

# The Machinery of Regulatory Reform

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*Regulatory reform is evolving rapidly. As experience accumulates, so does understanding of the problems and how they might best be solved. As a result, reform now embraces a much wider range of instruments, processes and institutions than in the early days of simple deregulation strategies. The focus is now on 'regulatory management' as an integral part of the permanent business of government. It aims at enabling governments to use regulatory powers more carefully and effectively within globalising and liberalising markets, to react more quickly and to wield a wider range of tools that protect public-policy objectives at lowest cost.*

Regulatory reform is evolving in three general stages in OECD countries, although with much variation from country to country. The 'deregulation' strategies which began to emerge in the late 1970s and early '80s were first prompted by economic slowdown and business complaints about rising regulatory burdens. Simultaneously, it was becoming clear that regulations restricting competition and consumer prices had enormous costs with respect to efficiency and innovation. These perceptions unleashed a wave of deregulation, initially in the United States, the United Kingdom and Canada, which focused on industries such as transport, telecommunications, media and energy and which continues today in a widening range of countries.

Removal of 'economic' regulations (those that set prices, block entry, establish quotas) has brought major benefits. But general deregulation is neither feasible nor desirable in many rapidly growing areas of 'social regulation' (that is, regulation which aims to achieve goals like health, safety or environmental standards). Here a different strategy is required to control regulatory costs without compromising voters' wishes for improved standards of protection. New, more sophisticated regulation can also help promote competitive outcomes in some recently privatised industries, especially as a transitional strategy while new markets develop.

The next step in the evolution of this thinking is focused on producing better regulation – achieving the chosen objectives at minimum cost. It involves both the systematic review and reform of existing regulation and the improvement of policy processes and capacities for creating new regulation of high quality. Regulatory reform is more forward-looking, but it is still targeted at

individual regulations and fails to meet the deeper problems which arise from the nature of regulatory systems themselves, such as regulatory inflation,<sup>1</sup> complexity, lack of coherence, unanticipated interaction between rules and transparency and accountability.

The response has been 'regulatory management',<sup>2</sup> which addresses the capacity of governments to implement and sustain general reform, to direct the longer-term evolution of the national regulatory system, and to strengthen links with other areas of governance. Increasing prominence is being given to the issue of total regulatory costs in the United States and the United Kingdom. In Australia, specific targets for cost reduction have been adopted. In Canada a 'Federal Regulatory Plan' notifies the public well in advance of forthcoming regulatory initiatives, and therefore assists consultation, co-ordination and consistency between areas of regulation.

In these and other ways, regulatory management is developing in a few countries into a routine element of the central-management func-

1. That is, rapidly rising aggregate regulatory costs. See John F. Morrall III, 'Controlling Regulatory Costs: The Use of Regulatory Budgeting', PUMA Occasional Paper, OECD, Paris, 1992; available free of charge from the OECD Public Management Service.

2. The concept of a three-stage evolution of regulatory reform, culminating in 'regulatory management', was first discussed in Scott Jacobs, 'The Future of Regulatory Reform', paper prepared for 'From Red Tape to Results: International Perspectives on Regulatory Reform', conference presented by the New South Wales government, in collaboration with the Commonwealth Industry Commission and the New Zealand Chamber of Commerce; available free of charge from the OECD Public Management Service.

3. Further information on the use of alternatives to regulation is available in Hans Huigen, 'Co-operative Approaches to Regulation', PUMA Occasional Paper, OECD, Paris, forthcoming 1997; available free of charge from the OECD Public Management Service.

4. Scott Jacobs and Juhani Korhonen, 'Opening-up Regulation', *The OECD Observer*, No. 195, August/September 1995.

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ions of government. This movement parallels the development of central budgeting agencies, now universal in industrial countries, in the early part of this century: both initiatives aim at establishing broad perspectives and improved administrative responses to political direction.

## Best Practices

The general design of reform programmes is far more important than any individual policy actions. A poorly designed system will never achieve the results desired of it, no matter how rigorously it is carried out. A well-crafted system has three basic elements. First, sustained political commitment, since resistance from potential losers from change is likely to be vigorous; second, explicit standards for regulatory quality and principles of regulatory decision-making using Regulatory Impact Analysis (RIA), the systematic weighing of alternatives<sup>3</sup> and broad consultation processes to allow the desirability of regulatory decisions to be assessed and provide the discipline of visibility; third, central management capacities. Expertise in regulatory reform and management must be gathered in a body or bodies with specific policy responsibility, and developed and extended over time.

An important determinant of regulatory quality is the systematic use of RIA for all regulatory proposals. RIA must be based on a cost/benefit approach to decision-making, identifying and assessing all the foreseeable effects of regulatory proposals to determine whether there is a net benefit. RIA should also be applied to feasible alternative policies to determine whether net benefits are maximised by the regulatory proposal under consideration.

Effective RIA requires consultation with the interest-groups and individuals likely to be affected. Targeted consultation at an early stage provides a cost-effective means of data collection and helps ensure all relevant impacts are identified. Wider consultation later in the process will provide maximum transparency and accountability, reducing the possibility of undue influence ('capture') by specific interest groups.<sup>4</sup>

Consultation thus serves the double purpose of providing technical input and of promoting democratic values of openness and accountability.

Regulations are likely to become progressively less effective and appropriate over time as changes occur in technology, tastes and so on. A programme of regular review and updating is thus essential to maintain the effectiveness of existing regulation. Such an approach should be based on the same RIA disciplines as new regulation and targeted particularly towards the most costly regulations. Automatic repeal programmes should be considered, whether 'guillotines', which simply abolish all regulation over a certain age, phased repeals, or 'sunsetting', which sets limits on the lifespan of new regulation at the time it is made. In addition, programmes that seek to use information technology and co-ordination opportunities between government agencies, both for information and approvals, are likely to be important. A critical view of information requirements will help reduce red tape and government formalities.

## What Results?

The results of regulatory reform are intrinsically difficult to measure. Many of the important benefits are hidden, since they consist of mistakes avoided. Others, such as an enhancement in the quality of democracy, cannot be quantified. One clear improvement is that officials are increasingly willing to question whether 'traditional' regulation is the best solution to perceived problems and to consider the use of alternatives



such as performance or process-based regulations, tradable permits or tax or subsidy arrangements.<sup>5</sup> The extent of this change of attitude is suggested by the use in 18 OECD countries of Regulatory Impact Analysis as a guide to regulatory decision-making. Of these 18, 14 have also established central management capacities through dedicated groups within the bureaucracy to advocate, monitor and co-ordinate regulatory reform and to provide crucial training and support.

Most of the goals laid down by politicians are, nonetheless, expressed in terms of the quantity and cost of regulation. It is clear that, despite all the reform programmes, the quantity of regulation, whether measured in pages of new rules or their raw numbers or by the resources allocated to regulatory agencies, has steadily increased over the 1980s and '90s. Nonetheless, in many industries, such as aviation, road transport, telecommunications and energy, purely economic regulations have been eliminated or

5. See pp. 14-18.

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radically reduced and productivity has made quantum leaps. Labour productivity in the US airline industry, for instance, more than doubled after deregulation. Repeal programmes have dramatically reduced outdated regulations in countries including Australia, Canada and Sweden. Evidence from Australia and the United States also suggests that reform programmes may have slowed the rate of growth of new regulation by 20–35%.

Data on costs are even more elusive. Only one country, the United States, can provide figures. They suggest that, for a decade or more, total regulatory costs probably fell but that more recently they have begun to rise again as savings from further economic deregulation dwindle and costs of social regulation (in health, safety, housing, the environment, and so on) continue to rise. Improved regulatory systems probably do

mean that the quality of regulation – that is, the benefits delivered for each dollar of costs – is almost certainly much higher. There is also clear evidence that RIA and reviews of existing regulation have reduced costs below what would otherwise have been the case: in the United States, for example, the Office of Management and Budget estimated that its RIA programme had reduced the compliance costs of new regulations by around \$100 billion over a 10-year period. And in Queensland, Australia, reforms to existing regulation were estimated to be saving businesses A\$370 million per annum.

Independent estimates of the impact on government efficiency are virtually impossible to find, although most officials involved with reform are certain that, on average, the cost-effectiveness of regulation has improved substantially. The movement away from economic towards social regulation tends to support this view, given the major economic gains

that have been associated with economic deregulation. So, too, does the increased use of more flexible, performance-oriented standards, which allow business to choose the most efficient means of achieving outcomes.

Management capacities have thus clearly improved, with the adoption of explicit policies for reform, the appointment of specific groups and the establishment of quality standards for regulation through guidelines and legislative requirements. Co-ordination between government departments on regulatory issues is also being stepped up.

Improvements in the openness and accountability of democratic institutions might be expected to be still harder to document, but it is clear that more countries are involving a wider range of groups in consultation on policy-formulation than ever before. That consultation,

too, is occurring earlier and is more intensive and more transparent. The ability of individuals and dispersed interest-groups to influence policy has definitely increased, although the possibility of undue influence by large, organised groups remains an issue that must be monitored carefully.



Further work is required to identify new and more effective approaches to management and reform. Formalities in taxation, permits and licences are a near-universal concern, licences in particular because they can impede the establishment of new firms. Information technology may provide innovative solutions to these problems, enabling dissemination of information more rapidly and at lower cost. Better co-ordination between agencies should also reduce information gathering requirements.

International regulatory co-operation is likewise growing in importance as trade flows increase and regulatory authority is spread through different institutions. Effective new processes for improved co-ordination are urgently required, as is clarification of the role of national parliaments in the globalising regulatory world. Implementation and compliance issues will also become more prominent as the volume of regulation continues to increase while enforcement resources remain limited. New approaches will have to be developed, emphasising issues such as effective targeting of enforcement resources, better designed sanctions regimes and provision of positive incentives for compliance. ■

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