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**BUILDING CAPACITY FOR REGULATORY QUALITY:
STOCKTAKING PAPER**

Note by the Secretariat

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This paper is presented to the PGC for information. An update of the 2002 report "Regulatory Policies in OECD Countries: from Interventionism to Regulatory Governance", this paper is a contribution to a synthesis report, "Taking Stock of Regulatory Reform: A Multi-disciplinary Overview from 20 Countries' Experiences" [SG/SGR(2004)1] which will be presented at the 3rd meeting of the Special Group on Regulatory Policy (SGRP), 14-15 June 2004. It will also be discussed at the meeting of the Working Party on Regulatory Management, 27-28 September 2004.

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BUILDING CAPACITY FOR REGULATORY QUALITY: “STOCKTAKING PAPER”

1. Introduction

1. Regulatory Policies in OECD Countries : from Interventionism to Regulatory Governance (OECD, 2002), assessed progress made in the regulatory quality agenda over the last ten years, drawing evidence from the OECD’s programme of country reviews. This paper updates the analysis and conclusions of the 2002 publication¹. In doing so it restates and in some cases develops the most important notions underlying the pursuit of regulatory quality². It takes account of the most recent reviews³, as well as recent work on regulatory quality by the OECD Secretariat, and includes the regulatory quality perspective on some of the broader issues that have emerged from the country reviews. The paper identifies some key points for further debate and development, and is a contribution to further discussions about updating the OECD reference checklist for regulatory decision making of the 1995 *OECD Council Recommendation on Improving the Quality of Government Regulation*, and the policy recommendations of the 1997 *OECD report on regulatory reform* (see annexes 1 and 2).

2. The key elements that make up an effective regulatory quality landscape have become clearer since the mid-1990s, when the 1995 recommendation and its checklist set the first international standard on regulatory quality, and the 1997 principles of good regulation were endorsed by the OECD Council. In principle, if not always in practice, the focus has shifted from the relatively simple goal of deregulation to the improvement of regulatory quality, including re-regulation where necessary ; from the idea of one- off regulatory reform to the continuous promotion of regulatory quality; from legal quality to substantive, “fit for the policy purpose”, quality. The three essential and linked pillars for the promotion of regulatory quality -regulatory policy, regulatory institutions and regulatory tools- have been confirmed via the evidence of the country reviews. There is now a much better understanding in most OECD countries of how these pillars need to be developed.

3. Progress has been made in developing a stronger conceptual framework for regulatory quality, but there is some way to go yet for regulatory quality to be firmly implanted in practice into the wider governance framework of most OECD countries. In general, all three pillars of regulatory quality need strengthening. Regulatory policy needs to be more clearly articulated in many cases, and its importance

¹ It does not cover all the issues examined in the report, but highlights those which have emerged as the most important.

² **Regulatory quality** defines a regulatory framework in which regulations and regulatory regimes are efficient in terms of cost, effective in terms of having a clear regulatory and policy purpose, transparent and accountable. **Regulations** are the instruments by which a government places requirements on enterprises, citizens and the government itself. They include all primary laws and all other subsidiary rules, issued by all levels of government, as well as rules issued by non-governmental bodies to which governments have delegated regulatory powers. They cover economic, social, and sectoral regulation among others, as well as administrative regulation (paperwork and administrative formalities through which governments collect information and intervene in individual economic decisions).

³ Reviews of Finland, Norway, Germany and France.

promoted and assimilated across all levels of government. Regulatory policy is a dynamic and continuous process. The institutional context within which regulatory quality needs to be embedded is more complex than was perhaps first appreciated, raising a challenge for the evolution of new central structures to promote regulatory quality, as well as problems of fragmentation and inadequate linkages between different bodies. Regulatory tools, most importantly RIA, are often poorly applied. Further, often considerable, progress needs to be made on some of the current agenda of what used to be known (and often still is known) as “regulatory reform”⁴, such as reducing administrative burdens, and promoting more efficiency and competition in the network sectors.

4. A major issue highlighted by the most recent country reviews is the public sector, and its comparative neglect in the practical application of the regulatory quality agenda. The public sector is a very large part of the economy of all OECD countries. The public spending to GDP ratio in the OECD area stood at slightly over 40% in 2002⁵. This means that an important part of the regulatory quality agenda needs to be about “regulation within government”⁶. This aspect of regulation should in principle be subject to the same regulatory quality standards of efficiency, effectiveness, transparency and accountability as other regulation.

5. A linked issue is that 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 State⁷. 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 of the State to 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 economy⁸. This is proving a difficult task because of entrenched vested interests in established 20th century approaches, and risk aversion to change. Political changes such as the rise of NGOs add to the challenges.

6. 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. 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 due to technical aspects and the need to promote competition in an asymmetric framework. The decentralisation of executive power has also resulted in a proliferation of rules from different levels of government.

7. The paper starts with comments on the broader context and relevance of regulatory policy, followed by an assessment of how far OECD countries have now evolved in their capacities for promoting

⁴ This paper deliberately avoids using the term “regulatory reform”, as far as possible, in order to underline the shift in thinking that has taken place over the last few years which emphasises a continuous process rather than a series of *ad hoc* reforms.

⁵ “Surveillance of Public Expenditure: synthesis of findings in EDRC countries”. Economics Department Policy Committee, Working Party No 1 on macroeconomic and structural policy analysis (2003)

⁶ Note that this paper takes no view on the size of the public sector. It is simply concerned with the application of regulatory quality principles in both private and public sectors, and at their interface.

⁷ This was true at different times for Europe and North America. For example both Europe and the US saw an increase in the role and presence of the State in the 1930s, and again in the US in the 1960s and 1970s; the State’s role increased dramatically after the Second World War in Europe.

⁸ The “regulatory State” has a more specific meaning in the context of State- owned enterprises: separating the State’s rule-making, enforcement and ownership functions.

regulatory quality, in terms of the three linked pillars : regulatory policy, regulatory institutions and regulatory tools. An important part of this section touches on the issue of regulatory performance. It then considers how well regulatory quality has so far been put to work in selected areas which have been the focus of the country reviews, and the challenges raised by the public sector. It identifies actions to help support the future strength and development of regulatory policy. The conclusions include brief comments on updating the 1995 checklist and the 1997 principles from the regulatory quality perspective.

2. Regulatory policy : its context and relevance

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

8. Regulatory policy may be defined broadly as an explicit, dynamic, continuous and consistent “whole of government” policy 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. It 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.

9. Regulatory policy is an integral part of the process which links a policy goal, policy action, and regulation to support the policy action. There is a powerful relationship between policy development and regulatory development. Regulatory policy is not 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 understanding. It helps define the interface between the State, society and the economy.

10. A well-implemented RIA illustrates this⁹. By dissecting the purpose of a proposed rule it helps to define the policy goal. These statements may appear self-evident to the proponents of regulatory quality in government, but an understanding of this link is not widespread. Yet, as the 2002 report noted, integrating regulatory quality into government processes requires a “re-engineering of policy development”. It is not simply a matter of grafting on.

11. 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.

⁹ The 2002 report noted that “In essence, RIA attempts to clarify the relevant factors for decision-making. It pushes regulators toward making balanced decisions that trade off possible solutions (including the decision to do nothing) to specific problems against wider economic and distributional goals. Far from being a technocratic tool that can be simply « added on » to the decision-making system by policy directive, it is a method for transforming the view of what is appropriate action, indeed what is the proper role of the State. Experience makes clear that RIA’s most important contribution to the quality of decisions is *not* the precision of the calculations used, but the action of analysing-questioning, understanding real-world impacts, and exploring assumptions. Significant cultural changes are required to make such analysis genuinely a part of increasingly complex decision-making environments”(p.47).

- Promote timely and necessary change to support economic and social renewal, so that this can take place more quickly and at least cost.

12. Formal evidence to prove the connection between effective regulation and the successful implementation of public policy goals, however, is weak. More research on the economic impact of high-quality regulation promoting competition and market openness would be useful. Performance indicators which go beyond the ones already devised to assess the degree of regulation and competition in markets [SG/SGR(2003)7].

Meeting specific policy goals with the help of regulatory quality

13. 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. 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. Anticipation 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.

14. The OECD's horizontal country reviews have made an important start with the reviews of network industries and other sectors such as professional services. The more recent country reviews suggest scope for making the link with an even broader range of policy areas.

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

15. What does government want to achieve? What is the desired outcome, for which new or reformed rules, regulatory frameworks or deregulation are needed? If the policy objective is clear, it is easier to define the necessary rule(s) to meet it. If the policy goal is not clear, it will be difficult to design effective rules. If other necessary actions such as structural reforms are not also taken, the rules may not have the desired effect.

16. Policy making also increasingly requires solutions that cross ministerial boundaries, because of policy interactions, and the need for trade-offs to deal with policy conflicts¹⁰. Dealing with these interactions and conflicts is difficult. Some interactions are not easy to spot or anticipate¹¹. Policy conflicts do, however, need to be managed. Ways of doing this might include the identification of recurrent policy "trade-off" problem areas and developing a stronger awareness of how/which 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.

The link between regulatory policy and the broader governance framework

17. Regulatory policy is already a key part of the OECD's work on governance, the goals of which are transparency, legitimacy, accountability, trust in government, efficiency and policy coherence. Regulatory policy and the promotion of regulatory quality also need to be linked into the much broader governance framework, which includes other horizontal policies such as competition policy.

¹⁰ An example among many might be the need to balance health and safety concerns against cheaper drugs and consumer choice.

¹¹ For example German electricity prices fell after market opening as hoped for, but environmental taxation to support renewables pushed them up again.

18. Competition policy is one of the most important of these other policies, and its link with major regulatory reform has been very strong in the recent development of some OECD countries, competition policy acting as a powerful spur to market opening and deregulation.

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

19. 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, globalisation notwithstanding.

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

Regulatory policy

21. Regulatory policy still needs recognition as a field on its own. The scope and quality of regulatory policies across the OECD remains extremely uneven. Many countries still only have fragmented elements of a regulatory policy in place, some dating back many years¹², but few yet have a comprehensive policy. Few meet the test in terms of the three essential pillars and of linking them up effectively. Regulatory policies should incorporate explicit goals or targets with regular reporting requirements. The principles underlying the regulatory quality agenda 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, and the authority of such bodies may need strengthening, for example when there are no requirements for the formal oversight of RIA. Measures must be built in to ensure compliance with regulatory quality processes and tools, including sanctions.

22. Implanting 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). It can therefore often generate incomprehension, if not resistance. Competition from other, more established, easily identifiable and understandable policies (fiscal or environmental policy for example) can blur its importance.

¹² For example Finland's 1975 HELO instructions.

23. Most important in relation to long term impacts, regulatory policies are usually some way from integrating fully the concepts of dynamism and continuity. As the 2002 report explained, 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 report 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”.

Regulatory institutions

24. Regulatory policy needs to find its place in a country’s institutional architecture. This section reviews tendencies in setting up central oversight bodies for regulatory quality, and goes on to consider the broader institutional context and the issues that this raises for progress on regulatory quality. As well as updating specific institutional developments (such as independent regulators) it develops an issue which started to emerge with the 2002 report, that the institutional context for implanting regulatory quality is complex and remains fragmented.

25. The country reviews 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.

26. Institutional and legal systems across OECD countries range from systems adapted to small societies with closely knit governments that rely on trust and informality, to large federal systems that must find ways of dealing with high levels of autonomy and diversity. Institutional traditions also vary, from weak government centres and strong ministries, to the opposite. Legal systems have a powerful influence on the regulatory environment.

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

27. 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 probably essential in some shape or form. These bodies help ensure regulatory quality principles are successfully applied. They can perform a number of different functions to that end. The two main ones are:

- An advocacy role. They can be « engines of reform » to focus the interest of existing powerful centres of government and other important stakeholders in support of regulatory quality development.
- Practical and technical support. They can help to develop analytical expertise through training and guidance. They can also help to promote consistency, avoid the proliferation of procedures, and prevent the re-emergence of poor quality regulatory practice.
- Challenge Function. They can assess, or challenge, the quality of RIAs.

28. These 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.

29. 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 interests¹³. 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 evolving¹⁴.

30. What can be made of the different approaches taken across OECD countries? 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.

31. Some countries are finding the concept of new central bodies for regulatory quality promotion hard to accept, linked to a resistance in accepting the need for a 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, close and informal networks of contacts within government and society based on mutual trust, central bodies may be seen as necessary.

Central government institutions: understanding their perspective and necessary contribution

32. The institutional architecture of central government raises key issues for the coordinated promotion of regulatory quality. With or without central bodies the different parts of central government each have a key role to play in supporting the regulatory quality process¹⁵:

- 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 and Justice 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

¹³ For example the UK’s Better Regulation Task Force.

¹⁴ For example the Netherlands Economic and Social Council has a constitutional role and a long history. By contrast, the Australia Small Business Deregulation Task Force was established by administrative decision, is *ad hoc* and single function.

¹⁵ The order in which the different parts of central government are covered is not intended to reflect a hierarchy of importance.

longstanding actors with an important role in regulation¹⁶ may also need to be taken into account. The involvement of all these institutions is needed.

- 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 issues¹⁷, 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 officials may need to be reviewed and strengthened.
- The judiciary¹⁸. 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 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. The 2002 report notes, and more recent evidence confirms, that 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.

Independent regulators: helping to promote transparency and market competition

33. The 2002 report touched on independent regulators¹⁹. Their numbers have continued to rise since then. The term covers not just economic regulators for the network industries, but also other types of regulators such as those set up to support civil liberties and foster administrative transparency. Their main functions vary significantly across countries and between regulators in the same country. But very broadly speaking, they tend to be concerned with rule enforcement and the application of sanctions for non-compliance with rules relating to their areas of competence, and authorisations for the issue of licences and permits.

¹⁶ For example the French Conseil d'Etat.

¹⁷ Some of the German Länder representatives in the Bundesrat for example have been promoting better evaluation.

¹⁸ Because the judiciary is such a significant topic in its own right, only the briefest comments are made here. A review of its role in the regulatory quality context needs more development.

¹⁹ The term is used here for simplicity, but can be misleading for some countries. No simple definition exists, but very broadly they are semi autonomous agencies working within the ambit of policies set by governments under which they have specific delegated responsibilities.

34. Independent regulators are an important step forward for better regulation of sectors and issues, for a number of reasons. They help to prevent political interference and the influence of special interests. They contribute to the improvement of regulatory quality, transparency, stability and expertise. Not least, they are a necessary institutional development for marking out the separation of the State's roles as policy maker/owner and regulator, a role which is especially important in countries which have chosen to maintain a significant number of State owned enterprises. They can also be powerful advocates for further and more effective reform.

35. But they raise issues too. Their independence from ministers can be weak. They need adequate resources and competences to carry out their role and to enjoy an appropriate level of independence. But independence in turn raises the issue of accountability, perhaps the biggest challenge for their future development. The difference between policy making and regulation is not always clear. Regulators are primarily rule enforcers, but the line is often blurred between rule making and rule enforcement. Regulators are increasingly a source of technical expertise and are often consulted in the policy-making process and the preparation of primary legislation. They are often responsible for the interpretation of primary rules. Some regulators also make the secondary rules to back up more general primary legislation, which means a lot of interpretation.

36. Independence therefore needs to be balanced with clear accountability mechanisms. This is especially important in relation to parliaments: democratic legitimacy needs to be reinforced given that independent regulators are non-elected. The accountability "feedback loop" also needs to involve dialogue with policy makers, and directly with citizens (for example through clear information on websites). Evaluation mechanisms for their performance and governance structures need attention too, balancing flexibility with the need for independence and credibility. Appeal systems against independent regulators are needed, but again the right balance must be found to avoid the risk of undercutting their independence and effectiveness. Independent regulators should not be confronted with high level political/policy choices which are for other government institutions to resolve.

Other issues are:

- *Capture*. There are different kinds. Rules are needed to ensure independence from political capture and capture by the entities they regulate. Sector specific regulators may slow rather than encourage structural change, for example in converging sectors.
- *Regulatory quality standards*. Where regulators make rules or interpret them, they should be under the same disciplines as for other rule- makers notably as regards RIA and consultation.
- *Relationship with the competition authority*. Overlap giving rise to lack of clarity over responsibility for competition issues can be a problem and competition policy may become fragmented. Cooperation agreements are important. Cooperation can extend even further, such as joint projects to review difficult issues or sectors.
- *Sanctions and enforcement powers*. These are essential for their effectiveness but sometimes not strong enough.

37. There is a fairly rapid development of best practice and answers to these issues. The establishment of a general framework for the evolution of independent regulators may also be useful, to counter *ad hoc* developments with no guiding principles.

Competition authorities: their role in the regulatory quality agenda remains crucial

38. Much can be said about competition authorities, law and policy which are beyond the scope of this paper²⁰. From the regulatory quality perspective, three institutional issues can be mentioned. The first is that competition bodies self evidently have an important role to play in the enforcement of competition rules that are fundamental to the effective functioning of market economies. They can also be advocates for better regulatory quality if they have a policy role too. For example they can play an important role in the development or assessment of RIAs and administrative simplification programmes²¹. The third issue is their relationship with sectoral independent regulators, which needs to be well conceived in order to avoid different interpretations of the competition law and to manage conflicts with sectoral laws. Most countries have structures in place to achieve this.

Subcentral governments: increasingly important but a very imperfect link with the regulatory quality agenda

39. The importance of subcentral governments has emerged even more clearly with the recent 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.

40. In a few countries local governments have been active agents for improving regulatory quality, sometimes even the drivers²². But other countries still have some way to go in improving their regulatory framework at the local level. The regulatory quality agenda often does not reach out to local government yet. But there is a growing awareness of the issues and efforts in many countries to address them.

41. What should be devolved? The fifth criterion on the 1995 checklist already offers some important insights into the issues. 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 i.e. central targets for educational outcomes, with decentralised flexibility and responsibility for how to achieve them such as teacher recruitment and school management.

42. At a more strategic level it is important to get 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, but useful innovations are at least as likely to emerge in cities and regions.

43. Another key issue is fiscal relationships. Local governments need adequate resources for their tasks. Responsibilities must be matched with necessary budget allocations especially where new or broader

²⁰ A separate paper by DAFFE considers the competition policy dimension for the stocktaking exercise in detail (DAFFE/COMP(2003)19/REV1)

²¹ As in the UK and Australia

²² For example several Australian states pioneered the use of RIA. Australia also shows the potential for cooperatively negotiated reform agendas between federal and state governments, by devising an imaginative system of financial incentives for promoting competition principles in the economy.

mandates have been given. But it is also important to get the incentives right for wise spending. Tax and spending relationships between central and local governments need to promote incentives for cost control, and encourage the use of cost-benefit analysis. Effective regulatory frameworks to which regulatory quality principles are applied can help to address these issues²³.

Other issues raised by the central/local government relationship include:

- *Rule making quality.* 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.
- *Compliance and enforcement.* Who monitors compliance and enforcement of national rules at the local level?
- *Economies of scale.* There is a need to consider the number of local entities and the number of layers. Are there too many for efficiency?
- *Duplication and overlap.* Some overlap is unavoidable; Effective coordination/cooperative arrangements need to be in place. But there is need also to avoid too many arrangements, or too few.

The supra-national level: the global trade community is a powerful driver for moving the domestic regulatory quality agenda forward

44. Globalisation is a strong force for simplification and better regulatory quality, as international trade thrives on better, simpler and fewer rules. Market openness has been one of the main elements of the OECD regulatory reform programme of country reviews²⁴. International trade institutions and national companies broadly share a common agenda, to strengthen international trade flows and (for the latter) to sustain competitiveness in global markets. OECD countries' membership of global institutions to promote international trade (WTO, standardisation bodies) is helping to promote better domestic as well as international regulation.

45. From the domestic regulatory quality perspective, the important and helpful issue is the growing interest in the improvement of national regulatory environments. With the progressive lowering and elimination of tariff barriers to trade, the attention of the international trade community has focused on non tariff barriers. As well as the more trade specific agenda such as international standardisation, this means promoting better quality and more transparent national regulatory environments, so that foreigners are not disadvantaged. Open international markets need the support of further improvements in regulatory quality. Three of the six efficient regulation principles for market openness pick up the same themes. Under the "transparency and openness of decision-making" principle, for example, systematic public availability of information, clear, simple procedures for making and implementing rules, systematic reliance on public consultation, clear, open, effective appeals procedures, and efforts to ensure transparency in particular areas, have been highlighted by the country reviews as best practices for fostering market openness. Though there have often been significant improvements in these areas, important challenges remain. These include foreigners' difficulties in accessing consultation networks, integration of the trade dimension in RIA, and public procurement rules.

²³ See EDRC paper (earlier ref) for more detail on some of the budgetary aspects. The work underway as part of the Fiscal Federalism project is also relevant.

²⁴ A separate paper by the Trade directorate considers the market openness dimension for the stocktaking exercise in detail (TD/TC/WP(2002)25/FINAL).

46. The difficulty is that trade perspectives are often not well integrated into domestic rule making. Trade policy bodies tend not to be systematically involved in the day to day business of rule-making. A better working level relationship with national regulators and stronger advocacy of the trade perspective in national rule making would be very helpful.

An important issue for EU/EFTA countries is the increasing importance of EU rules

47. With one exception the most recent reviews have been of European countries (either in the EU or with close links). More generally EU countries account for nearly half of the OECD membership.

48. Perhaps half or more EU member country rules now come from Brussels. The EU is also shaping whole regulatory regimes. Most important perhaps in the regulatory quality context is the single EU market agenda, which involves a mix of deregulation and market opening alongside rule harmonisation so that goods and services can move freely within the EU/EFTA region. The coverage is wide. It includes product markets (such as cars), professional and other services, and horizontal policies such as state aids, public procurement, and competition policy as well as social and environmental issues. The EU plays a prominent role in the reform of network industries (telecoms, energy, rail, posts etc) where it usually sets *de minimis* regulatory requirements such as the nomination of an independent regulatory authority, and the separation of competitive from non-competitive activities. The EU's common external trade policy is another large area of relevant work.

49. The single market programme has been a major driver of deregulation and regulatory harmonisation. It has helped to open up economies and promote trade and investment flows. EU rules have often helped to enhance social, environmental, health and safety, and consumer interests. At a broader level the EU has helped in the development of the concepts of proportionality and subsidiarity in the application of rules.

50. The EU also generates an increasing number of rules, which confronts it with the same rule inflation problem as its member states. The EU authorities are aware of this²⁵ but (reflecting the EU policy making process itself) this is an issue that needs to be tackled from both ends: efforts from Brussels, combined with efforts from member states too. Experience suggests that EU member countries (depending on what they do already) may need to pay particular attention to the following issues:

- *Influencing the EU decision-making process.* Putting adequate and appropriate resources into negotiating EU rules, including economic as well as legal expertise. Applying the same or equivalent regulatory quality standards to EU drafts and rules as to national rules. The lack of systematic *ex ante* effort to evaluate the costs and benefits of EU laws is likely to make identification and prioritisation of issues that need to be promoted or opposed in Brussels a difficult task.
- *Consulting with and inform the business community and other interested parties.* The business community needs to comply with new regulations, and stands to gain from more open markets sharing the same rules.

²⁵

For example the 2001 EU White Paper on European Governance; the 2001 Communication to the European Council on improving and simplifying the regulatory environment; the 2002 EU Commission Action Plan to improve the EU regulatory environment.

- *Effective implementation and transposition.* Ensuring that implementation is timely and mechanisms are needed to ensure this²⁶. While some countries have a good record, many others have a significant overall implementation delay. This is damaging because of the uncertainty which it creates, especially in the business community. What is the legal position if a directive (not transposed yet past the date this should have happened) contradicts national law? As many directives are part of the construction of the single market, delay may put national companies at a disadvantage in this wider market, especially if reciprocity is applied (that is if a country chooses to deny access to another country's goods or services until the latter has complied with EU law). Implementation needs to be proportionate, avoiding gold plating in order to minimise unnecessary burdens on business.
- *Avoiding confusion between national and EU laws.* Care is needed over how EU law is integrated into domestic law. Perhaps the golden rule is to keep it as simple as possible. This implies careful coordination with all relevant government bodies in the process, from start to finish.
- *Coordination with national sector regulators.* There is a rapidly growing need to articulate the work of regulators for these sectors and that of the EU Commission. Informal mechanisms are already in place for some sectors²⁷.

Regulatory tools

51. Five key areas are considered below: administrative simplification, RIA, transparency and communication, alternatives to regulation, and the issue of compliance and enforcement²⁸. Though regulatory tools are on the whole more developed (at least in principle) than policies and institutional architecture, there are some gaps. Further research to help understanding of how to apply cost-benefit analysis (CBA), on self assessment, on alternatives to regulation, and not least on evaluating the performance of regulatory tools (among other areas) would be useful.

52. Though tools such as RIA offer a much broader and deeper scope for improving regulatory quality in the long if not the short run, many countries still focus much of their effort on administrative simplification. Overall, not enough use is made yet of the potential for deploying other tools.

Administrative simplification

53. This section starts with administrative simplification, partly to underline that it probably remains the most commonly used regulatory tool. But useful as it may be, it is not the only tool. The 2002 report noted that few regulatory reforms are more popular than promises to simplify government "red tape", and that one of the most common complaints from businesses and citizens in OECD countries is the number and complexity of government formalities and paperwork. The report also noted that reducing administrative burdens, permits and licences can help create a political constituency for reform, especially among SMEs, that can support subsequent deeper regulatory reform.

54. Reducing administrative burdens certainly helps businesses, especially SMEs. Burdensome administrative regulation raises company costs, impedes market entry and innovation, and hurts

²⁶ For example the UK makes individual ministers responsible for the rate of transposition and for informing Parliament of progress.

²⁷ For example the Florence Forum for electricity regulation and the Madrid Forum for gas regulation

²⁸ This is not an exhaustive list. The 2002 report considers a number of other issues such as appeals procedures.

competitiveness. Efforts at administrative simplification have been going on for many years. There has been steady progress with tools, especially use of the Internet (government websites, gateways to further information, online form filling, including for customs formalities), one stop shops, central registries of formalities, the redesign of formalities such as permits to reduce complexity, and sunseting processes for new laws.

55. But success is mixed. Burdens appear still to be rising, at the same time as government action is taken to try and deal with the problem. Most countries still face the challenge of identifying and managing administrative burdens imposed by new or existing legislation. This is sometimes poorly understood, as governments do not know the burdens on their businesses and cannot make informed policy choices to improve matters. Regulatory complexity is an issue in many countries, fed by a growing number of laws which then need interpretation.

56. There is another and deeper issue; the roots of the problem need attention. For example, re-designing permits sidesteps the question of whether permits are necessary in the first place. Regulatory quality principles applied *ex ante* to new rules and laws, before they are adopted, would improve clarity and simplicity, reducing the administrative formalities needed subsequently. *Ex post* simplification and codification is not enough, and may mask the real problem of poorly designed or even unnecessary rules.

RIA and effective ex ante evaluation

57. Regulatory Impact Analysis (RIA) is perhaps the most important regulatory tool available to governments, as its aim is to ensure the most efficient and effective regulatory options are chosen. Most of the 1995 OECD checklist relates to RIA good practice. It remains a highly valid reference. But RIA is a challenging process that needs to be built up over time.

58. The most recent country evidence confirms that it is indeed a challenge. Existing RIA guidelines are not always applied, or applied ineffectively or inconsistently, despite the fact that the use of RIA has become widespread if not universal, with initial efforts dating back to the 1970s and 1980s in some countries.

59. Two important issues that have emerged from the country reviews is that competition policy and trade perspectives are often not strong components of RIA in some countries, with no explicit reference to them. RIA is not often directly or consistently applied in terms of considering the impact of other rules on trade and investment, or indeed on trade and investment rules themselves. As for competition policy, the 1997 principles underline that “regulation should not impair competition, trade and investment any more than is necessary to achieve other, legitimate purposes”. But this principle seems so far to be imperfectly applied in the RIA process, and clear guidance on this is not yet widespread.

Other main issues with RIA may be summarised as:

- *Omissions.* RIA is not applied yet to all rules, and to all rule makers. The use of RIA remains partial, with large parts of the regulatory structure in most countries not subject to its disciplines at all (such as local governments, especially in federal States). Quasi regulation is an issue²⁹.

²⁹

Efforts to reduce regulatory complexity are often offset by the development of grey rules, often outside the disciplines of RIA and other regulatory quality tools. Such rules have an uncertain legal status of such rules. Though soft law is often meant as guidance for simplified laws, non compliance with the guidance may be taken as an offence. So it acquires the status of law, without going through the processes for “real” laws.

- *Whole regulatory regimes.* RIA is relevant not just for individual rules but also for whole regulatory regimes (such as for the network industries). Assessing individual rules out of context may undermine the potential of RIA to aid better rule-making.
- *Evaluation.* How well is the regulation likely to achieve its objective? There are important weaknesses in the use of quantification methods, CBA techniques and evidence-based justifications to support evaluation which need further deployment and development.
- *Compliance with RIA* (and other regulatory quality mechanisms) in the administration. This is often poor, with a lack of sanctions, and a lack of resources for enforcement.
- *Complexity and fragmentation.* Too many checklists exist in some countries, which can cover a range of issues (social and economic impacts, gender, regions, and business environment).
- *Targeting.* To avoid overload, RIA needs to be targeted at regulations with the largest potential impacts and the best prospects for changing outcomes³⁰.
- *Integration with consultation.* This is often separate from/not included in consultation processes, reducing the scope for generating the data needed to maximise RIA's effect on decision-making, and undermining its acceptance by stakeholders- and so slowing the cultural changes needed to ensure that it becomes a key part of the decision-making process.

Transparency and consultation

60. Transparency is one of the central pillars of effective regulation. It is a challenging task, and involves a wide range of practices, including standardised processes for making and changing regulations, consultations with interested parties, effective communication of the law and plain language drafting, publication and codification to make it accessible, controls on administrative discretion, and effective implementation and appeals processes.

61. Transparency is a growing challenge, as countries are faced with increasingly complex societies and globalisation. It can be difficult to accommodate those who may lack easy access to regulatory processes and who are not part of the “establishment”, but whose views are nevertheless important in securing effective regulatory outcomes. Less organised or broad groups such as taxpayers, consumers, SMEs and foreigners may be left out or play a more marginal role than they should.

62. Organised groups and vested interests have built up over time in many countries. This is especially the case in consensus driven societies with formal mechanisms for identifying and involving important stakeholders (they may end up excluding some, often unintentionally). Powerful players and interest groups in the traditional consultative structures such as organised labour can block change. The social partners (employer and employee groups) may also exert a special influence on consultation³¹. There is a risk in these situations of blurring the line between obtaining advice on policy issues and undermining government's democratic responsibility to take a final view.

³⁰ Korea and US offer examples of how to do this, by defining « significant reform » for priority treatment (based for example on costs, or the number of people affected).

³¹ These may cover a wide range of issues: not only wages, but employment policy and issues of working life such as social services, pension schemes, and taxation.

63. Consultation approaches need to be adjusted to the country's context. But general principles have emerged. More open and accessible procedures are more legitimate, less vulnerable to capture, and more likely to bring high quality information that improves analysis of regulatory and policy options. Discretion in deciding who and when to consult should be minimised and transparent to avoid insider capture. The "Notice and comment" procedure is proving a very effective means of maximising the engagement of relevant stakeholders. Online systems for communication and consultation are also increasingly used. But policy makers and regulators need to assess the implications of the digital divide for universal access. The design and update of websites needs care too.

64. Consultation fatigue appears to be a growing issue. The breadth and eclecticism of consultation mechanisms, or too much consultation, can unintentionally result in this. Local government, businesses, and citizens can easily be lost or overwhelmed.

Alternatives to regulation

65. The use of a wide range of mechanisms, not just traditional regulatory controls, for meeting policy goals helps to ensure that the most efficient and effective approaches are used. Approaches include green taxes and subsidies, voluntary agreements, information programmes such as eco labelling, self regulation, permit trading schemes, and performance -based regulation (where a sector or industry must comply with a standard, but can broadly choose how to meet it). These developments reflect a changing relationship between the State and businesses/citizens, and support the "light touch" needs of market economies. But alternatives are often poorly developed, and are still mainly used in the environmental context.

66. A significant implementation gap exists between available tools and practice. The first response to a problem is still often to regulate. As the 2002 report already noted, governments must lead strongly to overcome built-in inertia and risk aversion, and reinforce regulatory guidance. A better understanding is needed of options to regulation. A willingness to accept policy risks is another factor, as many alternatives are relatively untested. Substantial technical and practical support is needed, with economic training in evaluating options. Some alternatives such as emissions trading can be complex to implement. Other regulatory tools such as RIA may need adjustment to ensure that alternatives can be "drawn out". Implementing systematic reviews of the impact and performance of regulatory alternatives is likely to be helpful.

67. A cautionary note is needed on self regulation since the 2002 report was written. Self regulation needs to be handled with care. It can block new market entry, and the transparency with which self regulatory schemes are set up and sustained is an issue, which particularly disadvantages foreigners. Effective management and more vigilant oversight of self regulatory schemes is needed, including a stronger framework for determining when they are most appropriately deployed to minimise the risk of abuse and capture. How to do it properly is still work in progress, for example the appropriate level of government oversight, ensuring transparency, and controls to reinforce responsibility and accountability.

Compliance and enforcement

68. As the 2002 report already underlined, compliance and enforcement are the poor relations in the regulatory toolkit. Adoption and communication of a regulation sets the framework for achieving a policy objective. But effective implementation, compliance and enforcement are essential for actually achieving the objective. There is not much point having regulation with a low rate of compliance. And inadequate compliance may also be a major cause of regulatory failure. Countries, perhaps not surprisingly, find it easier to focus on the first issue-adoption and communication of a rule -than on the second- ensuring that it is respected. This is a particular problem in the transition economies.

69. Compliance is closely linked to good regulatory design in the first place, as well as effective enforcement tools. A well implemented RIA which includes *ex ante* assessment of compliance prospects is key. This is often part of countries' regulatory checklists and RIA guidelines, which stress the need to consider compliance when making regulations (and sometimes say that a regulation should not be adopted if the compliance prospects are poor). But is this taken seriously? Ex post review of the effectiveness and efficiency of existing regulations is also important to spot compliance issues, together with an assessment of enforcement efforts and capacities, and the development of strategic approaches to their improvement.

Regulatory performance

70. Regulatory tools and institutions not only need to be put in place as part of an effective regulatory policy, but they need to work well too. It is important to justify the costs of regulation against its benefits. Interest in this issue has continued to grow and broaden³². Policy makers involved in regulatory policy are being held accountable for the significant economic resources as well as political capital invested in regulatory management systems. With the development of regulatory policy, there is an increasing interest in systematically assessing regulatory policy performance. Do good regulatory policies deliver good regulation? Evaluation is needed of the performance of regulatory tools and institutions, as well as regulations themselves.

Developing a better understanding of the link between regulatory quality processes and actual regulatory performance

71. This is important, and *ex post* evaluation techniques are part of the answer. At the same time, this work supports a more effective "daily" application of regulatory quality. Which tools and institutions work? What contributes to their effective design? Work is in progress to identify and assess practices and methodologies for the assessment and monitoring of regulatory tools and institutions. Some countries already have an explicit strategy for their *ex-post* evaluation. Tools covered include RIA, consultation mechanisms, simplification measures, and institutions include central units and independent regulators. Evaluations have helped to strengthen tools and institutions, though important challenges have been reported by countries: methodological challenges, resource issues, some resistance from participating institutions, the need to find a home for regular audits, and data problems.

72. A step forward would be a broader and more systematic monitoring and evaluation of regulatory performance, one which might cover all regulations and take a consistent approach. Even more ambitious is an assessment of regulatory performance in the broader context of "good governance" and policy performance.

Learning from failure.. as well as success

73. Analysis of regulatory successes and failures should help to improve regulatory management systems. What went wrong... or right, and why? Was it a failure to update? A failure to comply? A failure to be clear about the primary goal (for example in relation to privatisation, revenue raising or real market opening)?/or of some key element(s) of the regulatory structure?.

74. Regulation may not work if other issues have failed to be addressed, for example structural reforms of the network industries to counter the discriminatory behaviour of vertically integrated monopolies. For SMEs to flourish, administrative simplification is important but a range of policies need to be in place. The network industries attract considerable attention, where failures can be spectacular

³² The first part of this section draws from "Regulatory Performance: Ex-post Evaluation of Regulatory Policies" (GOV/PGC(2004)5)

(electricity blackouts, rail crashes). But other policy areas deserve attention too: environmental and health and safety regulation have sometimes been rebuilt in recent years. Regulatory policy may be overshadowed by other major policy decisions and economic developments³³. This is important because successes and failures are likely to have roots that go beyond regulation. In the case of failures, where the reputation of regulatory systems is often on the line, regulation may not deserve all the blame. A careful assessment of the contributory factors to what is often labelled as regulatory failure is needed. Other policies and factors are often involved. *Ex post* evaluation of these issues may also help in reducing the risk of failure through monitoring and learning, and in picking up successful innovations.

4. Putting regulatory quality to work in practice: developments and challenges

The current agenda covered by the country reviews still has some way to go

75. The country reviews have considered a number of product and service sectors, many of which are or have been heavily regulated, and carry a significant weight in economies. The application of regulatory quality is especially important in these cases to ensure efficient, effective, transparent and accountable regulations.

76. Deregulation is still needed for closed and sheltered *product and service markets*. The retail trade, pharmacies, professional legal and other services, taxi services and many other markets are still relatively closed in many countries. Barriers to new market entry remain.

77. The *network industries* play a key role in the costs and efficiency of other sectors, as well as making a direct contribution in their own right to GDP. Efficient, good quality telecommunications, energy and other services are important for the competitiveness and economic performance of other sectors.

78. But many countries are reluctant reformers in some or all of these sectors (gas, posts, water, electricity, telecoms etc), especially, though not only, in Europe where the EU Commission is often the main driver of change. Former historic monopoly incumbents often still dominate their sectors. Full or partial State ownership remains fairly widespread.

79. Countries differ in their starting point for regulatory reform in this area, in their institutional and cultural constraints, and their public policy goals, not least the extent to which they may consider certain network sectors to fulfil public service functions. So any best practice list needs to be avoided. That said, much has been learnt from experiences of reform. For example the electricity sector is prone to problems of market power and there is a need to avoid concentration in generation. Non discriminatory access to essential inputs, especially the networks, is needed to ensure that competitors to original incumbents are able to get into, and stay in, the market³⁴.

80. The backlash from recent regulatory failures may give rise to the perception that, rightly or wrongly, market opening in the network industries could be a problem. This perception needs to be addressed by pinpointing the specific reasons for failures, and also identifying and publicising successes and the reasons for these too. From the regulatory quality perspective a number of factors appear to be making progress difficult:

³³ The German reunification burden and consequences, for example, are a major, perhaps the most important, factor affecting that country's recent economic performance. UK rail problems were largely due to chronic lack of investment over decades.

³⁴ A separate paper by DAFPE assesses the network industries in detail as a contribution to the stocktaking exercise (DAFFE/COMP/WP2(2003)9/REV2)

- The need for effective re-regulation, as well as market opening, to promote competition is not yet fully understood. Network sectors require both deregulation and re-regulation. Re-regulation can be poorly handled and tested best practice is not always adopted. Difficulties with effective third party access to networks, the unbundling of competitive from monopoly activities, independent regulation, and the separation of government ownership and regulatory roles are recurring themes.
- To complicate matters, many aspects of effective re-regulation are still « work in progress ». These include the complexity of promoting market economy principles in network industries with a monopoly core, and how to manage this monopoly core (for example system operation in electricity). The challenges raised by the reform of the network industries may involve some uncharted territory.³⁵
- Developing and sustaining competitive markets once they have been opened to competition requires continuous regulatory effort. Ex-monopoly incumbents often need to be vigorously restrained from seeking to regain their earlier pre-eminence.

81. Overall, the network sectors are an important example of the usefulness of “whole regime” regulatory quality analysis to draw out issues and potential weaknesses in relation to what countries are seeking to achieve for these sectors.

The public sector: an agenda of rapidly growing importance

82. The public sector accounts for a very significant part of GDP in all OECD countries. If efficiency and productivity can be raised in this part of countries’ economies it would have a major impact on economic performance and social welfare. The challenge to achieve better quality public services is not about the size of the public sector, but rather the fact that it implies a huge amount of regulation “by the State of the State” and the public sector. The application of regulatory quality principles inside the public sector and at the interface of the public and private sectors is just as important as their application to the private sector.

83. Containing and reducing public expenditure is a challenge for many countries, not least because of pressures to spend more. Pressures on public spending with respect to core merit goods such as health and education have continued unabated in almost all OECD countries. Ageing populations are putting more demands on health services as well as public pension provision. Education is another major element of the public expenditure budget. Citizens’ general demands for better services add to the overall pressure on governments to find ways of improving performance. There is scope for efficiency gains, through wider use of regulatory quality principles alongside other policies. For example, regulatory quality tools can be applied to the new governance as well as financial and human resource management systems that are needed. But it would be a mistake to approach this topic of public services narrowly or exclusively as a matter of containing costs. Investments are needed in these sectors, which have considerable impacts on regional and national competitiveness and on the relations between citizens and the state.

84. Overall, there is progress to be made: tools are relatively undeveloped, best practice not always yet identified, reforms often need to be country specific, and there is often considerable resistance to

³⁵ Second generation network industry reforms such as the UK NETA electricity reforms are helping to push thinking forward.

change. Most important perhaps, the appropriate role of the State in public services remains to be defined in a larger governance framework.

OECD countries vary in the extent to which they are prepared to allow competition in the delivery of public services

85. When public services provided directly by the State without any competition, their value cannot be measured, as there is no market for these services. Introducing competition with market providers enables services to be valued in some ways. It is then possible to relate the cost of inputs to a market price for the output³⁶. Productivity and efficiency gains should follow.

86. Public services can be opened up to competition in a variety of ways. Competition can be introduced whilst retaining direct State control. Under this approach, the service continues to be provided directly to consumers by the State. Competition is introduced by splitting the roles of purchaser (the State) and provider. For example the government calls for tenders from private providers. User charges can be introduced to contain demand. Or the State can withdraw entirely from the direct and sole provision of services to the consumer, in which case either consumers directly or intermediaries such as health insurers, but not the State, may influence service delivery. The ex-State provider may be commercialised, in other words the provision of the service is separated from other State activities through separate accounting, and the State charges for it. Consumers may then choose between it and private providers.

87. An agreed definition of which parts of the public sector can or should be exposed to competition does not exist in the OECD. A number of factors affect the definition, some of which are specific to particular countries or cultures. In addition, there are considerations of regional and social cohesion to be acknowledged. Countries tend to exaggerate the degree to which their definition of public service is unique. Attitudes over where to draw the line vary between countries, but there may be more common ground than first appears to be the case.

88. The regulatory quality agenda in many countries needs to include the development of a more coherent framework for governance frameworks to ensure competition in the public sector.

OECD countries vary, too, in the extent to which they are prepared to invite private providers

89. All OECD countries are market economies. Defined in its simplest terms, a market economy is an economic system in which decisions about the allocation of resources and production are made on the basis of prices generated by voluntary exchanges between producers, consumers, workers and owners of the factors of production. Decision-making is decentralised, and decisions are made independently by groups and individuals in the economy, rather than by the State or central planners. The means of production is privately owned.

90. In practice, however, OECD market economies offer a much more complex picture of State and private interactions. Market economies all ultimately function under State strategic direction in the broadest sense (setting the policy framework for example). But beyond this there is a wide spectrum of approaches across OECD countries. The definition of the public sector varies across countries, linked to deeply embedded views about the role and responsibilities of the State in the economy and society.

³⁶ . The GDP measure for much State output is taken to be equivalent to the measured input, irrespective of the efficiency with which the inputs are used. For example, two State employees digging holes for a public service that is not subject to competition are considered to produce twice the GDP output value of one employee, regardless of how much hole is dug.

91. In some parts of Europe, State ownership has traditionally been seen as the best way to manage a wide range of activities, some of which may be deemed commercial activities that could be carried out in a competitive environment under private ownership. As well as services such as health and education, the range of activities is likely to cover the network industries which are often deemed to have public service characteristics, but also industrial activities such as cars and aerospace. This may be a particularly European problem. Though the extent of State ownership has declined significantly in Europe over the last decade or so, it remains extensive in some European countries, and continues to generate debate³⁷.

92. The logical end point for activities that are clearly competitive and do not include any sensitive public service functions is privatisation. Activities with public service functions can also be privatised. Debate on this needs to be strengthened. A useful debate has been started in the EU on Services of General Economic Interest (SGEI), an attempt to define what is meant by public services and how they should be regulated and managed in market economies. Where differences tend to emerge is more in how to handle public services in a market context, and how far trust can be put in the market and supporting regulation via the « regulatory State ».

Careful handling is needed where public services have been opened to competition and the State continues to be a significant owner

93. Learning how to manage State-owned enterprises operating in a competitive environment is crucial. Government ownership of this kind on a large scale needs very careful handling, to avoid discrimination against private companies, and to maximise the pressures for efficiency on State entities.

94. The concept of the “regulatory State” is especially important in these cases to separate the regulatory, commercial and ownership roles of the State. The State cannot set public policy goals to be met by the market overall, if it is owner/shareholder of an entity (and what is more, usually the historic and still dominant incumbent) in that market, its direct operator, and regulator of the sector, without raising problems for effective competition. This leads to conflicts of interest between the various mandates of the State. As owner/shareholder the State will be tempted to maximise profits for its entity, which jeopardises an even handed oversight of the market. If it retains a direct role in the company’s operation, this adds to the problem of potential discrimination against competitors but also raises the issue of how to maintain pressure for the company to be efficient (the company may be cushioned by various advantages such as State guarantees). If the State also retains direct responsibility for regulation of the market, this is especially damaging for competitive neutrality.

95. Tackling these issues requires a coordinated set of policies, not just regulatory policy but other policies such as competition policy and corporate governance. Regulatory policy has two major contributions to make in the mix of policies that are relevant. First, and most important, it provides the impetus for setting up independent regulators and improving their institutional design. Second, it can

³⁷ An ongoing debate in Norway for example, opposes two radically different views. Can the private sector be trusted to deliver important public services? Or should the State, which has been trusted in the past, continue to be directly responsible?

provide input to establish effective rules for competitive neutrality frameworks³⁸, as well as public sector corporate governance frameworks³⁹.

96. This is positive work in progress. Regulatory and governance frameworks have been set up in a number of countries⁴⁰. The OECD's Principles of Corporate Governance, originally developed for private companies, is useful for publicly owned companies too.

In countries where significant indirect State control is exerted through policies that affect market decisions, regulatory quality principles also need to be applied

97. In some countries, the State may not be a big owner, but State-promoted policies and values may exert a particularly powerful role in directing market decisions. An example of the former is collective wage bargaining; examples of the latter are consumer policy. How far should consumers be expected to inform themselves, and how far do they need to be protected by the State? How far should restrictions on competition and/or foreign ownership be allowed because the market is not trusted to maintain cultural diversity, or to support regional policy and decentralised settlements?

98. There is a need to consider whether restrictions actually serve their purpose, and the costs. Applying RIA, including cost-benefit analysis (CBA), to areas such as rules for consumer protection and rules to protect cultural diversity, would help tease this out. Protecting a market is not necessarily the best way to promote innovation, including cultural innovation.

Applying regulatory quality to public services at the local level needs special attention

99. In most OECD countries the local level of government has important responsibilities for public services. The responsibilities vary, from simple delivery of services controlled and regulated from the centre, to responsibility for developing and implementing the rules for service delivery. But whatever the framework, the regulatory quality agenda urgently needs applying to this level of government.

100. Public procurement is a key issue at this level. Despite EU directives on public procurement and a WTO Agreement on Government Procurement, which lay down basic principles of transparency, non-discrimination and equal treatment, public procurement often seems vulnerable to insider domination (conscious or not). Compliance with procurement rules may be poor and tendering processes not always

³⁸ Competitive neutrality frameworks have been set up in a number of countries. They cover issues such as neutralising the potential advantages of State companies, removing subsidies and preventing cross subsidies, ensuring that State assets are not undervalued in initial balance sheets, neutral taxation, setting performance targets, and removing State guarantees.

³⁹ Corporate governance frameworks for State-owned enterprises still have some way to go. It is very difficult to retain State ownership and manage commercial activities in such a way that these can really mimic private companies, and not disadvantage the latter. State companies have no market value to provide an incentive for monitoring and directing performance. Lenders have reduced incentives to monitor performance if the loan is guaranteed by the State. There is also an unhelpfully wide range of participants in the oversight of these firms (voters, parliament, civil servants, ministers).

⁴⁰ Norway for example has now vested ownership of most State companies in a single ministry, and its White Paper "Reduced and Improved State Ownership" identified ten good corporate governance principles for State owned firms. For example State and company boards are independent and cannot include civil servants or members of parliament. A Finnish study of the State's framework for the management of State entities operating in a competitive environment concluded that overall efficiency, effectiveness and quality of service has improved.

used, or not very competitive. Competitive neutrality between private service providers and the municipalities' own service provider arm which may be in competition with the former also need to be reinforced, to encourage outsourcing. The regulatory framework for public procurement needs to be reinforced.

5. Promoting regulatory quality for the future: cultural change and communication

Promoting cultural change within administrations

101. In many countries administrations have not yet fully integrated the need for regulatory quality, and remain too inward-looking.

A more user friendly approach is the basic starting point

102. Improving the State- citizen and business relationship is the starting point. A modern State needs a strong relationship with its users. The administration needs to be approachable, avoiding secrecy, complexity and opacity in administrative acts. Modernising the public administration involves promoting a service and client oriented attitude from the staff of public institutions, and a less bureaucratic and administratively burdensome approach that seeks to help citizens and the business community efficiently at minimum cost. Most countries have already recognised and acted on these aspects of administrative culture. Examples include laws on access to administrative documents and the proper justification of administrative acts, and user charters.

But this is only the start: much deeper reforms are needed to embed a cultural awareness of regulatory quality and its importance

103. Ministers and senior management in administrations may lack a full awareness themselves of the importance of regulatory quality, and so often do not communicate it properly. Because the "cascade" effect from top management down is often missing, the incentives to act may not be very strong further down the line. RIA should be applied at the right moment in the policy making process (that is to say, early) and with sufficient enthusiasm and effort, by a "regulation-aware" culture. The cultural changes among regulators (defined in the broadest sense of the term) are required to support a regulatory system which systematically generates high quality regulation and which is fully integrated with the governance agenda.

Developing a stronger economic perspective

104. The legal quality of a rule often remains the primary focus, rather than the overall ability of the rule to meet policy objectives. The latter is often seen as an « add-on » which takes time and saps resources, rather than an integral part of the process. Some countries have strong legal cultures which permeate their administrations. A legal culture does not nurture an economic perspective or a full appreciation of the importance of evaluation.

Linking the cultural change agenda to broader governance changes for the public sector

105. The cultural change agenda is closely linked to public sector human resource management and budget management reforms. Modern public management techniques need to permeate more deeply, especially at local level. But all institutions related to the governance and policy making process need to be part of the cultural change. This is a sensitive issue where progress is likely to take time. But some countries have already gone a long way, successfully. The regulatory quality agenda is a potentially useful ally of public expenditure and human resources management reforms. These reforms include linking expenditure to outputs and outcomes, and evaluation of the effectiveness of public spending and of the

efficiency of the administration which manages the spending. Output oriented budgeting emphasises the regular evaluation of programme outcomes. Regulatory evaluation has a role to play.

Taking concrete measures to promote a new culture

106. Civil servants are, on the whole, not yet adequately trained to be effective regulators. Regulatory policy and regulatory techniques are generally a low priority in training programmes, with RIA a particular weakness. Making RIA requirements operational, especially CBA, and generally promoting better quality RIA means equipping officials (including local government officials) with the necessary skills.

Promoting better communication, engaging stakeholders

107. To move regulatory quality forward is an issue for governments everywhere. The list of challenges, as the 2002 report noted, is long. It includes vested interests, risk aversion, inertia, fatigue, opposition, lack of understanding of what regulatory quality can do, and confusion.

108. What is regulatory policy and what can regulatory policy do? This is not always yet clear enough to stakeholders. People outside the process may often consider only de-regulation and administrative simplification. The 2002 report noted that it can be part of a virtuous circle if governments can work on clarifying the contribution of regulatory quality to meeting easily identified objectives with a practical relevance to society, such as simpler administration, or lower prices. This can help citizens and businesses to be more supportive. But there is a need also to find a way of communicating effectively both strategic directions and the importance of the longer term (pensions reform linked to intergenerational equity for example).

Dealing with vested interests

109. Vested interests may not necessarily be aggressive in the face of change (though they can be) but their accretion over time puts them in a position of strength. An awareness of the potential strength of inbuilt resistance is one of the first steps to effective, planned, management of regulatory change. Yet governments often do little to prepare for resistance and to promote understanding of the importance of regulatory quality. Vested as well as new interests need to be engaged, in a process which might be defined as « escorting » the transition from old to new. This applies both internally to the administration as well as externally. Persuading government officials of the need for reform and the benefits of regulatory quality and giving them a stake in change (for example allowing officials from different ministries to work up new systems together) is a start.

Working through political cycles

110. The regulatory quality agenda needs to find a way of riding the political cycle across electoral shifts (whilst leaving room of course for political discretion) and maintaining momentum in the absence of a crisis. As the 2002 report noted, administrative simplification reforms are usually non contentious, because everyone can easily see the point of them. They may help to bridge the periods when bipartisan political momentum for reform is lacking, but ways are needed to promote a broader and deeper support of regulatory policy which extends well beyond this issue. Approaches might include strengthening institutions that are not linked to the political cycle, and the identification of stakeholders for change who are not linked to the political cycle.

Working with stakeholders

111. Identifying the stakeholders to be engaged, is an issue in itself. Modern constituencies are often fluid and ill defined. So far as the general public is concerned, promoting a shared responsibility for

necessary reforms is a starting point. Are they well informed, not just of proposals, but of developments and results? Does their understanding of reform lag the reality? Strategic coherence and clarity matters here. Communicating the intentions and benefits of reform- explaining the policy purpose- is one element. With pension reform for example, public opinion might be influenced to look more positively on early retirement programmes if long term official projections of demographic consequences on budget and pensions were highlighted. Monitoring and communicating reform progress and results are also helpful, to sustain momentum. For example important RIA results should be communicated. Introductory summaries to proposed rules do not say much about costs for business and citizens. Feedback from the regulated can also help to pinpoint what works and what does not, such as poor service quality regulation in newly opened network industries.

112. Currently stakeholders who would benefit from reform but lack a strong voice would be useful allies, and if necessary, procedures might be adapted for them. SMEs for example often find it hard to afford the time and money to participate in the traditional rule making process.

Dealing with winners and losers

113. Consumers are potential winners, but governments need to be honest about expected reform timescales and results, so as not to undermine future support for reform efforts. Results may take time.

114. One key group of losers is linked to the introduction of competition and privatisation in monopoly sectors. They need time to adjust, and to be involved in the transition. For example, they might be given a say in the changes and a stake in the end result, such as cheap shares out of privatisation. Losers from reform are often a small group made up of individuals who bear relatively large losses (such as loss of employment with no realistic expectation of getting another job because of age), and region specific with negative multiplier effects on local economies. Gainers are the country at large, and individual gains are small and often invisible. Strategic coherence and clarity of the whole regulatory agenda help to promote an understanding of the overall benefits of reform.

5. Renewal of the Action Plan

115. That regulatory policy is emerging as an identifiable policy in its own right is an important message. Deregulation and regulatory reform tend to remain at the top of governments' practical application of regulatory policy. This ignores the much richer agenda for regulatory quality that could be deployed. Establishing, integrating and justifying regulatory policy within the broader governance agenda and for its contribution to the continuous structural adjustment of economies and societies, has still some way to go.

116. Meanwhile capacities for regulatory quality are growing and best practices have started to emerge, but the pace of change is often slow. Because many countries are still at a basic level in practice, the gap between regulatory leaders and followers appears to be widening. Working to improve existing tools for the support of regulatory quality, notably RIA, remains important. What do these conclusions imply for the 1995 checklist and 1997 principles?

117. The 1995 checklist about regulatory decision-making and the 1997 principles about policy on regulatory reform remain highly relevant but can better reflect policy trends and the lessons of a decade or more of implementation. The three most important new ingredients for regulatory quality missing from the 1995 checklist and which need greater emphasis in the 1997 principles are the dynamic perspective, ex-post evaluation of regulatory performance, and the institutional dimension:

- The checklist and principles should reflect the dynamic dimension of regulatory management and reform. Regulatory quality is a continuous process. Existing regulation needs updating to ensure it remains effective and relevant. Regulatory policy must be integrated into the long term policy agenda for structural reform.
- *Ex-post* as well as *ex-ante* evaluation are important tools.
- A supportive institutional architecture is critical, whilst taking care to respect individual countries' traditions and structures.
- Regulatory quality is not just about individual rules, but also whole regulatory regimes and the interactions between regulatory regimes and policy goals.
- Substantive as well as legal quality is important and needs to be underlined, to emphasise the linkages between regulation or regulatory frameworks and policy goals?

118. The 1997 principles should be revised to reflect the lessons learned about implementation and current trends in regulatory policy. The set of principles is multi-disciplinary, like the country reviews themselves. A revision of the principles, drawing on the contributions of the committees and working parties responsible for trade, competition policy and regulatory management, will help governments in their efforts to develop actions plans with high visibility. To this end, a revised set of 1995 Council Recommendations, which can be prepared for the Working Party on Regulatory Management to discuss at its September 2004 meeting, will provide a pillar to support a revised set of 1997 principles. The SGRP, at its fourth meeting in December 2004, can decide whether to submit the 1997 principles, revised, to Council for approval.