JANUARY 2015

Building agencies to rate public policy

Ricardo Hausmann

Independently rating proposals made to governments by interest groups could lead to better, more valuable policies, says Ricardo Hausmann, director of Harvard University's Center for International Development.

The avenue to economic growth is often blocked by an inadequate supply of productivity-enhancing public goods. Modern production requires many inputs. Markets provide some, but others are provided by governments. For example, a biomedical plant is more valuable if there is good infrastructure, a trusted drug authorization system, and health insurance. These inputs are deeply affected by government actions, embodied in millions of pages of legislation and thousands of government agencies.

To increase overall productivity, governments need to improve the provision of millions of different public goods. Given this complexity and the vast and changing array of needs, how can this be accomplished efficiently? Markets face a similar problem: they need to provide a changing basket of billions of different private goods. However, markets have the advantage of the invisible hand: a decentralized system that provides the information, the incentives, and the mobilization of resources needed for the system to self-organize. Every private good has a price. Goods are provided by profit-motivated firms that respond to prices. Capital markets allocate resources to those expected to be profitable.

But the public sector cannot rely on this invisible hand. Public goods usually have no price, the government usually does not have a profit motive, and there is no decentralized capital market that decides which public goods to fund. This leaves the government at a severe disadvantage that can easily transform public goods into a constraint to growth.

The solution is not to attempt to develop an omniscient central planner but instead to develop a market-like mechanism that can generate feedback, crowd-source ideas for reform, and create incentives for improving performance. This tends to happen naturally but inefficiently. Because different private actors have different needs, they tend to organize themselves into interest groups to lobby the government for the public goods that most affect them. Some of their requests are win–win, raising overall productivity. But others are not; they are about redistributing rents, as when interest groups seek government coercion to suppress suppliers, workers, and competitors or when they ask for tax privileges. In fact, lobbying groups are often deservedly perceived as enemies of the public interest. However, without them it is difficult to generate information about opportunities, obstacles, and solutions at the level of detail that is required.

To create an alternative invisible hand for public goods, we need interest groups to play a more constructive and socially legitimate role. This requires improved transparency and smaller informational asymmetries. Here we can learn from the role that credit-rating agencies and auditing firms play in building trust in capital markets. These organizations summarize massive amounts of information, allowing market participants to more efficiently assess the performance or risk of each firm or security. I propose the creation of *independent public-value rating agencies* that would analyze the proposals to government made by interest groups in terms of the public interest and the creation of shared value. Having initiatives rated by independent agencies would enhance the ability of societies and political systems to assess the legitimacy and value of requests for reform and would create incentives for interest groups to focus on win–win rather than rent-seeking requests, thus improving the provision of public goods that enhance shared growth.

Ricardo Hausmann is the director of the Center for International Development, at Harvard University, and a professor at Harvard's John F. Kennedy School of Government.