CAPX

What does good regulation really look like?

Quentin Wray

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Politicians pretend to hate red tape and bureaucracy. But they need it the way a country singer needs heartache and pain.

Without it, they cannot exist – after all regulation is one of the three options they have to exercise power over us. They give us money through spending (which we quite like), take our money through taxes (which we don't), and tell us what to do through regulation (which we generally don't like – until things go wrong, in which case we bemoan the fact that there isn't enough of it).

In October at a forum on Innovation and Regulation (an oxymoron?), Czech Prime Minister Andrej Babiš reiterated the point made by many of his political colleagues – that the European Union's growth-limiting regulations need reform and that Brussels spends too much of its budget on regulatory structures.

Granted, he welcomed statements by incoming EU President Ursula von der Leyen that regulations will be cut on her watch, but he is still calling for real change in the way the EU operates.

Railing against Brussels is a big part of the schtick employed by many of the continent's more right-leaning politicians but it is backed up by the data: research done in 2012 by Harvard University economist Jamal Ibrahim Haidar looked at 172 countries and found that each regulatory reform measure on average raised economic growth by 0.15 percentage points.

Only swivel-eyed loons argue there's no need for any regulation whatsoever. Equally, only the most hard-core believer in the all-encompassing nanny state will say we don't need protections against regulatory overreach and that there is no case to be made for change.

As Czech trade minister Karel Havlíček rightly notes, national and supra-national governments need to be careful of overreach. They set up the playground and act as referees, but must be careful to leave the playing of the game in the hands of the players. Excessive regulation and official support for specific sectors, such as through the EU's several Structural Funds, means that regulators are now playing the game and supporting particular teams. This interferes with regular market forces with "winners and losers".

Ryan Bourne of the Cato Institute told the forum that as far as possible, policymakers should allow permissionless innovation rather than being too precautionary. Regulatory intervention should only happen when there was a clear need to do so for some specific application in a given product market.

According to the OECD and the UK's Better Regulation Executive, regulations should be proportionate to the risks posed after costs have been identified and minimised, consistent and fair, targeted on the problem, transparent, and accountable. This is eminently sensible.

Bourne says that "new products often come with new safety features, for example, changing the balance of risks or mitigating previously perceived market failures. As such, innovation can compete with the regulator as well as incumbent products. He adds that it would be a mistake to try and pursue regulatory perfection as this deters new innovations through fines or high compliance costs. If regulation is required, it should aim to "solve the perceived problem proportionately and provide certainty for business," says Bourne.

Gabrielle Inzirillo, from early-stage venture capitalist firm Plug and Play Tech Center, said that "regulation isn't going to go away — and it shouldn't" but that "we are seeing new solutions and new products [but] start-ups get doors slammed in their faces when they try to deal with the regulators".

This can lead to a situation where developers of new technologies skirt dealing with regulations and may decide that their product falls into a grey zone and go ahead with the rollout. This leaves them open to the risk that they could simply be shut down by regulators.
If this happens, we risk good ideas dying. And that way everybody loses. Regulatory Impact Assessments (RIAs) as espoused by the OECD are one way of ensuring that regulation does what it should. These are not perfect and are still not applied in all jurisdictions, even those that say they do.

Daniel Trnka, a senior policy analyst in the OECD's regulatory division, says that the only countries he has worked with where businesses did not complain about the level of regulatory burdens were Estonia, Latvia and Denmark. Here there are permanent forums for communicating with businesses to get input on burdensome or problematic regulations, discuss issues, find solutions and, sometimes, explain why some of these issues cannot be solved.

Another problem in many jurisdictions is that consultations with stakeholders take place very late in the process when there is not enough time or willingness to change a draft regulation substantively. The OECD believes stakeholders should be involved in the early stages of making regulations when defining the problem and looking for potential solutions.

However, the key to making them work, according to Food and Drink Ireland's Paul Kelly, is engaging stakeholders in the drawing up of new regulations and RIAs, and giving them a sense of ownership for their eventual implementation.

Kelly says that while headlines get made when the number of regulations is cut, what really matters is the quality of the rules that remain. For him, RIAs should not only focus on the immediate impact on businesses but should also take into account international trade flows and what is happening in the domestic market.

Trnka says that while regulation is an essential way of protecting consumers and levelling the commercial playing field, it is vital that its goals are achieved without imposing unnecessary burdens, namely burdens without which the targets would have been achieved anyway. This is harder than it looks. All regulation imposes costs which have to be measured and justified by the societal benefits they deliver. Without this, there is a risk that more regulation will merely create barriers to entry which ultimately exclude smaller, more innovative participants from the market.

Nobody knows what kind of Brexit we're going to get in the UK, but there can be no doubt that British regulators are going to be far busier than they have been for the past 40 years.

Only by approaching things on a case-by-case basis and pragmatically taking into account business and consumer needs and preferences can they ensure that the benefits that generally accrue to freer economies will be enjoyed. The aim is better regulation, not more regulation.

Products that carry a risk to health should of course be regulated. But poorly designed, and burdensome regulation distorts markets and is costly and ineffective.

Any new growth-promoting regulatory regime will, at the very least, follow the OECD's Principles of Better Regulation and espouse open and transparent decision making, input from a wide range of stakeholders, evidence, and a desire to minimise the burdens imposed by regulations.

A failure to do so, or a misguided desire by politicians and regulators to pursue some form of ideological purity, irrespective of its real-world impact, risks giving us the worst form of Brexit possible. And Project Fear will have been proven right.