POLICY BRIEF

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Regulatory Reform and Economic Development

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A growing economy and a safe and healthy environment are highly desirable, but local policy makers often confront choices between protecting the environment through regulatory actions on the one hand and promoting economic growth and development on the other. Too often these conflicting goals involve pitting one part of community against another: the environmental interests of the relatively well-to-do versus the economic interests of the poor. We argue this tradeoff is not inevitable because regulatory reforms that reduce uncertainty in the regulatory permitting process provide a means for protection of the local environment without imposing onerous burdens on industry and developers.

We have empirically estimated the development effect of reforms designed to consolidate and coordinate local government regulatory permitting procedures. Based on this evidence we argue that local regulatory agencies can pursue policies that have the potential to ensure environmental protection while not undermining economic growth that provides higher incomes and jobs for the poorest segments of the population.

How Does Regulation Affect Development?

Regulation can increase the costs of new development and the costs of producing goods. Local regulatory programs affect the return on development investment by increasing construction and production costs. Mounting empirical studies document increased production costs resulting from compliance with environmental regulation and provide evidence that these locally based regulatory costs lead to reduced output, higher prices, and reduced income in a community.

The development implications of regulatory costs in a jurisdiction are magnified by competition from neighboring communities. Inter-jurisdictional competition may even result in regulatory relief being used as a development incentive. After a firm has decided to locate in a particular region based on non-governmental factors, local government policy is an important consideration in the choice among communities within a region. This means that local governments may use lower regulatory costs as incentives to gain advantage in this competition, potentially compromising its quality of life. The result could be the regulatory equivalent to Gresham's Law where bad regulation pushes out good regulation resulting in a "race to the bottom."

Regulating Without Economic Loss

Are tradeoffs between the social benefits of regulation and the economic benefits of development inevitable? While regulation may deter economic growth in some contexts by increasing production costs or creating inefficiencies, in other circumstances the benefits of regulation may be obtained with little or no loss of economic development. Reforming the regulatory processes to make property rights more secure by streamlining the regulatory process and reducing regulatory uncertainty is one mechanism to overcome this tradeoff.

The effect of regulatory programs on property rights has direct consequence for the decisions of potential investors and developers in a community. If regulations are complex, unclear, or subject to frequent and unpredictable change or revision, it creates uncertainty. Regulatory uncertainty raises costs and increases the risk of new investment for firms and entrepreneurs. Uncertainty becomes especially costly for potential investors, if variations in future regulatory directives cannot be anticipated. Because regulations modify existing property rights, if they change rapidly or unpredictably, they create a risky investment environment and increase capital costs which raise upfront costs that lower the rate of return. Complex regulatory processes which create uncertainty will therefore discourage new investment

On the other hand, even relatively stringent regulatory requirements, if they are clear, stable and certain, may diminish investors' risks and perhaps even increase investment in a high quality community. This suggests that local governments with stringent regulation, but stable and certain patterns and processes of regulation may have some hope of enjoying both the social and environmental benefits resulting from regulation as well as a growing economy.

How can communities reduce regulatory uncertainty and create a more stable and predictable regulatory environment? One answer is to streamline and consolidate the procedures, administrative designs and requirements of the regulatory permitting processes for new development. Efforts to centralize, coordinate, and streamline these programs, provide an effective means to reduce uncertainty in the regulatory environment.

The most popular mechanism for streamlining regulatory procedures is to establish a one-stop facility permitting program that consolidates the process of gaining approval for new development and facility expansion and helps to simplify and coordinate local regulatory actions. The purpose of this regulatory reform is not to relax standards or to reduce the stringency of regulatory regimes, but to assist businesses and developers meet regulatory requirements through a coordinated regulatory processes that reduces the time necessary to get development approval and reduces uncertainty regarding regulatory requirements. This approach has even been praised by some environmental organizations because coordinated regulatory processes can better address multi-media pollution problems.

Evidence that "one stop" permit issuance process simplifies regulatory processes and leads to higher levels of private investment is provided by a survey of local government economic development officials conducted by the International City Management Association in 1989. The survey reports that over 40 percent of the responding cities had adopted one-stop permitting practices.

Using statistical analysis we examined the effect of this regulatory reform on the number of new firms communities attracted and the amount of new capital invested in manufacturing. Our analysis controlled for other factors that influence new firm location and manufacturing investment, including economic conditions and political factors. We found clear evidence that consolidated one-stop permit issuance programs had a significant and positive influence on new manufacturing establishments and on new investment. We estimate that within a five year period, implementation of one-stop permitting resulted in a 5 percent increase in manufacturing establishments and an increase in manufacturing investment that was about 3 percent more than the community would be expected to attract without regulatory reform.

Our analysis highlights the importance of regulatory reform for economic development. The statistical results suggest that local governments may reduce hard choices between regulatory protections and economic development if they are able to reduce uncertainty over property rights through efforts to coordinate and consolidate regulatory decision-making. By reducing uncertainty and risk through streamlines one-stop regulatory permitting, local government may promote both regulatory goals and economic growth. Since economic growth is important for the economic well-being of the poorest members of the community, such reforms that have the cost of maintaining environmental quality are highly desirable.

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