro shocks
 - controlling for some time varying influences

- But there are still potential issues of non-random placement of policies.
 - policies may be correlated with unobserved economic and political conditions
 - policies may also proxy for other unobserved components of policy.

Evidence

- There is now a body of work that looks at these issues exploiting cross state differences.
- Heterogeneous policies at the state level do seem to be strongly correlated with state level performance in ways that can be interpreted



● Rank of Labour Regulations — Fitted values

Examples

- – pro-worker labour regulations reduced manufacturing development
 - * Besley and Burgess argue that pro-worker labour regulations are correlated with low manufacturing growth and higher urban poverty
 - * Aghion et al find that there is a link to the impact of trade liberalization on the performance of manufacturing firms
- court delays affect access to finance
 - * Chemin looks at 170000 small informal firms from NSS 55th round and finds that greater court delays are associated with less access to finance.

Regulation and Growth

- Regulation can be a source of unbalanced growth
- In India this is particularly germane to the absence of large scale labour intensive manufacturing.
 - although poor quality infrastructure is also an issue

A Few Comments on Public Private Partnerships

- There are recent estimates that India needs \$320 billion of infrastructure spending by 2012.
- A lot of faith is being put in PPPs to achieve this.
- The idea is to strengthen the hand of market forces in infrastructure provision and to rely less on direct provision by the state.

- But PPPs require a strong contractual environment.
 - this is related to the observation that outsourcing is "contract intensive".
 - such projects are potentially subject to significant "hold-up problems"
- Once there is a move away from traditional state solutions, it is essential that there are the structures in place to support alternatives.

Concluding Comments

- India has been reappraising the role of the state in a wide variety of spheres.
- There is some distance yet to go in providing market supporting institutions.
- It is reasonable to argue that the pattern of regulation has had a real impact of the structure of Indian growth.
- But a naive deregulation agenda must recognize the need to find alternative institutions to make sure that social objectives are achieved.

- one could be quite sceptical whether this can be taken up by courts
- There is little substitute in the medium run for strengthening the public sector.