TOWARDS BETTER REGULATORY GOVERNANCE: the OECD Council's Recommendations of 2012

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Much of the influence that governments have on their societies and economies occurs, in one form or other, through the medium of regulation. But devising regulations that promote economic and social advancement is rarely straightforward. There are technical complexities and uncertainties to grapple with, and often there are political constraints and pressures to surmount. The result can be regulatory initiatives that are deficient in various ways. They may have unintended consequences, including 'collateral damage' on those not directly targeted. They may achieve their goals at excessive cost. And in some cases they may not even serve their goals at all.

Governments therefore have to be alert to the potential for things to go wrong in their regulatory endeavours. Failure to do so may not only detract from economic performance or societal wellbeing, it may also have adverse political consequences for governments themselves. The global financial crisis, the aftermath of which is still impacting on most OECD governments, is the most dramatic recent illustration of the consequences of regulatory failures – involving in this case a combination of problems in financial market and consumer credit regulation, housing policy and systemic risk management.

Far from being accidental or exceptional, poor regulation can be the inevitable outcome of how governments go about their business. A lack of evidence to inform policy development; difficulties in resisting rent seeking behaviour; a tendency to use regulation to solve problems for which it is ill-suited, and reluctance to expose policies in place to review – such phenomena are all too common. And because regulatory authority is necessarily delegated across government, there is the potential for such regulatory mishaps to emerge from many quarters. Moreover, the passing of time can bring its own challenges: even the best regulation when made is unlikely to remain so for ever, and in some dynamic market settings (such as finance and telecommunications) its 'use by date' may not be far away.

The financial crisis has put governments across the OECD on notice, elevating the importance of building stronger foundations for their regulatory frameworks. Many governments have responded with initiatives to improve or reform regulation in specific areas. But there is also a need for systemic approaches that go to the root causes of regulatory failures and that can work to improve the regulatory environment more broadly across government. Broader regulatory reform can also help economic recovery and fiscal consolidation by reducing costs and unleashing productive potential throughout our economies.

Previous OECD recommendations on regulatory management

The need for a more systemic approach to regulatory management motivated the OECD's 1995 *Recommendation of the Council on improving the quality of Government Regulation*. It was concerned with the need to take steps to improve the quality and transparency of regulations at all levels of government. To this end, it provided a 'checklist' of actions to improve regulatory quality. This principally focussed on having transparent, consultative processes to determine whether a proposed regulation is necessary and likely to be cost effective. In other words, the reverse of the 'regulate first, ask questions later' approach which has often been the practice.

This envisaged regulatory reform not merely as a series of ad hoc deregulatory actions, but as an integrated approach that would assist governments in the pursuit of broader policy goals, in areas such as environmental quality, health and safety, as well as employment and income growth.

A central insight was that lessons from implementing reform in some member countries could be used to facilitate reform in others, including through strategies to minimise associated disruption or adjustment costs. The approach included a complementary focus on regulatory policy, competition policy and trade policy, drawing on the expertise of the respective OECD committees.

A series of Regulatory Reform Reviews was subsequently undertaken across 24 member countries (as well as Russia, China, Brazil and Indonesia). The reviews confirmed the need for regulatory reform to be more than a one off event if it is to promote government-wide improvements and deliver ongoing benefits to businesses and citizens.

The country reviews provided a testing ground for the tools, policies and institutions that the OECD had been advocating to support good regulatory outcomes. It was acknowledged that regulatory policy had made -- and had further potential to make -- a significant contribution to economic development through enabling more efficient use of resources and meeting social and environmental needs in cost-effective ways. Reform also supported and strengthened the rule of law, through simplification and increased transparency, and improved access to legal remedies and to appeals systems.

Nevertheless this comparative work demonstrated that there remained a significant gap between the aspirations of regulatory policy and its application in practice – particularly with regard to economic goals. Though widely endorsed by OECD governments, good practices often failed to be manifest 'on the ground' – both in the development and implementation of policy and the application of regulatory authority. At the heart of this has been a continuing failure to approach rule-making powers dispersed throughout government as part of a regulatory *system,* in which sound regulatory governance and public engagement is needed to gain traction and promote change.

A systems and governance focus

Through the activities of the Working Party on Regulatory Management and Reform, the OECD had for many years actively advocated measures to overcome the practices within public administrations that were contributing to poor regulation.

In 2010, this Working Party was elevated by Council to become the present Regulatory Policy Committee; the first 'level one' committee to have been created in over a decade. Its timing was no doubt influenced by the financial crisis -- not because the new Committee could be expected to provide advice specific to the regulation of financial markets, but because of the more general difficulties governments faced in managing influences that can lead to policy failure in a variety of areas. (Another significant perceived regulatory failure around that time was the oil platform crisis in the Gulf of Mexico.)

Breakdowns in such key regulatory areas focus political attention. Ministers are required to explain what went wrong, why regulation was ineffective, and what steps are being taken to prevent problems recurring. This is as it should be, and is often a necessary catalyst for reform. The risk, however, is that governments can find themselves 'on the back foot' -- pushed to commit to regulatory responses that have not had time to be adequately thought through.

In light of new imperatives, the Regulatory Policy Committee set out to reassess and revise the existing principles in a process that ultimately resulted in the 2012 'Recommendation of the Council on Regulatory Policy and Governance'.

As noted, this new Recommendation drew on findings from the various country reviews that demonstrated implementation deficiencies and, in particular, the need to adopt more systematic approaches to how regulations are designed and implemented. This included the need to address the issue that key players in different policy areas often fail to see their actions as forming part of a wider regulatory system.

This led to an increased focus on systems of regulatory governance -- on the role of institutions for regulatory oversight and advocacy, the conduct of regulators, the key role of Ministerial responsibility and, ultimately, the role of the legislature. In particular, it set out to provide a framework within which countries could evaluate the merits of their regulatory systems, and to provide guidance on how the key players in the regulatory system could be held to account.

The 12 principles

The 2012 Recommendation naturally contains a number of familiar elements, having been constructed on the foundations of the earlier OECD principles. The objective also essentially remains the same; namely that all regulatory decisions should be informed by an understanding of why regulation is the best option and of its likely effects on the wider community. However, there is more emphasis on regulatory co-ordination and implementation, and its main thrust is on the systemic application of governance principles and practices.

The Recommendation begins (see attachment) by noting the importance of having political commitment at the highest level, recommending that this be expressed through a whole-of-government regulatory policy directed at the public interest. Without strong political leadership, little progress can be expected in reforming long-standing practices and cultures that have seen regulatory burdens grow.

Of the other eleven elements, five could be said to be most directly about good governance, paraphrased briefly as:

- adherence to transparency and public consultation
- establishing oversight institutions and support mechanisms
- publication of regular reports on regulatory and regulator performance
- designing regulatory agencies to secure their objectivity and consistency
- ensuring procedural fairness and access to review mechanisms.

Each of these makes an important contribution to building a system that can deliver well-informed regulatory decisions; decisions that will can also be well implemented and, importantly, that can win the trust of the community.

For example, 'transparency' – open, inclusive processes -- is crucial to the testing of regulatory proposals and enabling those affected by them to raise concerns that may need to be addressed. It can also shed light on the true nature of a problem for which regulation is being considered, and help ensure that regulatory action only occurs when warranted. It is also key to ridding the 'devil from the detail' of regulatory initiatives, thereby reducing the scope for unintended consequences.

A system cannot operate effectively without institutions to control, monitor and report on its operations. This is particularly so for regulation, given its diffuseness and pervasiveness. The next two principles above are directed at this. Ideally, such institutions would have a degree of independence, as those officials involved come under significant pressure from time to time, particularly in relation to 'gate keeping' roles.

This is equally important for bodies administering regulation itself. Without objectivity and consistency on the part of regulators, support for regulation and indeed trust in government itself can be undermined. And, given the need for discretion when applying regulation and the scope for error, the last of the above governance principles – ready access to review – is also fundamentally important.

The remaining six parts of the Recommendation involve what could be called 'action' or 'process' requirements for a sound regulatory system:

- integrate RIA into early stages of regulatory development
- conduct systematic reviews of regulations in place
- apply risk management and risk communication strategies
- take into account existing international standards and external impacts
- promote regulatory coherence across domestic jurisdictions
- foster regulatory management capacity at sub-national levels.

In most cases, regulations that do not turn out well were not subjected to sufficient analysis and scrutiny at the outset. Regulation Impact Assessments are intended to provide such analysis prior to decisions being made. Unfortunately, too often they become a form of ex post justification for decisions already taken at a political level. Sound regulatory systems would ensure that RIA came first, not last -- to inform decisions on the basis of sound evidence about a perceived problem and the relative merits of different options for dealing with it (including non-regulatory ones). Doing this well can be hard. It requires trained analysts and involves time and expense. But experience suggests that such an investment can also pay big dividends through enhanced regulatory outcomes (and that lack of such work can cause major problems, including for government itself).

The testing of new regulations is a basic requirement of good process. However the stock of existing regulation far exceeds the flow of new regulation. Even if all regulations were well made, they may no longer be fit for purpose as circumstances change. Of course, many will *not* have been well made and this may be imposing a costly legacy. It is therefore essential that the regulatory stock be periodically reviewed. This is potentially a very big task.

Finding ways of identifying key problem areas and prioritising reviews is important. But sunset provisions and other ways of managing the stock more generally over time can also be effective, including by culling outdated or ineffective regulation.

Governments and regulators have finite resources and need to focus their efforts where the payoff is likely to be highest. This is assisted by regulations that address higher risks, and instruments and approaches by regulators that can target them. A proportionate and discriminating approach is needed, but often lacking.

The last three principles listed above recognise the importance of taking 'borders' into account. Regulation is typically seen as a within-jurisdiction matter, but it has effects on business and other activity that is increasingly cross jurisdictional or even global. Reducing unnecessary regulatory differences across jurisdictions reduces transaction costs and promotes trade and growth. This has been addressed through international agreements in areas like finance and trade, but individual countries can also test their own regulations against international standards and seek to minimize unjustifiable disparities.

Finally while national governments are responsible for important areas of regulation, many of the regulatory burdens borne by individual businesses occur within lower jurisdictions. Building capacity for the effective development and management of regulation at local and regional levels of government is accordingly an imperative if the system as a whole is to function well.

An ambitious agreement

All twelve principles embodied in the Recommendation are elaborated through specific proposals. Many of these would take some governments well beyond where they are today. Considered as a whole, the ambition reflected in the Recommendation is striking.

Of course, it is one thing to agree on principles, another to follow through and put them into practice. The Regulatory Policy Committee was accordingly charged with monitoring progress in the implementation of the Recommendation and reporting back to the OECD Council by early 2015.

Of course, no government can be expected to exhibit best practice in every dimension, and some may struggle to sustain heights previously scaled. The Recommendation was intended to provide a ‘light on the hill’, setting aspirational standards and clarifying for each country where the biggest gaps remain. Addressing these in the years ahead will influence the capacity of governments to harness their countries’ economic potential, while realising their social and environmental goals.