



“The Institutional Context for Better Regulation”

Josef Konvitz

Simple is Better: Effective Regulation for a More Competitive Europe

Amsterdam, 7-8 October 2004

“THE INSTITUTIONAL CONTEXT FOR BETTER REGULATION”

The role of the State in relation to the economy and society is in transition. The 20th century saw a rapid growth in the role and presence of the State. War and economic crisis on the one hand, and a belief in technocratic rationalism and efficiency on the other, drove centralisation forward. Efforts were started in the late 20th century, both to “roll back the frontiers of the State” in order to free up market economies, and at the same time to redefine the relationship between the State, the economy and citizens. In terms of regulatory policy this has given rise to the concept of the “regulatory State”: a State still strategically responsible for the economy and society, but with a more arms’ length relationship to citizens and the economy. The reduced scope of macroeconomic policy today, means that regulation is relatively more important as a dimension of competitiveness. Less direct forms of intervention in place of command-and-control or direct provision of public services however pose fresh problems of co-ordination and coherence, with implications for the structures or institutions of policy, the main focus of my remarks. Regulatory policy helps define the interface between the State, society and the economy. In the final analysis, regulation is about two central aspects of the political sphere: 1) assuring that the interventions of government have a legitimate basis, and contribute to a regime which is based on and strengthens the rule of law; and 2) assuring that economic growth is sustainable over the medium term, the basis for individual and collective well-being, cohesion and peace. This is why the subject of regulatory policy is one of good governance.

Paradoxically, in this period of transition, regulatory inflation affects most OECD countries. Citizens seek better services, as well higher standards of social and environmental welfare, which are translated into mandates and regulations. But regulation also arises from the consolidation of market economies and the move away from direct economic intervention by the State. When the State acts directly in the economy, the rules governing its actions are either internalised or do not exist. Regulation emerges when others take over what used to be State functions. For example, specific rules are needed for liberalised network industries in order to deal with asymmetric market structures, natural monopoly cores, and technical complexities. The decentralisation of executive power has also resulted in a proliferation of rules from different levels of government.

Although the trends are global, they also have a European dimension. Change in the European Union has been more complex and far-reaching in the 1990s in matters affecting regulatory policy than in other regions of the OECD. Europe has changed institutionally and economically in ways that are not reflected in comparisons of the rate of growth in different regions of the world, a statistical measurement which cannot capture the scale and scope and future impact of these transformations. The distinctive feature of Europe in geopolitical and economic terms is that nowhere else have the key trends of globalisation and structural adjustment, including the privatisation of network utilities, coincided with massive institutional change -- enlargement, and new measures for regional governance including devolution and decentralisation. These trends affect the larger and smaller states of the European Union asymmetrically, while affecting the European Community as a whole.

Let me present some comments on the broader context and relevance of regulatory policy, before turning to the question of the structures appropriate to the design and implementation of policies for quality regulation.

1. Regulatory policy: its context and relevance

The contribution of regulatory policy to the achievement of public policy goals

Regulatory policy is an explicit policy for a dynamic, continuous and consistent “whole of government” approach to pursue regulatory quality. Experience confirms that an effective regulatory policy needs to be made up of three components which are mutually reinforcing: policies, tools and institutions. Regulatory policy is not only about specific regulations for a sector, but about the process by which regulations are drafted, updated, implemented and enforced, set in a broader context of public policy objectives. The evaluation of policy therefore includes not only the social and economic impact of regulations, but the links between regulatory processes or systems on the one hand, and those outcomes on the other. Nothing contributes more to scepticism about regulation than regulatory failures: the impression that rules respond to special interest pressures, and the recognition that rules often do not achieve their objective. Mistakes can be avoided. A forward-looking perspective is also important: for example, planning ahead for the regulatory and other reforms that will be needed to facilitate the adaptation of economies to ageing. Will ageing societies be more or less open to change? Should regulatory reforms therefore be accelerated? Or postponed? Where will people want to live? And what are the implications of their choices for infrastructure and public services? We know something about the levers of change in societies that are young and growing; we know next to nothing about what happens in societies that are ageing rapidly.

At its broadest level, the existence of a strong regulatory quality framework can be linked with improved economic performance and higher levels of social welfare. An effective regulatory system can help to:

- Promote flexibility, innovation and new ideas.

- Encourage competition rather than protection. Bear down on costs from the accretion of rules over time, removing complexity, red tape, and inconsistencies.
- Encourage new or previously unheard stakeholders into the policy debate, so that policy is better grounded.
- Promote timely and necessary change to support economic and social renewal, so that this can take place more quickly and at least cost.

The quality of regulation is often key in achieving specific policy goals. But this implies making a link between whole regulatory regimes, not just individual rules, and policy goals. In our work at the OECD, we are putting an emphasis on work on indicators of regulatory performance, and on the feedback loop between evaluation and the design of better regulations. The cumulative effect of rules over time is an important consideration. Existing regulation and regulatory processes can block progress in meeting policy goals, if they are not adapted. Regulatory frameworks need regular review so that they can continue to meet original policy goals, as well as complete reworking to meet new policy goals. Regulatory policies are usually some way from integrating fully the concepts of dynamism and continuity. In order for this to happen they need to incorporate two dimensions: managing the flow of rules (appraising new rules) but also, crucially, regularly appraising the stock of rules (ensuring that rules remain relevant). The 2002 OECD report *From Intervention to Regulatory Governance* noted that “the need for regular review and renewal of regulation is a fundamental lesson that remains largely unlearned to date, at least at the practical level”.

Policy goals: clarity, complexity, overlap and trade-offs

The first question to ask is whether a government action is justified. From this follows questions about whether regulation is the best form of government action, considering issues such as costs, benefits, distributional effects and administrative requirements. In 2005 OECD will take up the question of alternatives to regulation. This topic, which includes self-regulation, performance-based regulation, and economic instruments, is particularly timely given the growing awareness of the importance of risk and risk assessment. Pressures for regulation often come in response to a dramatic event, be it a spectacular case of industrial pollution or of contamination in food, or a blackout, or property loss in a flood. Government regulation can reduce the burden of risk on business, even if it adds to their administrative burdens. But equally, government regulation can increase the responsibility of government when the unexpected occurs.

The Canadian government report *Smart Regulation – A Regulation Strategy for Canada* (2004; www.smartregulation.gc.ca), highlights risk as another lens through which to examine regulation, together with competition and market openness, and one perhaps more relevant to early 21st century concerns. The report states that at present, Canada lacks federal risk assessment standards and guidelines. Government regulations have cumulative and unintended impacts, making an interdepartmental perspective necessary if a co-ordinated strategy is to be achieved. This process will involve priority ranking, analysis of how and why risks are expected to evolve in the future, an understanding of the choice of instruments and of their impact when implemented, and measures to assure compliance. In the final analysis, risk management is about good judgement which over time builds trust between government and society.

Implementing an effective regulatory policy is complicated by the fact that it is a horizontal policy which cuts across other policies, and often comes up against a traditional “stovepipe” institutional architecture for policy making (that is, one in which horizontal connections between different ministries are relatively undeveloped). Competition from other, more established, easily identifiable and understandable policies (fiscal or environmental policy for example) can blur its importance. Regulation is not a specialized function; neither can it be pursued if each sectoral ministry considers that regulation is only a by-product of its activities.

Policy making increasingly requires solutions that cross ministerial boundaries, because of policy interactions, and the need for trade-offs to deal with policy conflicts. Dealing with these interactions and conflicts is difficult. Some interactions are not easy to spot or anticipate. Policy conflicts do, however, need to be managed. Achieving the right balance between different and sometimes conflicting policy goals is a recurring challenge. So rapid has been the expansion in the scope and objectives of regulatory policies that they may try to adopt too many quality criteria in pursuit of too many goals. The requirements of the policy may exceed the capacity of regulators to respond coherently and in a timely fashion. Moreover, many policy goals involve inherent conflicts. Which goals will be considered paramount? The problem of pursuing multiple objectives gives rise to pressures to put more emphasis, at least today, on improving the business environment. But is this a short-term objective which will be superseded by something else in two years’ time? How can consistency be achieved over the medium term? From this perspective, the title of this conference is itself an oversimplification: the challenge is to cope better with complexity and evolving agendas. I raise these questions because they cannot be answered at the technical level, but instead require political guidance.

Ways of doing this might include the identification of recurrent policy “trade-off” problem areas and developing a stronger awareness of how specific policy goals interact; strengthening the intra-governmental cooperative arrangements for dealing with these areas; and last but not least, ensuring that regulatory tools such as RIA are deployed to help find a way forward. Regulatory policy can help to tease out the balance which may need to be struck between policy goals.

2. Building capacities for regulatory quality: where do OECD countries stand today?

Regulatory policy

The 20 country reviews conducted by OECD since 1998 demonstrate that regulatory policy still needs recognition as a field in its own right. The scope and quality of regulatory policies across the OECD remains uneven. Though some countries have made considerable progress, many countries still only have fragmented elements of a regulatory policy in place, some dating back many years.

Regulatory policy should be adopted at the highest political levels, contain explicit and measurable regulatory quality standards, and incorporate a regulatory management system that will track and promote regulatory quality. It is a core government policy with a legitimate place as a permanent, ongoing role of government.

To be effective and influential, regulatory policies need to link up a range of issues and processes. They should incorporate explicit goals or targets with regular reporting requirements. Key principles should be articulated, notably the broad scope of regulatory quality to support social welfare and public policy goals, not just sectional interests (when confined to the latter, regulatory policy is vulnerable to capture). Resources must be allocated to promote regulatory policy, for example to central oversight bodies, which need adequate authority for their tasks such as the formal oversight of RIA. Measures including sanctions must be built in to ensure compliance with regulatory quality processes and tools.

Regulatory institutions

Regulatory policy needs to find its place in a country's institutional architecture, a context which remains complex and fragmented. The 20 OECD country reviews of regulatory reform carried out to date paint a picture of a wide range of institutions with regulatory functions or influence, which therefore need to be harnessed to the regulatory quality agenda. Many are long established, some are new, some have a new or evolving role. Some are helpful to regulatory quality, others less so. Fragmentation, both in terms of policy purpose and effective coordination arrangements, is often a problem. How can all relevant institutions be encouraged to support the regulatory quality agenda? What role should each have, taking into account accountability, feasibility, and balance across government? The need for some form of central mechanism to promote regulatory quality (which goes beyond the simple coordination of existing bodies scattered across government) appears to be essential if durable progress is to be made.

Central oversight bodies for promoting regulatory quality: probably essential but often difficult to establish

The relationship between an effective, comprehensive regulatory policy and the existence of a central oversight body appears to be strong. They are mutually supportive, and where one exists, the other is usually also present. Central bodies going beyond improved coordination between existing bodies are therefore probably essential in some shape or form. These bodies help to ensure that regulatory quality principles are successfully applied. They can perform a number of different functions to that end: an advocacy role, a challenge function (the critical assessment of RIA), and practical and technical support for the application of regulatory tools. Too much should not be expected of RIA. There is a political dimension to RIA. The selection of issues or effects to be assessed is a political decision. And the use of ex-post evaluation should imply that the results will influence the design or revision of regulations in the future.

Quality control of regulations needs improvement, through enhanced challenge and oversight functions. A central pillar of regulatory policy is the concept of an independent body assessing the

substantive (rather than the legal) quality of new regulation, and working with ministries to ensure that they comply with the quality principles embodied in the assessment criteria. The regulatory challenge function centres on this ability of the oversight body to question the technical quality of regulatory impact assessment and of the underlying regulatory proposals. To perform these tasks, the oversight body needs the technical capacities to verify the analysis of impacts, and the political power to ensure that its view prevails in most cases, rather than being over-ridden.

At the same time a careful balance needs to be struck: too much concentration of responsibility, authority and expertise in one place may undermine interest, commitment and responsibility in the different parts of government that occupy the regulatory “frontline”. The different functions may be split between a technical unit and a body with ministerial and/or external representation. Experience suggests that central units are best placed in (or report to) the centre of government, preferably close to traditional management functions such as budgeting, rather than in a line ministry which is likely to be too closely linked to specific policy and regulatory functions. Seconding staff from powerful existing ministries such as Finance ministries so as to establish “ownership” is often helpful.

Outsiders to government and ministers are powerful levers for increasing effectiveness, especially as regards advocacy. Advisory bodies have been created in some countries which are external to the administration and hence to vested interests. Ministerial committees may be set up with outside participation. But what these bodies look like and where they are will depend on the country context and the need to work with its existing structures. Different models exist and are evolving. Japan and Mexico provide interesting examples.

Some countries question the concept of central bodies for regulatory quality promotion as well as the need for an explicit comprehensive regulatory policy. In large countries they may be easily perceived as undermining or rivalling other more established centres, as well as raising a possible threat to the potential for ministerial discretion. In small countries, with small homogeneous societies, and close and informal networks of contacts within government and society based on mutual trust, central bodies may be seen as unnecessary.

Different approaches have been taken across OECD countries in recent years, which makes this an interesting arena of innovation in governance. Many countries have developed new specialist bodies, both inside and outside the administration. But these developments are far from universal. Even where they are set up, they usually have to fight their way in to existing structures and interests, and often lack adequate resources and authority. They occupy an uncertain place, somewhere in the executive, cutting across many different vested interests within the executive and elsewhere, as well as traditional conventions of ministerial and departmental autonomy and the direct political accountability of ministers. So they are necessarily controversial, and may face some hostility from established interests. Also their relevance and importance is often not clear to other players because of the lack of understanding of the nature and breadth of the regulatory quality agenda. The challenge is to find a balance between co-ordination and centralisation.

Central government institutions: understanding their perspective and contribution

The institutional architecture of central government raises key issues for the coordinated promotion of regulatory quality. With or without central oversight bodies the different parts of central government each have a key role to play in supporting the regulatory quality process.

- The executive. Strong existing central government institutions and traditions exist in all countries. This includes all individual ministries, but in particular ministries such as Finance, Justice, and Trade and Industry, which will continue to retain central responsibilities closely linked to the regulatory quality agenda. The executive is also a key source of regulation, both in terms of proposing new laws to parliament, and setting secondary rules to give effect to primary legislation. Other longstanding actors with an important role in regulation may also need to be taken into account.
- The legislature. Parliaments have a formal responsibility to vet and agree primary legislation. They need to be more closely integrated into regulatory quality systems and processes, which are generally much less readily available to the legislature. Approaches to this could be strengthened. Some countries for example have built up specialised committees for specific issues, such as EU legislation. Aligning the approach taken to scrutinising legislation with the regulatory quality approaches adopted in the executive is promising, as they should be mutually reinforcing. Parliament for example needs to be able to take account of information obtained through RIA. Parliaments can sometimes lead on regulatory quality issues, and appear generally to be taking a more active interest in regulatory quality and supporting tools such as RIA. The training needs of newly elected members may need to be reviewed and strengthened.
- The judiciary. They are an important influence on the regulatory process because of their key role in enforcing the rule of law. For example timescales for the judiciary's decisions, and the relative ease or difficulty with which rules can be challenged, are relevant factors. A close working relationship with regulatory institutions helps to smooth out difficulties.

- Others. Two should be highlighted. National audit offices have emerged in many countries as valuable allies for the promotion of regulatory quality, progressively widening their role. They now often play an important role, beyond accounting for the efficient use of resources, in assessing the performance of the administration, including the effectiveness of implementing regulatory regimes. They focus on whole areas of policy and on outcomes, so they help to fill the gap of current regulatory quality approaches which often fall short on this. They have an advantage too in being independent from government (usually reporting to parliaments), transparent in their work and with a remit to operate in a wide range of areas. Secondly, national ombudsmen play an important role in reinforcing democracy, by promoting administrative accountability.

The importance of subcentral governments has emerged clearly in the reviews. Local governments are of increasing importance in unitary States, including historically strong ones. There is an increasing awareness of the importance of the federal/state interaction in federal States. These are positive general developments as they help to release local initiative in the management of the economy and society, and bring government closer to the citizen. Regulatory quality needs to be systematically cascaded through the different levels of government. Failure to carry out effective regulation at one level of government can undermine efforts elsewhere.

A multi-level perspective: increasingly important but a very imperfect link with the regulatory quality agenda

In a few countries local governments have been active agents for improving regulatory quality, sometimes even the drivers. But other countries still have some way to go in improving their regulatory framework at the local level.

Concerns about rule-making quality at the local government level do not get the attention they deserve. Businesses and citizens often encounter problems related to land use planning and construction decisions, which usually are taken within a regional or local regulatory framework. Public procurement, often carried out at local level, can raise issues for foreigners and others too, if processes are not transparent. The creation of new local rules is often not subject to central disciplines such as RIA. There is often a lack of resources and training to promote more effective rule-making. Procedural delays and gold-plating are two common phenomena. Compliance and enforcement are another issue. Who monitors compliance and enforcement of national rules at the local level? The number of local entities and the number of layers has been picked up as an issue in some countries. Are there too many local entities for efficiency? Is there an issue of duplication and overlap? Some overlap is unavoidable. Effective coordination/cooperative arrangements need to be in place. But the reviews suggest that there also a need to avoid too many arrangements, or too few.

What should be devolved? The importance of deploying appropriate levels of government for policy areas and articulating their role will differ according to the policy area. This is important both for the efficiency of the economy, and the effectiveness of government action. For example the OECD PISA study suggests that successful education systems are those which combine standardised central targets for educational outcomes, with decentralised flexibility and responsibility for how to achieve them such as teacher recruitment and school management.

At a more strategic level it is important to achieve the right balance between central authority and local autonomy. Decentralisation in unitary states inevitably saps some of the driving force behind action by central governments, as the levers of power must be shared. A strong and strategic direction for regulatory quality must be retained at the centre. At the same time, useful innovations are at least as likely to emerge in cities and regions.

Japan has launched a significant innovation in this regard. The creation of special zones for structural reform is intended to ease the regulatory burden on a given sector. Municipalities choose the measures they want to try out. Prefectures, businesses or local governments can submit proposals to the central government, which can grant a derogation. The objectives must be measurable, and they must be subject to evaluation. There is an ad hoc body, headed by the Prime Minister, responsible for promoting, coordinating, evaluating and monitoring experiments under the programme. Once a year, this body reviews the evaluations, and takes a decision whether to diffuse a local measure of deregulation – or exemption -- nationally, and permanently. This process could be accelerated. This promising combination of top-down and bottom-up processes meets the three criteria for an effective regulatory system: it has support at the highest political level; it contains explicit and measurable regulatory quality standards, and it provides for a continuing regulatory management capacity.

The multi-level dimension is especially relevant in the European context. Many regulations which are known to compromise labour mobility and entrepreneurship relate to housing, land use and the environment, regulations which are either set or are enforced at regional and local levels, where analytical capacities are often under-developed, and where compliance and enforcement can leave much to be desired. It is not unheard of for regional and local governments to use regulation to insulate their economies from competition. For political and sometimes constitutional reasons, national governments are often unwilling to tackle these regulatory obstacles to resource allocation and investment.

Dealing with the challenges which may be raised by different governance systems

Values, public policy goals, institutions and legal systems vary across countries and affect the way regulatory quality can be built up in practice. They have deep roots in historical, cultural and political development, as well as geography. They contribute to the democratic process and accountability of a country's political and policy making system, and are the glue that binds societies together. Regulatory policy, tools and institutions must therefore be adapted, and differences acknowledged, as these are integral part of distinctive societies.

Regulatory policy is not therefore a question of "one size fits all". But the value systems and governance of a country may be reflected and taken forward in regulatory systems and processes which can be unhelpful for regulatory quality. Issues include changes which are too slow and gradual for the needs of an evolving society and economy. For example consensus building, for all its other merits, may slow change and prevent the adoption of more radical but necessary options. Consensus based decisions may also mean a relative disregard for the practical evidence of what might work best. The exclusion of outsiders from traditional consultation processes aimed at building consensus, often unintentionally, can be another issue. Another set of challenges arises from the different role traditionally attributed to the State in OECD countries, and different attitudes regarding the scope and influence of competition policy in managing the economy.

3. Implications for the European Community

The European Union does not need a structure for regulatory policy that mimics the structures of member countries, but it faces many of the same challenges in this policy arena which individual countries confront. In particular, it must address the low priority given to considerations of regulatory quality by sectoral departments. Are regulatory quality principles expressed clearly? Is there adequate institutional and strategic support to sustain the policy? How can co-ordination among different directorates which have separate policy and sectoral responsibilities be improved? In this regard, at the European as at the national level, there is a need to focus better on the complementarity between a legal approach, which emphasizes the basis for a regulation, and an economic approach, which emphasizes outcomes assessed against costs and benefits. This has implications for the process by which regulations are designed, including the framework for consultations, and for public information. Finally, the dynamic approach to regulation calls for systematic efforts to review existing regulations at the same time as new regulations are adopted. How are the lessons of evaluation incorporated into this process? And what mechanisms and criteria exist for evaluation? What regulations will be subject to regulatory impact analysis (RIA) and what units will have the responsibility for overseeing that the process is carried out to a high analytical standard?

Taken together, this agenda highlights a crucial challenge for regulatory policy: to encourage cultural changes within regulatory institutions. The adoption of a new or non-traditional approach, including the use of alternative tools to “command-and-control” regulations, may involve a risk to the regulator that is greater than his political comfort-level. Improving the policies and institutions for regulatory quality therefore depends in part on other measures to build regulatory capacities throughout an administration and to improve public understanding. The test of course comes when applying principles in practice: how can pursuit of regulatory quality lead to the choice of better policy instruments, those which are more efficient and effective?

Two interlinked issues will determine how progress is made toward regulatory quality in the European Union: how well regulatory systems function in member countries, and how well they function in

the institutions of the European Communities. There is of course no single model for either. The experience of OECD countries is however telling in five respects: first, major change often comes only in response to a crisis; second, countries with a highly inferior regulatory policy and an inadequate set of regulatory institutions can make rapid progress; third, piecemeal reforms have less impact than a whole-of-government approach; fourth, member countries are increasingly engaged on similar issues, making the diffusion of international best practice and of innovation faster and easier; and fifth, institutions do matter.