US Experience With Regulatory Oversight: History and use of RIA

John F. Morrall III, Ph.D.
Senior Scholar Mercatus Center
George Mason University

Institute of Brazilian Issues
Washington DC
March 16, 2010
John F. Morrall III, Ph.D.

Worked for six Presidents of the United States in two White House Offices starting in 1975. Earlier had been an academic.

Began working at Office of Management and Budget (OMB) as an economist in 1981 when the Office of Information and Regulatory Affairs (OIRA) was established in OMB.

1989-2008: Acting Deputy Administrator and Branch Chief for OIRA. The Deputy Administrator is the highest career job in OIRA.

Responsible for reviewing the regulations and regulatory impact analyses issued by the Departments and agencies of the Federal government under E. O. 12866.

Published several books and numerous articles on benefit-cost analysis and regulatory reform.

Lead author for OMB’s annual Report to Congress on the Costs and Benefits of Federal Regulations.

Advised APEC, OECD, EU, Sigma, and dozens of governments on the US regulatory oversight system.
Overview of Talks

- US Regulatory Review Approach
- History of White House Regulatory Policy
- Use of RIA In US and ROW
- Has RIA Improved Regulatory Decision-making?
- Potential Benefits and Costs of Improved RIA for Brazil
- Conclusions
U.S. Approach to Regulatory Policy

- Centralized Management and Leadership
  - Emphasizes the importance of and adherence to regulatory principles and procedures.

- Transparency and Accountability
  - Addresses concerns about undue influence and allows all interested parties to be heard.

- Regulatory Impact Analysis
  - Contributes to more informed policy decisions and open government.

- Smarter Regulation
  - Use behaviorally informed approaches, improved RIAs, and retrospective analyses to extend or expand rules with net benefits or reassess or discontinue those that are under-performing.
Federal Rulemaking Process

Congress passes law authorizing/requiring regulation.

Agency drafts and clears internally a proposed rule.

If “significant,” OMB reviews and clears draft proposed rule.

Agency publishes notice of proposed rulemaking (NPRM).

Public reviews NPRM and submits comments to agency.

Agency reviews public comments and develops/clears draft final rule.

If “significant,” OMB reviews and clears draft final rule.

Agency publishes final rule.

Rule takes effect.

Congress reviews final rule.

Agency publishes final rule.

Disapproval resolution passed.

Rule challenged in court.

Court “vacates” all or part of rule.
Office of Management and Budget

- Assists the President in the development and implementation of budget, program, management, and regulatory polices.
  - Develops the President’s annual budget submission to Congress.
  - Assists the President in managing the Executive Branch, developing the Administration’s position on legislation before Congress and executing the law.
  - Promotes high quality regulatory analysis to manage regulation.

- History
  - 1921: Bureau of the Budget (BoB) established within the Treasury Department.
  - 1939: BoB moved from Treasury to the Executive Office of the President.
  - 1970: BoB reorganized into the Office of Management and Budget.
History of White House Management and Leadership

- Evolution of Presidential Oversight of Government Regulatory Policy

  President Nixon: Quality of Life Review

  President Ford: Required, for the first time, regulatory impact analysis (RIA) requirement for major regulations (over $100 million in impact).

  President Carter: Established the Regulatory Analysis Review Group.

  President Reagan: Solidified regulatory oversight authority within the White House, issuing Executive Order 11291, which required OMB review and approval of rules.

  President George H.W. Bush: Continued the Reagan Executive Order.
History of White House Management and Leadership

- President Clinton: Issued Executive Order 12866, which focused OMB oversight on “significant” rules and increased the disclosure of contacts with outside parties.

- President George W. Bush: Maintained the Clinton Executive Order that requires the agencies to do RIAs and send significant regulations to OMB for review. Added “prompt” letters.

- President Obama: Continued EO 12866, reaffirmed centralized review, and emphasized improving regulatory analysis through more open government and disclosure.
Centralized Management and Leadership

- Role of the Office of Information and Regulatory Affairs within OMB

- OIRA was established by the Paperwork Reduction Act of 1980, partially in response to the explosion in regulation that occurred in the 1970s and earlier in the U.S.

- As part of the Office of Management and Budget, OIRA is a central body that has special standing with the agencies.

- OIRA manages and coordinates Federal rulemaking and oversees Federal information management and statistical policy.

- Administrator is a PAS (Presidentially appointed Senate confirmed). In press often called the “Regulatory Czar” Cass Sunstein is current Administrator.

- About 50 staff in five branches
Birth of a Regulation, Initiation Phase

Office of Management & Budget

OMB Approval of Reg Agenda?
- No: SBREFA Panel (EPA, OSHA)

Rule Consistent with Admin. Policy?
- Yes: Revise Rule
- No: Withdraw Rule

Regulatory Agency

Agency Initiates Rule Making Action
Notice, Comment, & Finalization

**Office of Management & Budget**

- Final Rule Consistent with PRA & Admin. Policy?
  - Yes: Proceed to next step
  - No: Revise Rule

**Regulatory Agency**

- Agency Incorporates Public Comment into Final Rule

**Publish NPRM in Federal Register**

- Notice & Public Comment Period (30 to 90 Days)

**Prepare (revise) Final Rule and RIA. Send to OMB 90 days before publication in Federal Register**

- **Withdraw Rule**
- **Revise Rule**
Publication & Possible Review

- Publish Final Rule in *Federal Register*
- Congressional Review
- Final Rule Effective after 30 Days
- Judicial Review
Centralized Management and Leadership

Presidential Executive Order 12866 (September 30, 1993)

- Executive Order 12866 on Regulatory Planning and Review governs OMB’s oversight of agency rulemaking, requiring OMB review of “significant” agency regulatory actions.

- Agencies submit draft significant regulations (both proposed and final) to OIRA for an up-to-90-day review before publishing them in the Federal Register.

- OIRA reviews 500-700 regulations per year—those determined to be significant—out of about 2,200 that are issued.

- About 70-100 of the regulations reviewed are “economically significant” (over $100 million per year in economic effects). These require a Regulatory Impact Analysis (RIA).

- During its review, OMB examines the RIA and the regulation and makes suggestions to improve both the RIA and the rule’s cost-effectiveness and to make sure that it comports with the underlying statute, the Executive Order’s principles and the President’s priorities.

- If the agency refuses to make changes or needs more time to make the changes, OMB can return the rule to the agency for reconsideration.

- All done “To the extent permitted by law”
Regulatory Transparency and Accountability

- Administrative Procedure Act of 1946
  - The Act requires that agencies go through a notice and comment process open to all members of the affected public, both U.S. and foreign.
  - Before agencies can issue a final regulation, they must respond to the public comments, make sure that the final regulation is a logical out-growth of the proposal and the public record, and is not arbitrary or capricious.
  - The public record (including RIA) is used by the courts in settling any challenge to the regulations brought by the affected public.
Regulatory Transparency and Accountability

Disclosure of Information Under Executive Order 12866

- The public can consult OMB’s website and learn each day which rules are under review or have been cleared: http://www.reginfo.gov/public/

- OMB’s website notes which outside groups have recently lobbied OIRA on rules under review.
  - http://www.whitehouse.gov/omb/oira_meetings/

- All written information given to OMB while a rule is under review is sent to the agency, placed in OIRA’s public docket reading room, and posted on its website.

- Return letters sent to the agencies outlining concerns with are posted on website. Prompt letters are also posted.

- All agency rulemakings and public comments can be found at Regulations.gov
Regulatory Impact Analysis

- Required of Departments and Agencies for regulations with impact of over $100 million issued by Executive Branch agencies (independent agencies and Congress not covered)

- Basic Goals
  - Maximize net benefits to society—or at least ensure that benefits to society justify costs.
  - Promote economic efficiency by regulating where markets fail, and when regulating, by using cost-effective and market-based approaches.
  - Increase the transparency of the regulatory system.
  - Use in Executive, Judicial, and Congressional decisions
  - Use in retrospective evaluations
Key Elements of US Regulatory Impact Analysis

- Elements of a Regulatory Impact Analysis (scorecard)
- Based on OMB Circular A-4

1. Statement of need for the proposed rule that identifies the nature and significance of the problem (e.g., correction of the market failure, removing distributional unfairness, or promoting privacy or personal freedom).
2. Examination of alternative approaches to addressing the problem.
3. Analysis of the costs and benefits of each alternative.
4. Analysis of the costs and benefits of proposed action.
5. Discounting by 3% and 7%.
6. Cost-effectiveness analysis (CEA) if health, safety, or environmental regulation.
7. Formal uncertainty analysis for over $1 billion costs (Monte Carlo analysis)
8. Distributional effects (who gains who loses) estimated by income, geography, age, etc.
KEY ANALYTICAL STEPS IN EU IMPACT ASSESSMENT

- WHAT IS THE PROBLEM?
- WHAT ARE THE POLICY OBJECTIVES?
- WHAT ARE THE POLICY OPTIONS?
- WHAT ARE THE LIKELY ECONOMIC, SOCIAL AND ENVIRONMENTAL IMPACTS?
- HOW DO THE OPTIONS COMPARE?
- ARRANGEMENTS FOR FUTURE MONITORING AND EVALUATION
Question No. 1

Is the problem correctly defined?
The problem to be solved should be precisely stated, giving clear evidence of its nature and magnitude, and explaining why it has arisen (identifying the incentives of affected entities).
OECD

Question No. 2

Is government action justified?

- Government intervention should be based on clear evidence that government action is justified, given the nature of the problem, the likely benefits and costs of action (based on a realistic assessment of government effectiveness), and alternative mechanisms for addressing the problem.
OECD

Question No. 3

Is regulation the best form of government action?

- Regulators should carry out, early in the regulatory process, an informed comparison of a variety of regulatory and non-regulatory policy instruments, considering relevant issues such as costs, benefits, distributional effects, and administrative requirements.
OECD

Question No. 4

Is there a legal basis for regulation?

- Regulatory processes should be structured so that all regulatory decisions rigorously respect the “rule of law”; that is, responsibility should be explicit for ensuring that all regulations are authorised by higher-level regulations and consistent with treaty obligations, and comply with relevant legal principles such as certainty, proportionality, and applicable procedural requirements.
Question No. 5
What is the appropriate level (or levels) of government for this action?

- Regulators should choose the most appropriate level of government to take action, or, if multiple levels are involved, should design effective systems of coordination between levels of government.
OECD

Question No. 6

Do the benefits of regulation justify the costs?

- Regulators should estimate the total expected costs and benefits of each regulatory proposal and of feasible alternatives, and should make the estimates available in accessible format to decision-makers.

- The costs of government action should be justified by its benefits before action is taken.
OECD

Question No. 7

Is the distribution of effects across society transparent?

- To the extent that distributive and equity values are affected by government intervention, regulators should make transparent the distribution of regulatory costs and benefits across social groups.
OECD

Question No. 8

Is the regulation clear, consistent, comprehensible, and accessible to users?

- Regulators should assess whether rules will be understood by likely users, and to that end should take steps to ensure that the text and structure of rules are as clear as possible.
OECD

Question No. 9

Have all interested parties had the opportunity to present their views?

- Regulations should be developed in an open and transparent fashion, with appropriate procedures for effective and timely input from interested parties such as affected businesses and trade unions, other interest groups, or other levels of government.
OECD

Question No. 10

How will compliance be achieved?

- Regulators should assess the incentives and institutions through which the regulation will take effect, and should design responsive implementation strategies that make the best use of them.
OECD Indicator Project

1. UK
2. USA
3. CAN
4. NZL
5. CZE
6. AUSTRALIA
7. FINLAND
8. DENMARK
9. IRELAND
10. MEXICO

- 2008
- Self Assessment
- Measures extent of RIA process, not effectiveness
- Portugal at bottom
- Followed by Iceland, Luxemburg, Turkey and Spain
- CZE Republic moved from bottom quintile to top quintile from 2005
Building Quality Control In the US

- OMB Circular A-4: Guidelines for the Development of Regulatory Analysis
  - Issued September 2003 after Notice and Comment, peer review, and agency comments
  - Emphasizes careful consideration of qualitative and intangible values.
  - Conducted training sessions for agency staff

- Expanding OIRA’s Staff
  - Traditionally, OIRA’s professional staff consisted mostly of economists, public policy analysts, and lawyers.
  - OIRA has hired PhDs with expertise in risk assessment -- epidemiology, toxicology, public health.
  - Staff available for consulting with agency staff on BCA and risk analysis
Uses of US RIAs

- Quality Control
  - Review, revise, and/or return
  - Interagency review
  - Public comment period
  - Judicial review

- Scorecard
  - Eight elements tracked internally for staff bonuses
  - May publish scorecard for rating agencies in future
Regulatory Impact Analysis

- Types of RIAs
  - Competition Analysis for “economic” regulation
  - Transfer analysis for fiscal and distributional impacts using “administrative” regulations with primary impact on the budget
  - Benefit-Cost Analysis and/or Cost-Effectiveness Analysis for “social” regulation
  - Regulatory Flexibility Analysis for regulations with significant impact on small and medium size businesses

- Depth of Analysis proportionate to potential impact
  - < $100 million, >$100 million, and >$1 billion
Recent Developments with RIA

- President Bush Amended EO 12866, Regulatory Planning and Review, on January 18th 2007 with EO 13422
  - Required agencies to inform OMB of significant guidance documents.
  - Required agency Regulatory Policy Officers (RPOs) be Presidential Appointees.
  - Required a RPO to authorize commencement of a rulemaking.
  - Required identification of market failure

- President Obama revoked EO 13422 on January 30, 2009.
  - Put Vice President back in charge (WH Chief of Staff during Bush)
  - Also asked for suggestions to improve regulatory review and RIAs.
  - Nominated Cass Sunstein, Professor of Law at Harvard Law School.
  - Confirmed by Senate in September
Recent Developments with RIA

- President Obama asked for suggestions on:
  1. Relationship between OIRA and the agencies
  2. Disclosure and Transparency
  3. Public participation
  4. Role of cost-benefit analysis
  5. Role of distributional concerns, fairness, and concerns for future generations
  6. Ways to reduce undue delay
  7. Role of behavioral science
  8. Identifying best tools

- Got 183 comments from public and agencies
- No new Executive order yet
President Obama’s Regulatory Policy

- More decentralized, pragmatic, and active
- “Humanizing Cost-Benefit Analysis”
  - Homo Sapiens not Homo Economicus (use behaviorally informed approaches)
  - Examples include: cognitive availability bias, inertia, loss aversion and endowment effect, probability neglect, behavior influence of others
- Leads to regulatory approaches that emphasize
  - Disclosure
  - Simplifying choices and default rules
  - Salience
  - Social norms
President Obama’s Regulatory Policy

- Improving Regulatory Impact Analysis
  - Clear tabular presentation of benefits and costs including nonmonetary
  - Use retrospective analyses
  - Take account of effect on future generations and least well-off
  - Do better job of taking into account variables that are difficult to quantify and monetize

- Democratize data by more disclosure and open government
  - “Sunlight is the best of disinfectants” Justice Brandies
  - OMB’s Open Government Directive
  - Tapping the diverse knowledge of the people, Hayek
Has RIA Improved Regulatory Decisions?

- Seven US Presidents in a row (4 Rs & 3Ds) have reaffirmed its use
- Adopted by 30 countries following US (Jacobs 2006)
- US record on costs of regulation (OMB 2009)
- US record on benefits and costs (OMB 2009)
  - Farrow (2000)
  - Hahn and Tetlock (2008)
  - Morrall and Shapiro (forthcoming)
- Case study evidence (Morgenstern 1997, Graham 2008)
- Trans Fatty Acid rule (Morrall 2009)
The Rise of RIA Programs

Source: Copyright by Jacobs and Associates, 2006
Figure 2-1: Costs of Major Rules (1981-2008)
Figure 2-2: Benefits and Costs of Major Rules (1992-2008)
Cost per Life Saved of US Regulations
(Updated from Morrall 2003 in millions of $2002)
Case Studies of Using RIAs to Improve Decision Making

- Economic Deregulation in US from 1975 to 1990s
- Lead phase-down in gasoline (DeMuth 1994, Nichols 1997)
- Economic Analysis at EPA, (Morgenstern (Ed) 1997)
  - All 12 case studies found an increase in net benefits due the RIA
- Saving Lives Through Administrative Law and Economics (Graham 2008)
  - 2004 Non road diesel engines rule
  - 2005 Clean Air Interstate rule (sulfur and nitrogen)
  - 2003 and 2005 CAFÉ standards for cars and light truck rules
Effectiveness of RIA: The Case of Trans Fatty Acid

- Regulation issued 2003 required firms to label separately trans fat content of foods in nutrition facts panel
- A 1999 Clinton proposal to add trans fat to sat fat content had stalled at the Food and Drug Administration
- First OIRA “prompt letter” September 2001 based on BCA analysis in 1999 PRIA and new risk assessment evidence that trans fat intake caused Chronic Heart Disease (CHD)
- Using CEA: I had published several cost per statistical life saved (CSLS) “league” tables and found trans fat labeling to be a very cost-effective potential regulatory action
Effectiveness of RIA: The Case of Trans Fatty Acid

- Of 76 final rules issued, 32 above $7m per CSLS and 27 above $21m per CSLS.
- $7 million based on willingness-to-pay (WTP) and $21 million based on Health-Health Analysis fatal cutoff estimate
- I estimated trans fat to be less than $10k
- RIA for the new improved 2003 rule.
  - Based on consumer surveys trans fat was about 2.5% of energy intake with 2.0% being added by food processors
  - Reformulation of margarine and consumer avoidance estimated very conservatively to reduce intake by 0.04% (1/50th of total)
Effectiveness of RIA: The Case of Trans Fatty Acid

• After doing risk-risk analysis due to substitution of other fats the net reduction in CHD is from .05% to .1% using risk estimates for CHD from various fats

• Given 1.1 million heart attacks per year in the US (40% fatal), labeling reduces from 200 fatal and 400 nonfatal heart attacks per year to 480 fatal and 720 nonfatal depending on the mechanism assumed (LDL or both LDL and HDL).

• Cost analysis based on the number of labels needing change (300,000), products needing testing (60,000) and costs of voluntary reformulation (45 products)
  • One time costs of $140m to $250m
Effectiveness of RIA: The Case of Trans Fatty Acid

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>• $230 million to $2,839 million per year</td>
<td>• $9 million to $26 million per year</td>
</tr>
<tr>
<td>• Reasons for range:</td>
<td>• Weaknesses</td>
</tr>
<tr>
<td>• Discount rate of 3% and 7%</td>
<td>• Distribution analysis (affect on poverty) not done</td>
</tr>
<tr>
<td>• Life years gained and QALYs</td>
<td>• Alternatives not estimated</td>
</tr>
<tr>
<td>• WTP and Medical costs</td>
<td></td>
</tr>
<tr>
<td>• B/C=92  $1.6 billion net benefits</td>
<td>• My best estimate was $3,000 CSLS</td>
</tr>
</tbody>
</table>

Weakeress

• Distribution analysis (affect on poverty) not done
• Alternatives not estimated
Regulatory Quality Leads to Strong Macro Performance

- Was the original justification for the US regulatory reform program during the stagflation days of the mid 1970s and has been a Presidential priority since then.

- Since the mid 1980s, US economic performance (per capita growth, inflation, and employment) has been one of the best in the developed world, contrary to the per capita income convergence theory.

- Studies by the World Bank (Doing Business series), the OECD, Heritage Foundation, and the Fraser Institute consistently find positive impacts to improvement in regulatory quality. Countries with flexible and efficient regulatory systems coupled with well defined property rights have the best record of growth in per capita income as well as social indicators such as life expectancy and the UN Human Development Index.

- According to the World Bank study, moving from the bottom quartiles to the top quartile of 135 countries adds 2.3% to average annual economic growth -- even after controlling for other growth factors such as education, civil conflict, investment, and income. (Djankov, McLiesh, Ramalho, 2006)
What does Doing Business measure?

Doing Business indicators:

☑ Focus on regulations relevant to the life cycle of a small to medium-sized domestic business.

☑ Are built on standardized case scenarios.

☑ Are measured for the most populous city in each country.

☑ Are focused on the formal sector.

☑ **DO NOT** measure all aspects of the business environment such as macroeconomic stability, corruption, level of labor skills, proximity to markets, of regulation specific to foreign investment or financial markets.
How are the rankings constructed?

<table>
<thead>
<tr>
<th>Starting a business</th>
<th>Protecting investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Procedures, time, cost and paid-in minimum capital to open a new business</td>
<td>Strength of investor protection index: extent of disclosure index, extent of director liability index and ease of shareholder suits index</td>
</tr>
<tr>
<td><strong>Dealing with construction permits</strong></td>
<td><strong>Paying taxes</strong></td>
</tr>
<tr>
<td>Procedures, time and cost to obtain construction permits, inspections and utility connections</td>
<td>Number of tax payments, time to prepare and file tax returns and to pay taxes, total taxes as a share of profit before all taxes borne</td>
</tr>
<tr>
<td><strong>Employing workers</strong></td>
<td><strong>Trading across borders</strong></td>
</tr>
<tr>
<td>Difficulty of hiring index, rigidity of hours index, difficulty of redundancy index, redundancy cost</td>
<td>Documents, time and cost to export and import</td>
</tr>
<tr>
<td><strong>Registering property</strong></td>
<td><strong>Enforcing contracts</strong></td>
</tr>
<tr>
<td>Procedures, time and cost to transfer commercial real estate</td>
<td>Procedures, time and cost to resolve a commercial dispute</td>
</tr>
<tr>
<td><strong>Getting credit</strong></td>
<td><strong>Closing a business</strong></td>
</tr>
<tr>
<td>Strength of legal rights index, depth of credit information index</td>
<td>Recovery rate in bankruptcy</td>
</tr>
</tbody>
</table>

The index is calculated as the ranking on the simple average of its percentile rankings on each of the 10 topics.
Top 30 on the ease of Doing Business 2008/09

<table>
<thead>
<tr>
<th></th>
<th>Country</th>
<th></th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Singapore</td>
<td>16</td>
<td>Finland</td>
</tr>
<tr>
<td>2</td>
<td>New Zealand</td>
<td>17</td>
<td>Mauritius</td>
</tr>
<tr>
<td>3</td>
<td>Hong Kong, China</td>
<td>18</td>
<td>Sweden</td>
</tr>
<tr>
<td>4</td>
<td>United States</td>
<td>19</td>
<td>Korea, Rep.</td>
</tr>
<tr>
<td>5</td>
<td>United Kingdom</td>
<td>20</td>
<td>Bahrain</td>
</tr>
<tr>
<td>6</td>
<td>Denmark</td>
<td>21</td>
<td>Switzerland</td>
</tr>
<tr>
<td>7</td>
<td>Ireland</td>
<td>22</td>
<td>Belgium</td>
</tr>
<tr>
<td>8</td>
<td>Canada</td>
<td>23</td>
<td>Malaysia</td>
</tr>
<tr>
<td>9</td>
<td>Australia</td>
<td>24</td>
<td>Estonia</td>
</tr>
<tr>
<td>10</td>
<td>Norway</td>
<td>25</td>
<td>Germany</td>
</tr>
<tr>
<td>11</td>
<td>Georgia</td>
<td>26</td>
<td>Lithuania</td>
</tr>
<tr>
<td>12</td>
<td>Thailand</td>
<td>27</td>
<td>Latvia</td>
</tr>
<tr>
<td>13</td>
<td>Saudi Arabia</td>
<td>28</td>
<td>Austria</td>
</tr>
<tr>
<td>14</td>
<td>Iceland</td>
<td>29</td>
<td>Israel</td>
</tr>
<tr>
<td>15</td>
<td>Japan</td>
<td>30</td>
<td>Netherlands</td>
</tr>
</tbody>
</table>
2010 Doing Business Rankings for BRIC Countries

<table>
<thead>
<tr>
<th></th>
<th>Overall</th>
<th>Starting a Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>89</td>
<td>151</td>
</tr>
<tr>
<td>Russia</td>
<td>120</td>
<td>106</td>
</tr>
<tr>
<td>Brazil</td>
<td>129</td>
<td>126</td>
</tr>
<tr>
<td>India</td>
<td>133</td>
<td>169</td>
</tr>
</tbody>
</table>
Potential Benefits of Improving Regulatory Quality for Brazil

- Regulatory Impact Analysis is **necessary but not sufficient** to establish well-defined property rights (or the rule of law) and market friendly regulation. Two key components of Regulatory Quality

- Well-defined property rights and market friendly regulation are key drivers of economic performance

- Increasing number of econometric studies as well as common sense economics support these propositions
Determinants of Per Capita Income

- Found in leading principles of economics text books (Mankiw, Frank and Bernanke)
- \( Y = Af(L, K, N, H) \)
- \( \frac{Y}{L} = Af(1, \frac{K}{L}, \frac{N}{L}, \frac{H}{L}) \)
  - \( Y = \) quantity of output
  - \( A = \) level of technology, entrepreneurship, and political and legal environment (well-defined property rights)
  - \( L = \) Labor
  - \( K = \) physical capital
  - \( N = \) natural resources
  - \( H = \) human capital
Importance of Property Rights

“One specific function of government that appears to be crucial to economic success is the establishment of well-defined property rights. Property rights are well defined when the law provides clear rules for determining who owns what resources (through a system of deeds and titles, for example) and how those resources can be used.” (Frank and Bernanke, *Principles of Macro Economics*)
Worldwide Governance Indicators

- The WGI is a research project initiated by Daniel Kaufmann and Aart Kraay in the late 1990s and is now in its eight year. The WGI measure six broad dimensions of governance. Three are most relevant:
  - **Government Effectiveness**: the quality of public services, the capacity of the civil service and its independence from political pressures; the quality of policy formulation
  - **Regulatory Quality**: the ability of the government to provide sound policies and regulations that enable and promote private sector development
  - **Rule of Law**: the extent to which agents have confidence in and abide by the rules of society, including the quality of property rights, the police, and the courts, as well as the risk of crime
- For 2009 the indicators cover 212 countries and territories, drawing together hundreds of variables from 35 different data sources to capture the views of tens of thousands of survey respondents worldwide on the three dimensions above plus voice and accountability, political stability and corruption control.
Rule of Law and Income

- Better governance helps in the fight against poverty and improves living standards.

- Research by many scholars, including the WGI authors, shows that improved governance strengthens development, and not the other way around.

- When governance such as the rule of law is improved by one standard deviation, infant mortality declines by two-thirds and incomes rise about three-fold in the long run. (for Brazil implies $7,350 to $22,000).

- According to WGI authors “such advances in governance are readily achievable, since these differences constitute just a fraction of the difference between the worst and best performers”.

55
Rule of Law Index
Standard Deviations

Series 1

- Afghanistan
- Nigeria
- Brazil
- Uruguay
- Chile
- Norway
Cost of Entry and Income

- A recent study published in the *Journal of Economic Growth* (Barseghyan 2008) using one of the *Doing Business* indexes, the cost of starting a business relative to GNI per capita, is able to separate the effect of the rule of law from the relative cost of starting a business.

- This is a key measure of how *market friendly* the regulatory environment is and is also a main goal of many well designed RIA programs. It has strong support in the economic literature as a driver of economic growth (Djankov et al 2002).

- An increase in cost of entry by 80% of income per capita (about ½ a standard deviation) is estimated to decrease output per worker by 29%.

- Reducing Brazil’s relative cost of starting a business (10.8%(in 2007)) by 80% to the level of Germany implies an increase in income per capita of 29% or about $2,100.
Benefits and Costs of Improving Regulatory Quality

- The potential benefits of improving regulatory quality by say ½ a standard deviation of international norms implied by the above the studies are huge compared to any likely opportunity costs.
- The 29% increase implied by easing the costs of entry for SMEs translate into over $580 billion for Brazil’s economy (29%*$2T GDP using ppp).
- 200% increase implied by Rule of Law studies translates into $4 Trillion.
- But many caveats, uncertainties and discounting all must be considered.
Summary Of Benefits of Reform

- Based on US and international experiences the Potential Benefits of Regulatory Improvement are huge
- Actual benefits depend on the components of the regulatory quality improvement programs as well as implementation
- The actual design and implementation depend on the existing institutions and circumstances of the reforming country.
Conclusions From US Experience

- A firm and enduring commitment from the center of government is a necessary condition for a successful regulatory program.

- Accountability is required because special interests are especially powerful and benefits are diffused and lag political costs.

- An effective regulatory program should ensure that Regulatory Impact Analysis is of high quality and conducted to promote economic efficiency and fairness.

- Transparency and openness are necessary to maintain public support for a regulatory reform program.

- Potential Benefits of Improving Regulatory Quality are huge
References


- **Listing of regulations under Executive Order 12866 review**: [www.whitehouse.gov/library/omb/OMBREGSP.htm](http://www.whitehouse.gov/library/omb/OMBREGSP.htm)

- **Listing of OIRA’s meetings with outside parties on regulations under OMB review**: [www.whitehouse.gov/omb/oira/meetings.html](http://www.whitehouse.gov/omb/oira/meetings.html)


- **OMB guidance to agencies on Regulatory Analysis** (September 17, 2003): [www.whitehouse.gov/omb/circulars/a004/a-4.pdf](http://www.whitehouse.gov/omb/circulars/a004/a-4.pdf)

Questions?

John F. Morrall III
jmorrall3@aol.com