

Regulation, Government Involvement, and Red Tape around the World

The “LLSV” (and co-authors)
Compendium

Brief reminder of the predictions from different theories

- Corruption as grease:
 - Corruption and red tape negatively related. Corruption is efficient.
- Corruption as extortion:
 - Red tape (regulation) positively correlated with corruption
 - Delays can also be correlated with corruption
- Corruption as a necessary evil:
 - Corruption and red tape negatively correlated
 - Red tape and efficiency will be positively correlated

Questions we are left with...

- Relation between red tape and corruption
- Relation between corruption and efficiency
- Relation between red tape and efficiency
- Relation between government involvement in the economy, corruption, and red tape.

LLSV (and Botero, Djankov, Glaeser....)

- Collect very detailed data various aspects of :
 - Formal regulations
 - Actual law enforcement
 - Government involvement
 - ...around the world.
- Tremendous work. Extremely careful and useful
- Goals
 - Description.
 - *Explain* differences across countries.
 - Evaluate the efficacy of different arrangements.

Papers

- Law and Finance
 - Rules protecting creditors and shareholders against expropriation by management in 49 countries
 - Rule of law
- The Regulation of Entry
 - Number of procedures, official time, and cost a start up must bear before operating legally, in 85 countries.
 - Anywhere between 2 days and 152 days... between 0.5% of per capita GDP and 4.6 times per capita GDP
- The Practice of Justice
 - “Lex Mundi Project”: in 109 countries, procedures for evicting a tenant for non-payment and recovering a bounced check. Average length is 254 days for an eviction, 234 for a check. Varies from 49 days in the US to 660 in Bulgaria.
- The Regulation of Labor
 - Laws governing relationship between labor and firms in 85 countries.
- Government ownership of Banks
 - 92 countries. Government ownership of the 10 largest commercial or development banks that lend money to firms.
 - In an average country, government owns 42% of the equity of these 10 banks.

Theses (beware the Frenchmen...)

1. Legal origins
2. Civil law countries have
 - More regulation and lengthier processes
 - More government involvement
 - Less protections of investors
3. Regulation/gvt ownership and corruption are positively correlated (...and Regulation causes corruption).
4. Regulation/gvt ownership and efficiency are negatively correlated (...and Regulation causes inefficiency).
5. Persistence of transplanted institutions.

Legal Origins

- Countries have inherited Institutions of those who colonized them.
- Five broad families:
 - Civil law (french origin)
 - Civil law (german origin)
 - Scandinavian origin
 - Common law
 - Socialist origin
- France, Italy, Spain and the countries that have colonized them (Latin America and part of Africa) have civil law codes.
- Germany, Austria, Japan, South Korea, have Japanese origins
- US, UK, and countries colonized by them have english origin.
- Civil law: legal scholar derive rules from first principles. Civil law is characterized by professional judges, legal code, written record
- Common law is formed by judge who resolved specific disputes. Precedent from judicial decisions shape the common law. Common Law relies on lay judges, broader legal principles, and oral arguments.

The impact of Legal Origins

Compared to Common Law Countries, Civil law countries have:

- Less investors protections (LF)
- Worst rule of law (LF)
- More regulation of entry (RE)
- More regulation of labor (RL)
- More Ownership of Banks (BO)
- More formalism of judicial procedures, longer and more costly proceedings (PJ)
- Less honesty and fairness in trials (PJ)
- More corruption (PJ)
- ... (Except in France)

In Summary: More red tapes in the rules AND in practice. More corruption as well.

Regulation and Red Tape

- Regulation of entry goes from a number of steps to a number of days, assuming no unnecessary delays (RE).
- Greater formalism associated with longer proceedings *in practice* (PJ).
- Argue that this is a causal effect of formalism, rather than general interventionism. Use legal origin as an instrument for formalism. Problem??

Regulation and Corruption

- Measurement issue: Corruption measured by Transparency international (surveys of businessmen, etc....).
- More regulation of entry, more corruption and larger unofficial economies
- More formalist judicial process, less honesty and fairness of the judicial system (according to the World Survey of Business environment), more corruption.

Regulation and Efficiency

- Higher level of government ownership in 1970 leads to lower financial development and lower GDP and productivity growth in 1970-1990 (BO)
- More formalism in justice: Business people less likely to report that contract are enforceable, legal system is consistent, they have confidence in the legal system. Again, note who is asked their opinion... (PJ)
- More regulation of entry: less likely to be in conformity with international quality standard, no more likely to have good water, no less likely to have accidental death due to poisoning... (RE)

The Persistence of Institutions

- Shleifer central thesis (LLSV, Shleifer Glaeser, The Grabbing Hand)
 - Regulations are in part invented by extractive states for extortive purpose
 - However, there is also some autonomy of the legal framework. Legal rules matter, because of contractual incompleteness non-standard contracts may be difficult to enforce by courts (LF)
 - The Civil law, that work well with a benevolent government (France...), is particularly subject to capture by a dictatorship.
 - When civil law and common law institutions are transplanted in bad environment, the civil law institutions are captured, breed corruption and extorsion, and self perpetuate.

Summary

- LLSV want to argue two things:
 - Despotism breeds regulation and government involvement (i.e. less democratic government have more regulation of entry).
 - Regulation breeds more corruption and inefficiencies.
- Alternative:
 - Government ownership and regulation are an *answer* to a bad situation, which also explains the bad performance.
- Answer:
 - Look at effect of base period on subsequent performance (BO). Problem with that ?
 - Legal origin is an exogenous “seed” for subsequent institutions.
- Thus, the legal origin argument is central to the argument that there is a causality from regulation to corruption (rather than an omitted variable explaining both). E.g. in PJ, legal origin is formally used as an instrument for formalism (problematic since it is also associated with many other things, in the LLSV framework).

Alternative Theories (1)

- The French do not like industrious businesspeople
 - Note that the French do not systematically have LESS regulation, they have WORST regulation (LF: less investor protection, more concentrated ownership).
 - WORST in some specific sense: anti-business.
 - Other regulations exhibit different pattern: Immordino-Pagano
 - A distrust of business in French Origin countries would explain the results: Did these countries inherit a legal heritage or an anti-business culture among bureaucrats?
 - If the later were true, other results (worst enforcement of rule of laws as measured by businessmen (LF), systematic protections of renters (PJ), etc...), government ownership (GO) could be explained by this culture, rather than by ramification of an autonomous legal system.
 - The evidence provide no real TEST that more regulation breeds corruption.

Alternative Theories (2)

- The French like only the French
 - AJR: French legal origin colonies also tend to be more extractive States.
 - Once you control for early settlers' mortality, French legal origin still explain institutions, but NOT performance.
 - The correlation between legal origin and performance picks up something else than the impact of Institutions.