

A regulatory budget could grow the Danish GDP by 13.8%

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This briefing provides a summary of a recent analysis by the Centre for Political Studies (CEPOS). The analysis investigates the economic potential that can be realised by implementing a regulatory budget based on a '1-in, 1-out' model. The findings suggest that a regulatory budget can potentially increase the Danish gross domestic product (GDP) by 2.3 – 13.8 per cent (€7.8 – €46.5 billion) when compared to a business-as-usual scenario.

Regulation is negatively related to growth

International literature clearly documents that regulation hinders economic growth. The CEPOS analysis reviewed 68 studies, investigating the link between regulation and growth. The majority of these studies revealed a negative relationship, implying that higher regulation impedes growth. The primary aim of the analysis was to investigate the economic potential achievable by reducing the amount of regulation through the introduction of a regulatory budget that applies a 1-in, 1-out rule, which implies that every new rule must be accompanied by the repealing of one existing rule. The 1-in, 1-out rule will stall the usual increase in the amount of regulation.

The regulatory state in Denmark is continually growing

As measured by the number of words in the total body of legislation, the amount of regulation in Denmark has grown continuously in the last 30 years, almost tripling since 1989. Studies show that there were 7.5 million words in the collected legislation in 1989, whereas there were 19.3 million words in 2022. In the last 10 years, the amount of regulation has grown, on average, by approximately 1.4 per cent annually.

Regulation that successfully corrects market failures, such as pollution or greenhouse gas emissions, and protection of fundamental rights such as private property rights, is often the foundation for economic growth. However, regulation that does not successfully corrects market failures is likely to hinder economic activity and economic growth. It is likely that the threefold increase in the amount of regulation has substantially hindered growth.

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One example of growth-inhibiting regulation is the so-called '*Long-Distance Bus Act*'. This act imposes restrictions on public transportation by prohibiting long-distance buses from offering trips shorter than 75 km. Another example is the '*Taxi Act*', which effectively prohibits services like Uber from operating in Denmark. Herby (2018) and Herby and Bostrup (2018) have shown that the liberalisation of public transport yields large benefits for society.

Studies have estimated the economic effects of deregulation

We have identified five studies that can be used to estimate the economic potential of a regulatory budget. The studies are divided into three main groups: in the first group, the researchers investigate the economic consequences of not following international best practices. The studies are based on international comparisons of regulations in different countries based on indicators from the World Bank and Organisation for Economic Co-operation and Development (OECD) (Djankov et al. 2006; Guillemette and Turner 2018). The advantage of using best-practice studies is that it ensures that beneficial regulations, such as certain types of environmental protection, are considered, as this type of regulation is most likely to be in place in countries that follow best practices. A disadvantage of this approach is that studies such as the one by Djankov et al. (2006), using World Bank data, might not capture the true effects of deregulation, as best practice is not equal to optimal practice. Another disadvantage of applying the method used in Djankov et al. (2006) and Guillemette and Turner (2018) is that the indicators are based on relatively broad definitions, which means that they may not capture precise prohibitions, such as the aforementioned restrictions on public transport.

These drawbacks are more likely to be captured by the second group of studies, which are based on the economic effect of the total amount of regulation (Dawson and Seater 2013; Coffey et al. 2020). The advantage of this group is that all costs associated with regulations are accounted for. However, this also implies that regulations that exist to correct market failures are included in the costs.

The last group is a study of an actual regulatory budget in British Columbia, Canada (Coffey and McLaughlin 2021). The advantage of applying the results of this study is that it takes the prioritisation of regulation into account, which then illustrates the economic effects of reducing redundant regulations.

The best-practice studies can be interpreted as the lower boundary for potential economic growth, whereas the studies based on the economic effect of the total regulations can be considered the upper boundary for economic growth.

To study the effects of a regulatory budget, we assume that the observed growth in regulation in the period 2012–2022 will represent the regulatory growth in the next ten years. A regulatory budget with a 1-in, 1-out principle would maintain the current amount of regulation. The economic potential is then estimated as the benefit of maintaining the current regulation level.

A regulatory budget can increase the Danish GDP by 2.3 – 13.8 per cent over a ten-year period

The study by Coffey and McLaughlin (2021) is based on actual deregulation through a regulatory budget in British Columbia in Canada. For the first three years of the reform, the government worked with the principle of ‘1-in, 2-out’, which allowed them to reduce the amount of regulation by a third. After three years, they continued with the principle of 1-in, 1-out. A thorough review of the reform can be found in Herby and Andersen (2022).

Using a difference-in-difference estimation based on the reforms in British Columbia, Coffey and McLaughlin (2021) find that a 1 per cent decrease in the amount of regulation is associated with a 0.028 per cent increase in economic growth. In the Danish setting, we expect that the amount of regulation after ten years will be 22 per cent lower with a regulatory budget than without a regulatory budget. Using the results from Coffey and McLaughlin (2021), it is found that after a ten-year phase-in period, the total effect of the regulatory budget on GDP is 3.3 per cent.

Based on the elasticities obtained from Dawson and Seater (2013) and Coffey et al. (2020), it is estimated that a ten-year regulatory budget can increase the GDP by 7.4–13.8 per cent.

To apply the estimates from the best-practice studies by Djankov et al. (2006) and Guillemette and Turner (2018), we assume that Denmark will meet regulatory best practices over a ten-year period if a regulatory budget is implemented. Guillemette and Turner (2018) state that product market reforms in Denmark, as measured by the OECD, can increase the GDP by 2.3 per cent. Djankov et al. (2006) estimate the economic effect of improving business environments, as measured by the World Bank’s Doing Business indicator. Applying these results to a Danish context implies that a regulatory budget can increase the GDP by 5.6 per cent within a ten-year period.

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Based on the three groups of studies, it is estimated that by maintaining the current level of regulation over a ten-year period using a regulatory budget, the GDP could potentially improve by a total of 2.3–13.8 per cent. The improvements will originate from increases in productivity. Since productivity and wages are closely related, a regulatory budget can substantially increase wages for Danish wage earners. For an average working family, this could mean an annual salary increase before taxes of €2,700–16,000 as a result of a ten-year regulatory budget.

Uncertainty

As regulations vary across countries and over time, there is considerable uncertainty about the results in a Danish setting.

For instance, on the one hand, British Columbia had a reputation for poor-quality regulation prior to the reform, which was part of the reason for its underperforming economy. Denmark, on the other hand, has relatively high-quality regulation. Regulatory quality is measured by various indicators, such as the World Bank’s Ease of Doing Business indicator and the OECD’s Product Market Regulation indicator. On both indicators, Denmark is ranked within the top four in the latest updates. This means that applying the estimates from Coffey and McLaughlin (2021) to a Danish setting might lead to an overestimation of the results. However, as there is limited experience internationally with an actual regulatory budget, the study by Coffey and McLaughlin (2021) is our best estimate of the effects of a regulatory budget. Likewise, the studies by Dawson and Seater (2013) and Coffey et al. (2020) are based on American findings, which might not be directly comparable to Denmark.

Furthermore, it is uncertain whether the effects will materialise after ten years, as this depends on the speed with which harmful regulations are removed. The positive effects can be realised both faster and slower than a ten-year time span. The calculations also rely on the assumption that the growth in regulation in the next ten years will correspond to the average growth in 2012–2022 in the business-as-usual scenario. Historically, the growth in the amount of regulation has been rather slow over the last decade, which could either be a new trend or a temporary slowdown. If the latter is the case, our results might be lower-bound estimates.

Recommendation: A regulatory budget can release considerable economic potential

Although the results are subject to considerable uncertainty, they suggest that there is significant economic potential in introducing a regulatory budget where the level of regulation is set to stagnate over a ten-year period. Deregulation, by removing barriers, offers an immediate surge in a society’s wealth. Yet, it’s uncertain whether this deregulation can offer a lasting

enhancement to a society's growth potential. It remains unclear what portion of the observed growth is a one-time gain and what might constitute sustained growth.

Given all the uncertainty, the results indicate that a regulatory budget based on a 1-in, 1-out rule can result in great economic benefits. Even if only a small part of the cautious estimate of 2.3 per cent GDP growth is realised, it would imply a considerable increase in wealth in Denmark compared to other growth policies.

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