Is Regulatory Policy Important?

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2016

Abstract: *Regulation is of critical importance in shaping the welfare of economies and society. The objective of regulatory policy is to ensure that regulation works effectively, and is in the public interest. Regulatory policy, a comparatively young discipline, is taking shape in different ways across OECD members and beyond. Different pathways, however, are tending towards common objectives. Many OECD countries did not have a regulatory policy ten years ago; nearly all do now. There is growing interest in using regulatory policy to address broad societal concerns such as distributional equity and sustainable development. There is no room for complacency for the work which lies ahead to transform regulatory policy into a truly effective support for meeting public policy goals.*

Introduction

In the past 20 years a key topic of public sector reform in OECD countries has been the emergence and development of regulatory policy. During this period, the nature of regulation has undergone profound and rapid change. It evolved from early efforts of eliminating regulation and gave way to more systemic regulatory reform. These initial reforms, however, often assumed that change was episodic in nature. Moreover, they were based on the idea that it was possible to restore a regulatory structure to some ideal state through one-off interventions. Experience demonstrated that such views were untenable and they gave way in turn to the establishment of permanent regulatory management and governance practices. With time, these processes have become increasingly integrated into public policy making. Today, almost all OECD countries have established explicit institutions, tool and governance processes to implement regulatory policy. As with other core government policies, such as a monetary or fiscal policy, regulatory policy is an integral role of government and is pursued on a permanent basis.

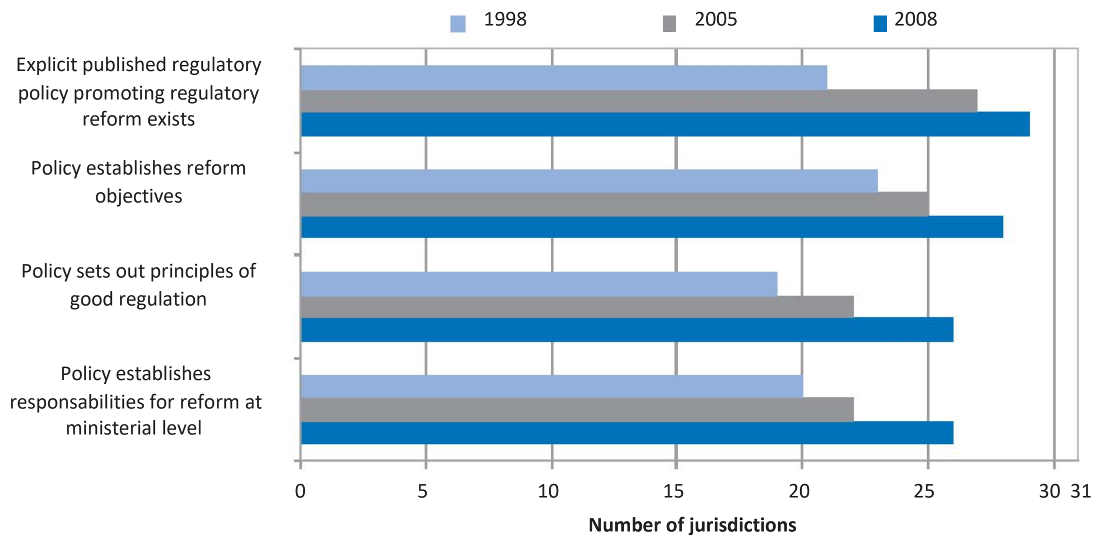
The objective of regulatory policy is to ensure that regulations are in the public interest. It addresses the permanent need to ensure that regulations and regulatory frameworks are justified, of good quality and "fit for purpose". As an integral part of effective public governance, regulatory policy helps to shape the relationship between the state, citizens and businesses. An effective regulatory policy supports economic development as well as the rule of law, helping policy makers to reach informed decisions about what to regulate, whom to regulate, and how to regulate.[1] It has a social as well as an economic dimension. Evaluation of regulatory outcomes informs policy makers of successes, failures and the need for change or adjustment to regulation so that it continues to offer effective support for public policy goals.

Regulatory policy in OECD countries

Figure 1.1 highlights the spread of regulatory policy across the OECD membership since 1998.

The data need to be interpreted with caution. Whilst indicators can reveal the broad lines of regulatory policy development, country reviews provide a qualitative test of what is really happening on the ground. Although most OECD countries had adopted a regulatory policy by 2008, a closer look reveals that their regulatory policy often consists not of one but of a series of often disjointed regulatory policies. For example, policies to tackle administrative burdens in existing regulations may not be fully joined up with policies for the *ex ante* impact assessment of new regulations. The reviews carried out under the EU 15 project, for example, show that for most of the reviewed countries, there is no single co-ordinated regulatory policy.

Figure 1.1. Adoption of explicit regulatory policy



Note: The sample includes 31 jurisdictions for 2008 and 2005. For 1998, 27 jurisdictions are included as no data were available for the EU, Luxembourg, Poland and Slovak Republic.

Source: Question 1 a), ai), aii), aiii), 2008 OECD Indicators Questionnaire, *Indicators of Regulatory Management Systems*, *2009 Report*, OECD, Paris, available at *www.oecd.org/regreform/indicators*.

Equally, the data does not reveal the relative strength (or weakness) of countries' regulatory policy in practice. In virtually all countries, the implementation and enforcement of regulations, once they have been enacted, is addressed rather less vigorously than the development phase. It is thus paramount to "mind the gap" between principles and practice. Regulatory policies are often well defined on paper but putting them into effective practice is proving more elusive. Tools and processes may be defined at a strategic level, but considerable work is then needed to give them concrete substance at the practical level of policy and law making. This appears to be especially true of *ex ante* impact assessment.

A core objective of this report is to explore what these issues imply and how to overcome them so as to give better effect to regulatory policy.

Regulatory policy as lever of state power

Regulatory policy can be viewed strategically, alongside fiscal and monetary policy, as one of the three core levers at the disposal of governments for managing the economy and society, implementing policy and influencing behaviour.[2] It may also be considered as the ultimate horizontal policy, supporting all other policies. Regulatory managers on the ground may consider this to be too conceptual, but it does no more than draw attention to a powerful reality, underlining the importance of regulatory policy, the need for it to be mainstreamed and to be at the centre of government's attention.

With major post crisis constraints on government expenditure and social resistance to higher taxes, regulation may receive more attention as a lever of state intervention. Although regulation can be a substitute for fiscal measures and may even be an efficient alternative to direct taxation, this needs careful management. More regulation carries the risk of moving costs to the private sector. The over hasty adoption of inappropriate regulation in reaction to events could add unnecessary burdens, inhibit innovation and harm competitiveness and open markets.

Regulatory policy as part of good public governance

The link between regulatory policy and the broader public governance framework lends it a critically important practical dimension. Good governance implies an effective regulatory policy. 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. An effective regulatory policy both depends on other well functioning aspects of public governance, and also contributes to them, for example as regards transparency and citizen engagement. The reform of the public administration will be affected by regulations inside government; and such reform will in turn shape the capacity of the state to support regulatory institutions and effective tools. Research carried out by the OECD into the conditions for effective reform,[3] highlights that key aspects of effective regulatory governance are critical in order to advance policy reforms:

- Policy design needs to be underpinned by solid research and analysis.
- Leadership is critical – whether by an individual or an institution charged with carrying out the reform.
- Appropriate institutions are needed, capable of supporting reform from decision to implementation (a long haul).[4] Quality control and analysis needs to be presented by an authoritative, non-partisan institution that commands trust across the political spectrum.
- Building such institutions takes time, as their effectiveness depends on their reputation. But this repays dividends, as their existence has enhanced prospects for reform in particular areas.

The emergence of regulatory policy

Regulatory policy is a comparatively young discipline.[5] It started to emerge in a few countries in the 1970s and has progressed steadily, through different phases, as a process that can be expected to (and needs to) continue. The OECD community began to give it a collective shape from 1995 onwards, with the adoption by OECD Ministers of a Recommendation on Improving the Quality of Government Regulation, a process which culminated ten years later with the adoption of the 2005 OECD Guiding Principles for Regulatory Quality and Performance (Annex C).

The journey started with a strong focus on economic objectives such as open markets, and the specific goal of deregulation. The significant development of recent years has been the emergence of a much wider vision, which includes the legal dimension of a strong regulatory policy and which puts the benefits for society centre stage. Serving the public interest, for which a strong economy remains essential, is the ultimate goal. The costs of regulation used to be the main preoccupation; its benefits are now more fully

acknowledged. The term regulatory policy can mean different things to different countries. In many European countries it has until recently been largely interchangeable with policies to reduce administrative burdens. In Canada, the term has been applied specifically to the process of developing regulations.

The emergence of regulatory policy was originally in response to changing public policy and especially, economic objectives across the OECD membership. It started life as deregulation in the 1970s and 1980s, following the rapid growth of regulation through most of the twentieth century and the dawning realisation that the accumulation of this regulatory stock was harmful to business, stifling entrepreneurship and innovation. This period saw the first attempts to cut red tape, and the first realisation that regulatory inflation (as it is now called) could be a serious problem. Front runners included the United States in the late 1970s and Canada in the 1980s. Generally speaking, Europe started later.

From deregulation to regulatory reform and the regulatory state

With policies to increase competition in markets and to "roll back the frontiers of the state"[6] in the 1980s and 1990s, deregulation broadened to become regulatory reform. Regulatory reform continued the deregulatory trajectory, but was also now aimed at liberalising key sectors of the economy which had been the preserve of monopolies, often state owned, such as the telecoms sector. The introduction of competition in these sectors required a reinvention of the regulatory framework fitted to their new context.[7] Regulatory reform became an essential adjunct to structural reforms, reaching out beyond the network sectors to encompass product market reforms as well as the liberalisation of professional services.

With the growth of free-market policies came the development of independent regulatory agencies to manage key aspects of economies and society at an arm's length from the political process. This became an important institutional aspect of the regulatory state. The regulatory state paved the way for the emergence of regulatory governance; an evolution from a traditional regulatory management approach to one that takes account of a participatory and accountability approach, which will be considered in more detail in Chapter 4.

From regulatory reform to regulatory management and welfare as the driver

Regulatory reform gave way to the idea of regulatory management in the first few years of this century, a process which acknowledges the permanent nature of the task, and the need for it to be applied across the board, not just to selected sectors or issues. Regulatory reform as a term sometimes implied that the regulatory framework could achieve perfection and that once this ideal state had been reached, regulatory policy makers could simply pack up and go home. It was not so simple.

Understanding grew that a key function of the state was regulation. This required active management if regulation were to be "fit for purpose". In some countries, especially European, members of the OECD, regulatory management entailed significant efforts to simplify and streamline the regulatory stock, with the intention of refreshing and clarifying the legal codes (groups of related laws) that underpin the systems of civil law which are prevalent in much of Continental Europe and beyond.[8]

It also gradually became clear that any public policy, not just selected issues, could potentially benefit from effective regulatory management and the application of regulatory tools and processes, such as Regulatory Impact Assessment. The aim is to enhance overall welfare, not just sectoral interests, and not just for the benefit of business. Some regulations have sector specific implications, but many others have much broader effects. Regulations and institutions for the promotion of social welfare (for example, health and safety) and the environment grew in importance.

This period saw important developments in regulatory institutions, tools and processes. For example, the concept of a central oversight body to encourage the application of regulatory quality principles and of key processes such as Regulatory Impact Assessment took hold, even if it has proved a challenge for many countries to put into place.

Developments at the EU level

The European Union took up the challenge of developing a regulatory policy in the early part of this century, as outlined in Box 1.1. The European Commission unveiled a new Smart Regulation Strategy in October 2010. This sets out plans to further improve the quality and relevance of EU legislation. It will evaluate the impact of legislation throughout the policy cycle, from design, to when it is in place and when it is revised. The European Commission will work with the European Parliament, the Council and member states to encourage the application of smart regulation. The strategy also seeks to strengthen the voice of citizens in the regulatory process.

Box 1.1. Regulatory policy and the European Union: Landmark developments

- **1995: Commission report to the Council:** Application of the subsidiarity and proportionality principles to simplification and consolidation.
- **2000: Lisbon Strategy for Growth and Jobs**: The Strategy identified the need to enhance the competitiveness of the EU economy through increased productivity growth as a key challenge, including measures to improve the regulatory environment for businesses.
- **2001: Mandelkern Report**: The Report develop a coherent strategy to improve the European regulatory environment. The Report made recommendations to member states and to the EU institutions in the areas of impact assessment, consultation, simplification, organisational structures for better regulation, alternatives to regulation, access to regulation, and national implementation of EU legislation.
- **2002: European Commission Communication**: This introduced a new integrated impact assessment system, roadmaps, alternatives to regulation, minimum standards for consultation, and guideline for using expert advice. It prepares the way for the introduction of an EU level impact assessment process.
- **2003: EU inter-institutional Agreement on better law-making**: sets a common framework for action by the European Commission, the European Parliament and the European Council of Ministers.
- **2005-08: EU Integrated Guidelines for Growth and Jobs**: This noted that "to create a more competitive business environment and encourage private initiative through better regulation, member states should reduce the administrative burden that bears upon enterprises, particularly SMEs and start-ups.

Box 1.1. Regulatory policy and the European Union: Landmark developments (*cont.*)

- **2005: Renewal of the EU's Lisbon Strategy for growth and jobs by the European Council of Ministers**: requires EU member states to establish National Reform Programmes, monitored by the European Commission, which issues annual progress reports.
- **2006 European Commission Better Regulation strategy. This strategy was set up as a central element in the efforts to raise productivity.** It set out that better regulation did not mean more or less regulation but rather, the adoption of a policy and processes aimed at ensuring that all regulations are of high quality. The strategy particularly emphasised the needs of businesses and especially SMEs.
  - 2006 Establishment of the Commissions' Impact Assessment Board as central quality control and support function on regulatory and policy proposals.
  - **2007 European Commission Action Programme for Reducing Administrative Burdens.** This was approved by the European Council of Ministers, set a target of reducing administrative burdens in EU legislation by 25% by the end of 2012.
  - 2007 Establishment of EU High-Level Group of officials on Better Regulation to advise the Commission on administrative burdens and simplification issues.
- **2010 European Commission Communication on Smart regulation in the EU.**

The tools of regulatory policy

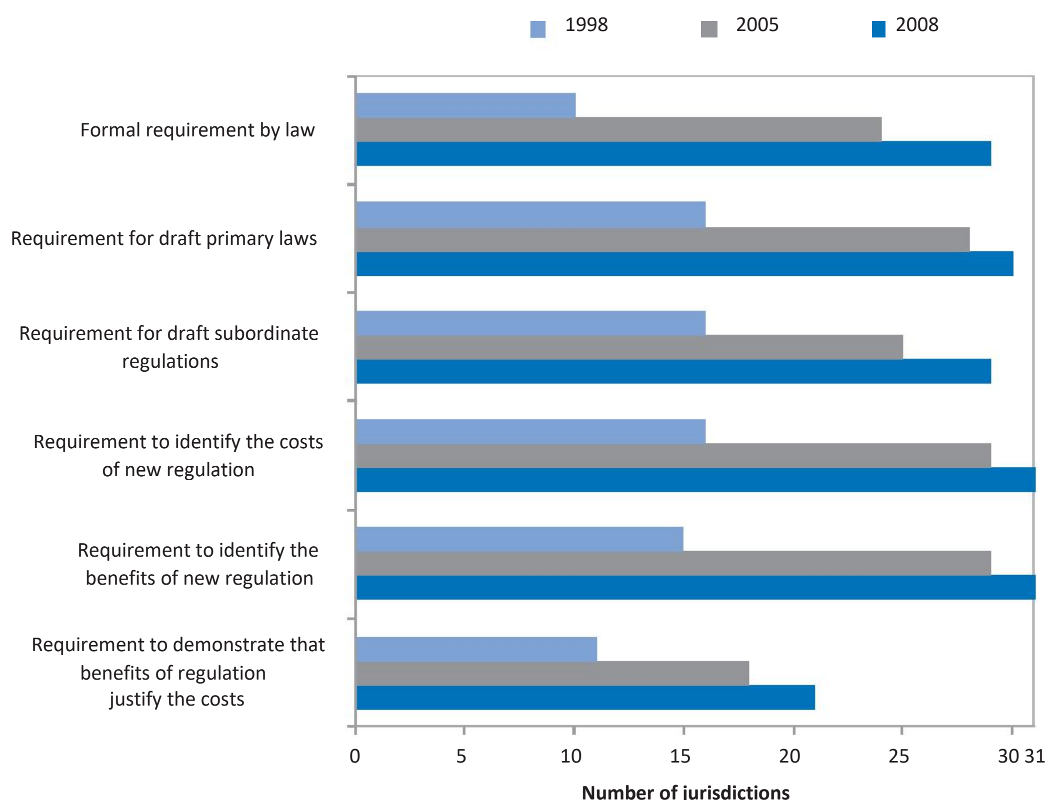
The task of improving regulatory decision-making has a number of dimensions. A range of tools must be deployed in a consistent and mutually supporting manner if systemic quality assurance is to be the result. The tools involve strategic approaches and the use of instruments to give effect to regulatory policy. The essential tools include regulatory impact analysis, the consideration of regulatory alternatives, administrative simplification, ensuring regulatory transparency and *ex post* evaluation.

Regulatory Impact Analysis

A trend toward more empirically based regulation is underway in OECD countries and the widespread use of Regulatory Impact Analysis (RIA) is a clear example of this trend. RIA examines and measures the likely benefits, costs and effects of new or changed regulations. It is a useful regulatory tool that provides decision-makers with valuable empirical data and a comprehensive framework in which they can assess their options and the consequences their decisions may have. A poor understanding of the problems at hand or of the indirect effects of government action can undermine regulatory efforts and result in regulatory failures. RIA is used to define problems and to ensure that government action is justified and appropriate.

The majority of OECD countries began to introduce RIA during the latter half of the 1990s. The use of this tool spread rapidly, and most countries rely on at least some form of RIA (see Figure 1.2).

Figure 1.2. Requirements for RIA at the central government level



Note: Data for 1998 are not available for the European Union, Luxembourg, Poland and the Slovak Republic. This implies that this figure is based on data for 27 countries in 1998 and for 30 countries and the EU in 2005-08.

Source: *Indicators of Regulatory Management Systems*, *2009 Report*, OECD, Paris, available at *www.oecd.org/regreform/indicators.*

There is no single model that OECD countries have followed in developing RIA programmes. Their design has take into account the institutional, social, cultural and legal context of the relevant country. That said, the experiences of OECD countries have made it possible to establish certain practices associated with effective RIA.

- To be successful in changing regulatory decisions in highly-charged political environments, the use of RIA must be supported at the highest levels of government. The most effective programmes have been those that require RIA as a condition for the consideration of new regulations and laws.
- Responsibilities for RIA are generally shared between ministries and quality control bodies. In a majority of OECD countries, ministries are primary drafters of both RIAs and regulations. Ministries have better access to the expertise and information that high-quality RIA depends upon. A number of OECD countries have found that a centrally located body can have an important role in quality control and oversight of RIA.

- Ideally, RIA should be applied to all significant regulatory requirements, regardless of their formal legal status. But analytical capability is a scarce resource that needs to be allocated using some rule of reason. Countries often target RIA where regulatory outcomes will have a noticeable economic impact.
- Data collection is one of the most difficult parts of RIA. The usefulness of a RIA depends on the quality of the data used to evaluate the impact of a proposed or existing regulation.

RIA is a challenging process that needs to be built up over time. It has to be integrated into the policy-making process if the disciplines it brings are to become a routine part of policy development. RIA has been seen in some administrations as an obstacle to decision-making or legislative work. In those situations when RIA is undertaken in the early stages of the decision-making process, it does not appear to slow the process down. Where RIA is not integrated with the policy-making process, impact assessments can become merely justifications of decisions after the fact. Integration is a long-term process, which often leads to significant cultural change within regulatory ministries and among consumers of the analysis, primarily ministers and legislators.

The overall assessment of RIA is mixed. There is nearly universal agreement among regulatory management offices that RIA, when it is done well, improves the cost-effectiveness of regulatory decisions and reduces the number of low-quality and unnecessary regulations. Undertaken in advance, RIA has also contributed to improve governmental coherence and intra-ministerial communication. Yet positive views continue to be balanced by evidence of non-compliance and quality problems. The scope of coverage of RIA remains patchy and exemptions are often broad. RIA is rarely used at regional or local levels.[9] Uneven coverage of RIA programmes seriously reduces effectiveness. Moreover, RIA is most of the time applied to a single regulation, rather than regulatory regimes as a whole. It thus can provide only very broad estimates of the cumulative impacts. Lastly, RIA has mostly been designed for command and control regulations. The increasing use of performance-oriented regulations and regulatory alternative provide substantial challenges to the effectiveness of RIA. The result of these limitations is likely to be the need for further consideration of the design and implementation of RIA requirements, including evaluation of its effectiveness in assessing the likely performance of non-traditional instruments.

There are different forms of regulation and a range of other measures that government may adopt to achieve its policy objectives. It is important for regulatory authorities to select the most effective tool to achieve the desired outcome. Thus, a fundamental stage in the regulation-making process is to identify and assess all feasible regulatory forms and other measures that could achieve the desired objective. Unless a full and proper assessment of all viable options is undertaken, the underlying policy problem may not be properly addressed.

Regulatory alternatives

An evidenced-based justification for regulatory action represents a logical first step in developing new regulations. Searching for alternatives represents a second step when investigating how to regulate and achieve policy objectives. Governments need to ensure that the regulations and instruments used to achieve public objectives are effective and efficient. In this context, other options and instruments may be more suited for addressing a particular policy issue and for a public intervention.

Regulation can be viewed as part of a "continuum", rather than as distinct categories, with explicit government regulation representing one end of this continuum, and self-regulation at the other extreme. The main other forms of regulation are summarised below.

- *Explicit government regulation* is sometimes known as 'black letter law'. It attempts to change behaviour by detailing how regulated parties must act under the law, and it generally imposes punitive sanctions (such as fines or even custodial sentences) in instances of non-compliance with these regulations.

- Performance-based and management-based regulations are more flexible, less prescriptive forms of regulation. Performance based regulation is regulation that sets objectives or standards for outcomes and allows the regulated entity some flexibility to determine the means by which they will meet these objectives. Management based regulation (sometimes called process based regulation) requires businesses to demonstrate that they are meeting regulatory objectives through the requirement to have in place management processes directed at achieving regulatory outcomes.

- *Co-regulation* typically refers to the situation where an industry or professional body develops the regulatory arrangements (e.g. a code of practice, accreditation or rating schemes) in consultation with a government. While the industry administers its own arrangements, the Government provides legislative backing to enable the arrangements to be enforced.

- *Quasi-regulation* refers to the range of rules, instruments and standards whereby governments influence businesses to comply, but which do not form part of explicit government regulation. Governments may assist in developing industry codes of conduct under quasi-regulation (e.g. through official endorsement, representation on monitoring committees, provision of funding), but the Government undertakes no enforcement activity.

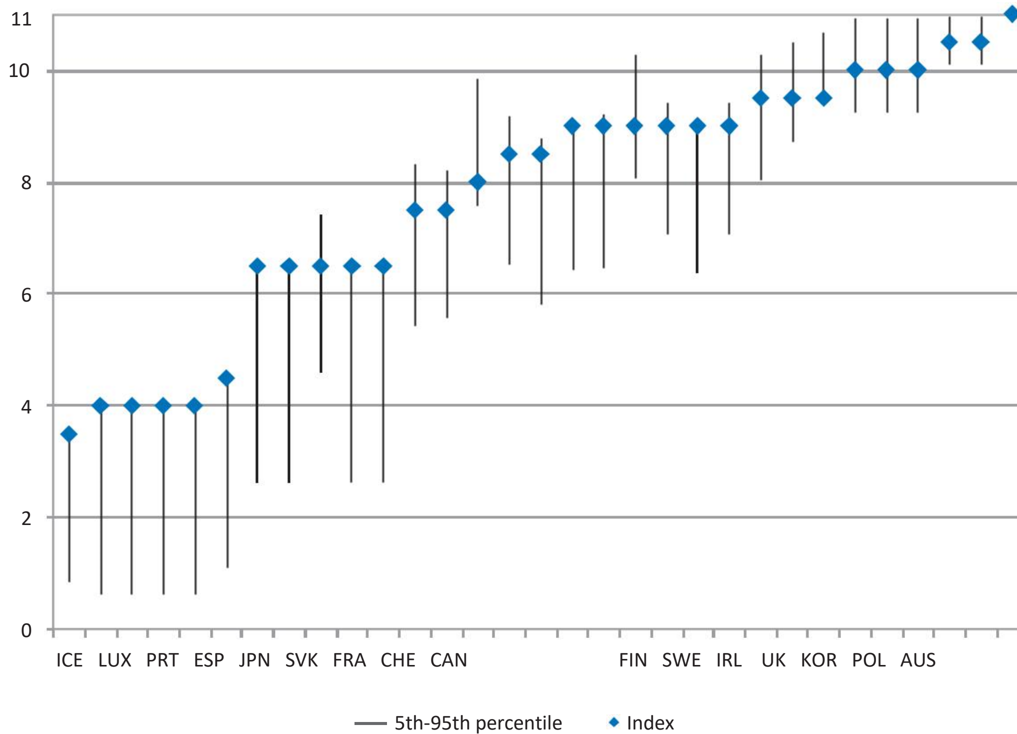
- *Self-regulation* is generally characterised by the development of voluntary codes of practice or standards by an industry, with the industry solely responsible for enforcement. The Government's role under this form of regulation is non-existent, or may be limited to the provision of advisory information.

An important regulatory alternative are market-based instruments which aims to change or modify behaviour through the economic incentives facing citizens and businesses. They primarily operate through changing relative prices or making trading opportunities available where they did not previously exist. Businesses and citizens respond by making decisions based on their own assessment of the costs and benefits of various actions given the incentives put in place by the market-based policy instrument. This is in contrast to traditional command and control regulation which often specifies in detail how the objective is to be achieved. The degree of government intervention involved in using market-based instruments to achieve policy objectives varies widely. In some cases the instrument may involve very direct government intervention – such as the manipulation of tax rates or subsidy payment to achieve objectives. In other cases the government's role may be to help establish the legal or institutional structure required for a market to function – but not be involved in the day to day operation of the market.

Information and education campaigns are instruments which aim to change behaviour by making more information available so that businesses and consumers can make more informed decisions. These instruments allow people to make decisions on the basis of greater information than would otherwise be available, rather than imposing a single solution on all as is often the case with traditional command and control regulation. These instruments are often characterised as being 'light-handed' because the degree of direct government involvement in decision making or directing behaviour is more limited than with other instruments. However, even with 'light-handed' instruments, the degree of involvement can vary. In some cases government can require companies to provide greater information to consumers, or government can provide the information itself. Alternatively, government can encourage and persuade businesses to provide additional product information without imposing a formal requirement on businesses to provide the information.

Figure 1.3. Provision of justification for regulatory actions

2008



Note: This figure summarises information about countries' provision of justification for regulation and their search for alternatives. It does not gauge whether these have been effective.

Source: *Indicators of Regulatory Management Systems*, *2009 Report*, OECD, Paris, available at *www.oecd.org/regreform/indicators*.

Finally, at the forefront of regulatory alternatives is an approach that focuses on changing behaviour. This approach aims to improve outcomes without using traditional command and control mechanisms by allowing citizens and business to retain choices but gently pushing them in a particular direction. Thaler and Sunstein (2008) develop a framework of how governments can manipulate "choice architecture" to change behaviour without diminishing choice. Choice architecture is based on an understanding that automatic and instinctive behaviour can prevail over more rational reasoning in determining many choices. It further posit the idea the government policy and regulation can "nudge" behaviour (through the use of default choices and "opt-in" clauses) towards more rational and efficient outcomes. Choice architecture and nudge regulation may be particularly promising in addressing policy problems where command and control options are less viable, such as modifying lifestyle behaviours to reduce the impact on chronic public health issues.

Administrative simplification

One of the most widespread complaints raised by businesses and citizens in OECD countries concerns the amount and complexity of government formalities and paperwork. Enterprises and citizens spend considerable time and devote significant resources to activities such as filling out forms, applying for permits and licences, reporting business information, notifying changes etc. In many cases, practices have become extremely complex, or irrelevant and cumbersome, generating unnecessary regulatory burdens – so-called "red tape". The costs imposed on the economy as a whole are significant. When excessive in number and complexity, administrative regulations can impede innovation, create unnecessary barriers to trade, investment and economic efficiency, and even threaten the legitimacy of regulation and the rule of law.

In response to these challenges, OECD governments have over the past two decades increasingly focussed on reviewing and simplifying red tape. Initiatives to improve the efficiency of transactions with citizens and business have included removing obsolete or contradictory provisions, producing guidelines on administrative regulations, and introducing new ways to measure administrative regulations and reduce their impact. Increasingly, innovative thinking and skilful use of information technology (IT) are leading to new and more effective approaches to administrative regulation.

OECD countries have focused on four broad trends in their efforts to cut red tape. First, and among the most important, is a gradual shift from an approach focused on easing administrative burdens after the event to one that recognises the need to ensure that unnecessary or unreasonable burdens are not implemented in the first place.

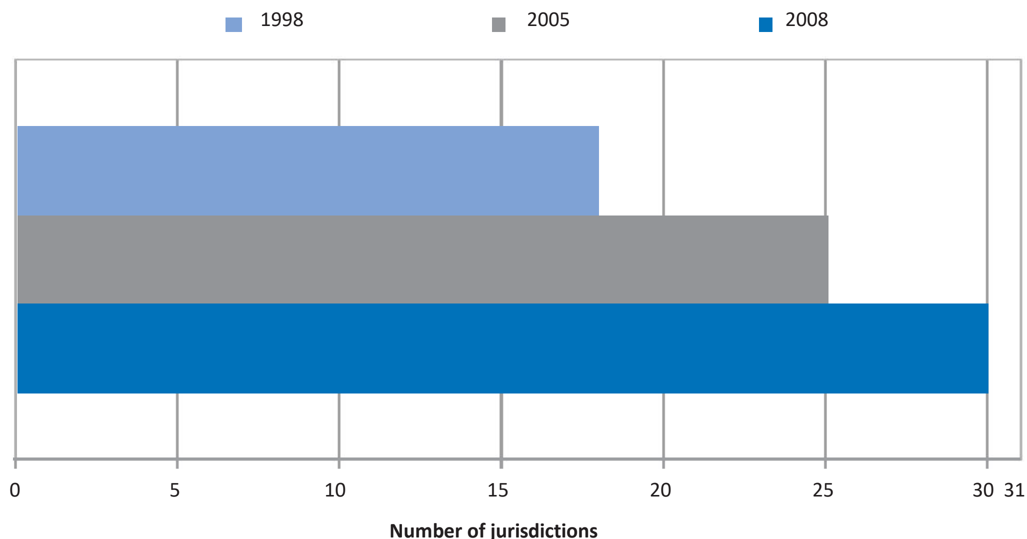
Secondly, while simplification initiatives have generally been "bottom-up" in nature over the past years, they are being supplemented by "top-down" initiatives by governments, and increasingly integrated into broader reform programmes. Typical bottom-up initiatives are business licence services. They often initially serve a specific need of a particular constituency, but tend to broaden their profile over time by identifying additional information and transactions of value to the same or related constituencies A prime example of "top-down" initiatives is the adoption of government Web portals and the merger of one-stop shops.

Third is a trend toward market-based policies that encourage simplification. Administrative simplification policies are increasingly influenced by the idea that economic agents should be free to conduct their business unless compelling arguments can be made for the need to protect the public, replacing previous more restrictive approaches to reform.

Finally, IT is putting governments under increasing pressure to cut red tape. IT is not only the most important "physical" tool enabling governments to reduce the amount of paper-shuffling involved in dealing with the public and business; it also provides strong dynamics and pressure to reduce administrative burdens. The exposure on the Internet of bureaucratic, unclear or duplicative forms has in many cases triggered strong direct reactions from users and media. Such pressure often goes beyond aspirations for further "simplification" of regulations. They can also lead to substantial changes in regulations and how they are applied.

In the absence of evidence-based appraisals, policies to simplify administration are often made in an information vacuum, where governments are unaware of the actual size of the burden and unable to measure progress and setbacks in reducing it. Measuring the existing administrative burden can be an important approach to foster political support for developing a policy to reduce it. Determining the size of the existing administrative burden can also form the basis for evaluating what policy initiatives are needed to improve and sustain long-lasting government efforts.

Figure 1.4. Explicit programme for reducing administrative burdens



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Source: Indicators of Regulatory Management Systems, *2009 Report*, OECD, Paris, available at *www.oecd.org/regreform/indicators.*

Regulatory transparency

The concept of transparency in government has rapidly become a central theme in governance literature and in public debate. Transparency is also a central demand of civil society groups and serves the basic democratic value of openness. The notion of transparency embodies the familiar concept of public consultation, but is considerably broader in scope. These concepts of transparency range from simple notification to the public that regulatory decisions have been taken, to controls on administrative discretion and corruption, better organisation of the legal system through codification and central registration, the use of public consultation and regulatory impact analysis and actively participatory approaches to decision-making.

Transparency's importance to the regulatory policy agenda springs from the fact that it can address many of the causes of regulatory failures, such as regulatory capture and bias toward concentrated benefits, inadequate information in the public sector, rigidity, market uncertainty and inability to understand policy risk, and lack of accountability. Transparency of the regulatory policy itself – as well as its institutions, tools and process – is equally important for its success. Transparency encourages the development of better policy options, and helps reduce the incidence and impact of arbitrary decisions in regulatory implementation. Transparency is also rightfully considered to be the sharpest sword in the war against corruption.

Public consultation is one of the key regulatory tools employed to improve transparency, efficiency and effectiveness of regulation. Consultation improves the quality of rules and programmes and also improves compliance and reduces enforcement costs for both governments and citizens subject to rules. Public consultation increases the information available to governments on which policy decisions can be based. The use of other policy tools, particularly RIA, and the weighing of alternative policy tools, has meant that consultation has been increasingly needed for collecting empirical information for analytical purposes, measuring expectations and identifying non-evident policy alternatives when taking a policy decision.

Ex post *evaluation*

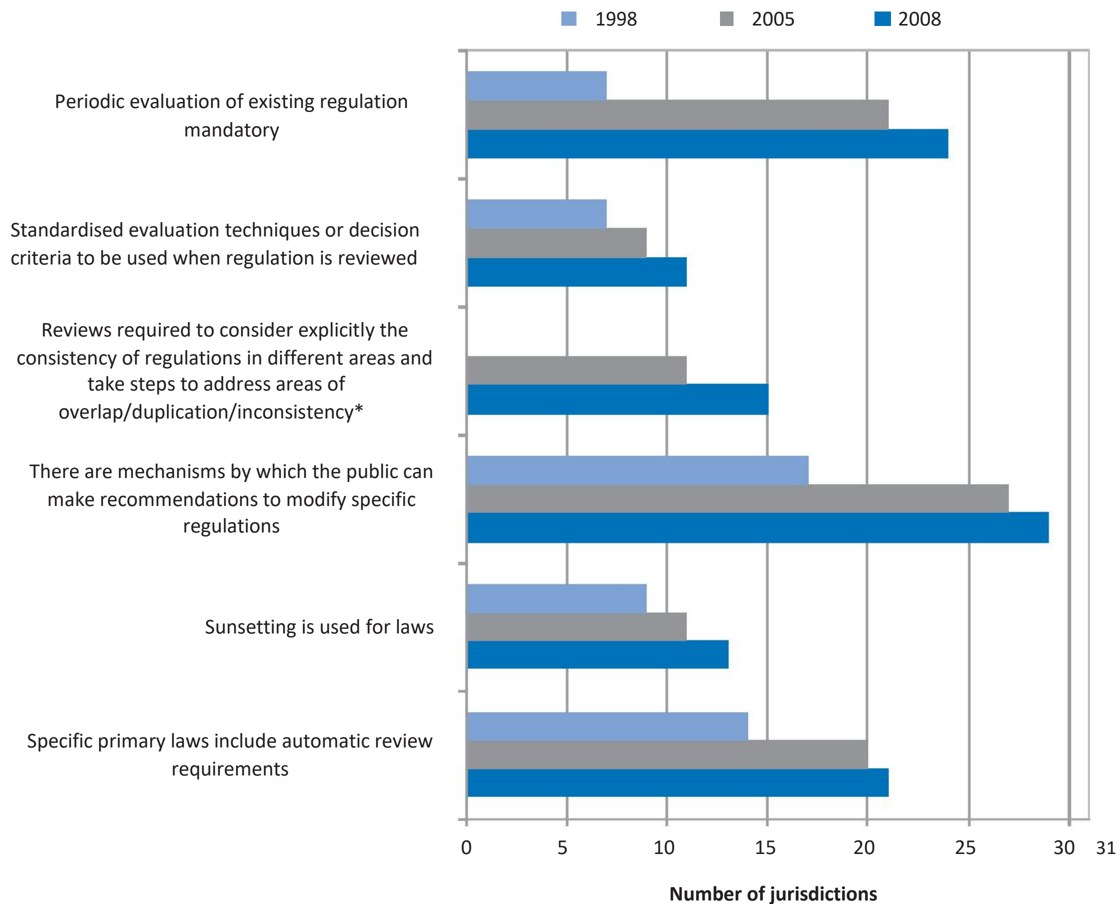
In recent years, policy makers in a limited number of OECD countries have begun to evaluate the implementation of new rules and regulations (*ex post*) to assess the outcomes and results of regulatory decisions. The tools of *ex post* evaluation, in their most sophisticated form, examine the relevance, effectiveness, and impacts of regulatory decisions, as well as identifying unintended outcomes, reasons for failure, and factors contributing to success. Results, derived from this management tool, form a key knowledge input for decision-makers, creating a feedback loop that completes the "regulatory governance cycle" described in Chapter 4.

A number of benefits accrue from the use of this evaluation tool. The formal processes of *ex post* impact analysis can be more effective than *ex ante* analysis at informing ongoing policy debate. At a fundamentally level, *ex post* analysis measures actual costs and benefits and thus uses more reliable data. *Ex post* evaluation is also not subject to the time pressure and political demands of *ex ante* analysis. There are, of course, costs to the use of *ex post* analysis. It can be difficult to direct scarce policy resources to examine existing regulation. There are anecdotal signs of significant resistance, both at the technical and political level, to undertake full scale and systematic reviews of existing regulation. In addition, businesses often complain and have difficulty

adjusting to the changes in the regulatory framework. An excessive use of *ex post* evaluation could result in regulatory uncertainly (albeit with "better" rules) potentially leading to implementation and compliance problems.

Figure 1.5. Regulatory review and evaluation

1998, 2005 and 2008



Note: Data for 1998 are not available for the European Union, Luxembourg, Poland and the Slovak Republic. This means that this figure is based on data for 27 countries in 1998 and for 30 countries and the EU in 2005-08.

*: No data available prior to 2005.

Source: Indicators of Regulatory Management Systems, *2009 Report*, OECD, Paris, available at *www.oecd.org/regreform/indicators*, available at *www.oecd.org/regreform/indicators.*

Taking account of this limited experience, and recognising that more ideas may emerge as *ex post* evaluation processes mature, the OECD and others[10] are attempting to identify a number of "success factors" for the effective use of *ex post* evaluation tools to assess the outcomes of regulatory decisions. They include:

- Integrating the methods of regulatory impact analysis into programmes for the evaluation and revision of existing regulations. These programmes should include an explicit objective to improve the efficiency and effectiveness of the regulations, including better design of regulatory instruments and to lessen regulatory costs for businesses and citizens as part of a policy to promote economic efficiency;
- Establishing clear guidelines that set out general standards, recognise differences between different types of policy goal, and allow flexibility of analytical methods;
- Scheduling evaluations to assess all regulation systematically over time, and reduce regulatory burdens. Priority should be given to regulation with significant economic impacts and/or causing highest irritation among users and/or impact on risk management. The use of a permanent review mechanism should be included in rules, such as through sun setting and review clauses in regulation;
- Monitoring, based on widespread consultation with affected parties, should be set up to facilitate the early identification of problems and progress, including the emergence of unintended negative consequences.

Different pathways moving towards common goals

Regulatory policy development has taken different pathways across the OECD, reflecting the diverse range of legal, political and cultural contexts on which countries have built their public governance. Broadly speaking, European countries have placed more emphasis on regulatory stock management, whilst others have sought to strengthen the *ex ante* impact analysis of new regulations. The European Commission stands out, having advanced on both fronts simultaneously.

The drivers of regulatory policy are diverse. Nearly all countries attach importance to the economic dimension. Entrepreneurship, support for SMEs and the related need to have a more efficient public service in support of business (and citizen) needs, are important factors. Regulatory inflation in some countries is a significant driver, as well as the need to sustain the clarity of the law. A growing factor has been the association of regulatory quality with support for citizens.

From these different perspectives, there is growing evidence of a convergence, as countries have sought to cover a widening range of issues, building on their initial experiences. All now have the same broad understanding that regulatory policy is important and of what it implies in terms of processes. This was not the case when the first OECD country regulatory reform reviews were carried out in the late 1990s. Countries also share the same challenge, to ensure that what they have already put in place can be made to work more effectively. The next step on this evolutionary pathway is to strengthen regulatory governance, an issue that is considered in Chapter 4.

Box 1.2. The Regulatory Cost Model developed by the Bertelsmann Institute

The Regulatory Cost Model (RCM) is a toolkit, developed by the Bertelsmann Institute. It is based on the principles of the Standard Cost Model (SCM). It seeks to measure all regulatory costs including administrative, financial, material costs and "business as usual" and opportunity costs. The model also takes into account irritation costs, without quantifying them.

The costs incurred by duties requiring action can be classified as personnel, material and financial costs. Personnel costs are determined by multiplying the time taken by the associated hourly wage rate, whereby specific standard processes for each type of duty requiring action are used to establish the time required. Material costs include costs for materials, incoming goods, third-party services, financing and infrastructure costs as well as depreciation and amortisation. Financial costs include taxes and other levies such as fees.

Personnel and material costs represent "business-as-usual" costs, either partly or in their entirety, if applicable. Business-as-usual costs are costs which would be incurred even if there were no statutory duty. Additional costs, in contrast, are costs incurred solely by the statutory duty. Financial costs in principle only represent additional costs as the regulated entity would typically not pay taxes to the state without the statutory duty to do so. If "business-as-usual" costs are subtracted from the sum of the personnel, material and financial costs (= Regulatory Costs I), this results in the additional costs (= Regulatory Costs II).

Finally, opportunity costs are calculated on the basis of these additional costs. Opportunity costs are defined as profits foregone, because statutory duties had to be fulfilled. For simplicity, the RCM determines opportunity costs by calculating interest gains foregone over a year. If the additional costs are added to the opportunity costs, the result is the total regulatory cost caused solely by law (= Regulatory Costs III).

As well as individual costs, the RCM offers the possibility of recording subjective burdens. Subjective burdens can be defined as "irritants (annoyance with the statutory duty)". Three sources of irritant are identified: lack of understanding; lack of fulfillment (feasibility); and lack of acceptance of the statutory duty.

Source: Handbook for Measuring Regulatory Costs, Version 1.0 (April 2009), Bertelsmann Stiftung.

European administrative burden reduction programmes have developed significantly from their starting point, which was to assess the information obligations (and nothing else) contained in existing regulations. Targets for burden reduction have started to become net targets, to allow for the fact that new regulations may contain unnecessary burdens which need to be "captured" so that there is real reduction in overall burdens. This has encouraged fresh thinking about *ex ante* impact assessment processes, and the merits of seeking to quantify costs before a new regulation is adopted. At the same time, under pressure from the business community which was dissatisfied with the narrow focus on information obligations, attention has turned to developing an approach that would capture compliance and other costs (Box 1.2).

Country contributions to regulatory policy development

Virtually the whole OECD membership, in one way or another, has been engaged in the development and testing of new approaches to the management of regulation over the last ten years. This has helped the forward movement of regulatory policy and the identification of best practices. Examples include:

- *Transparency and open government.* Denmark, Finland, Norway, Sweden, United States, Australia.
- *Quantifying regulatory costs.* Netherlands, United Kingdom, United States, Canada.
- *Multi-level governance.* Australia, Italy, Mexico.
- *Simplification and one-stop shops.* Austria, Belgium, Mexico, Portugal.
- *Networking within government.* Canada, Denmark, Korea.
- *Independent advisory bodies.* Australia, Germany, Netherlands, United Kingdom, Sweden.
- *Legal quality and access.* France, Germany, Italy.

Principles for better regulation

OECD Principles

OECD member countries collectively adopted a set of principles for effective regulatory management in 2005 (Box 1.3, full text in Annex C). The Principles are based on work which goes back fifteen years, to the mid 1990s. The 1995 Recommendation of the OECD Council on Improving the Quality of Government Regulation provided the first international statement of regulatory principles. Building on this to embrace market openness, competition policy and the link between regulatory reform, structural reforms and economic growth, OECD (1997) established seven principles of effective regulatory management and paved the way for country reviews to evaluate regulatory management capacities and progress. The results of these reviews supported the elaboration of the OECD's 2005 Principles, which kept the seven key points of the 1997 Recommendations, whilst at the same time developing new supporting text.

Box 1.3. OECD 2005 Guiding Principles for Regulatory Quality and Performance

1. Adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.
2. Assess impacts and review regulations systematically to ensure that they meet their intended objectives efficiently and effectively in a changing and complex economic and social environment.
3. Ensure that regulations, regulatory institutions charged with implementation, and regulatory processes are transparent and non-discriminatory.
4. Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy.
5. Design economic regulations in all sectors to stimulate competition and efficiency, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests.
6. Eliminate unnecessary regulatory barriers to trade and investment through continued liberalisation and enhance the consideration and better integration of market openness throughout the regulatory process, thus strengthening economic efficiency and competitiveness.
7. Identify important linkages with other policy objectives and develop policies to achieve those objectives in ways that support reform.

Country principles

A growing number of OECD member countries have established a set of principles to guide their own regulatory policy, endorsed at the political level, to impose a discipline on the development and management of regulations (Box 1.4).

Box 1.4. Country principles for better regulation

A growing number of countries have established principles of better regulation. An early example is the set of principles established by the United Kingdom's Better Regulation Task Force in 1998, an independent advisory body to the government at the time. The principles include: Transparency, Accountability, Targeting, Consistency and Proportionality.

A more recent example is from Australia. The Council of Australian Governments (COAG) released Principles of Best Practice Regulation in October 2007. COAG agreed that all governments will ensure that regulatory processes in their jurisdiction are consistent with the following principles:

1. Establishing a case for action before addressing a problem;
2. A range of feasible policy options must be considered, including self-regulatory, co-regulatory and non- regulatory approaches, and their benefits and costs assessed;
3. Adopting the option that generates the greatest net benefit for the community;
4. In accordance with the Competition Principles Agreement, legislation should not restrict competition unless it can be demonstrated that: *i)* the benefits of the restrictions to the community as a whole outweigh the costs, and *ii)* the objectives of the regulation can only be achieved by restricting competition;
5. Providing effective guidance to relevant regulators and regulated parties in order to ensure that the policy intent and expected compliance requirements of the regulation are clear;
6. Ensuring that regulation remains relevant and effective over time;
7. Consulting effectively with affected key stakeholders at all stages of the regulatory cycle; and
8. Government action should be effective and proportional to the issue being addressed.

Ireland, Finland, Canada and several other countries have also established principles of better regulation.

Regional initiatives

The Asia-Pacific Economic Co-operation[11] OECD Integrated Checklist on Regulatory Reform, agreed in 2005, sets out 11 criteria for better regulation, which are consistent with the OECD Principles (Annex D). The participating countries[12] of the MENA (Middle East and North Africa) Initiative endorsed the Regional Charter for Quality in Regulation at the 2009 Ministerial Conference in Marrakesh. The Charter is also consistent with the 2005 OECD Principles.

Pressure from business

In some countries, the business community has been especially active in helping to promote the regulatory reform agenda, challenging their governments over progress in reducing burdens and offering advice on the issues to be tackled (Box 1.5).

Box 1.5. The Board of Swedish Industry and Commerce for Better Regulation (*Näringslivets Regelnämnd- NNR*)

The Board of Swedish Industry and Commerce for Better Regulation, formed in 1982, is an independent, non-political business organisation whose main mission is to advocate on behalf of the Swedish business community for simpler, more business friendly regulations both within Sweden and in the EU. It can be seen as a form of external watchdog and, as a business organisation that only deals in Better Regulation issues, it has no exact counterpart in other European countries. It has a staff of five and is financed by its members, who include 15 Swedish business organisations and trade associations that together represent more than 300 000 companies in every sector and of all sizes. It represents a third of all active enterprises in Sweden.

The *NNR* has, since 2002, published an annual Regulation Indicators report which evaluates policy and progress on Better Regulation and makes proposals for action. The *NNR*'s work covers the whole range of Better Regulation issues, including impact assessment (co-ordinating business views on the quality of impact assessments for new or amended regulations); and administrative burden reduction (collecting proposals from business, work on the measurement of costs). The *NNR* carried out a perception survey of the government's Better Regulation work in 2006 (checking for the "noticeable effects" of government actions). It also carried out an analysis of business regulatory costs in 2006, which it plans to follow up.

The 2008 Regulation indicators report published in June concludes that the government's objectives are aligned with the views expressed by the business community. Many of the tools needed within government to achieve the objective of "a simple and efficient regulatory framework" are being put in place. The big challenge now is that politicians and civil servants must give priority to regulatory simplification and use the tools that are available.

Source: Better Regulation in Europe: Sweden (OECD, 2010).

What has been learned?

Perhaps the most important lesson of recent years is that the development of an effective regulatory policy is an evolutionary process which involves a broad scope of issues. It thus became clear earlier on that deregulation was too simple, that regulatory reform targeted at specific sectors was too narrow, and that a broader approach was necessary.

Some countries have been grappling with the issue of where and how to start the process of embedding regulatory policy as a core element of good governance. An incremental approach has worked in some settings, and many European countries have found it helpful putting their efforts into administrative burden reduction programmes in the first instance, partly because this secured political support. Most of these countries are now branching out to strengthen *ex ante* impact assessment and to consider the relationship with subnational levels of government, among other issues.

Developments can be fairly rapid. The EU 15 reviews show significant developments since previous reviews (carried out only five or so years previously in some cases), and there have been more developments since the reviews were completed.

Institutional complexity and diversity is a feature of many countries and appreciation has grown the importance of this factor in designing and integrating regulatory tools and processes. This goes with a growing appreciation of the diversity of legal and cultural contexts in which regulatory policy needs to take root. Understanding of this has grown with each OECD country review.

Culture change and capacity building within institutions and across government is an essential adjunct to the technical task of designing processes for regulatory management. It is very much a "work in progress". Processes can be unnecessarily "gold plated", whilst inadequate attention is paid to the individuals and organisations who must implement them. Effective regulatory management means new approaches to carrying out familiar tasks across the whole of government, even in the more "mature" countries. There are no magic bullets and this acculturation takes time. There is, not surprisingly, a strong link to broader public sector management and reforms, for example, emerging efforts to link better regulation with performance appraisal systems and ministry budgets.

Communication requires additional attention. One example concerns business administrative burden reduction programmes, where there is an issue of perceptions of progress which appear to undervalue the real progress being made. More broadly, a lack of appreciation and understanding of the whole picture and overall progress can be an issue, including for some inside government. In countries with less developed regulatory policies, awareness of efforts at regulatory management can be very low.

No room for complacency

There have been mistakes, omissions and a failure to grasp the serious consequences of poor regulatory management. The financial crisis and environmental disasters exposed the fragility of some aspects of current regulatory management, and put countries' emerging regulatory governance to an unexpectedly serious "stress" test, at least as regards one key sector of the economy.[13]

However, many of the difficult issues for regulatory management are longstanding. This historical perspective is important. It highlights that core regulatory management skills continue to need attention, alongside the need to address more complex challenges. Principles of effective regulation have often remained just that- principles. "Minding the gap" between principles and practice is a universal issue. For example, although nearly all countries have now established a Regulatory Impact Assessment process, considerable further work is necessary as regards institutional support, methodologies and other aspects before this tool can be considered fully effective.

The financial crisis did, however, put the spotlight on some important emerging issues and gaps in regulatory policy which will help to define the agenda for the future:

- Neglect of the needs and perspectives of the regulated (small businesses, citizens, consumers).
- Failure to grasp fully the complexity of the institutional structure and specifically, the role of regulatory agencies: accountability, gaps, or conversely, overlaps in coverage.
- Failure to take adequate account of the challenges raised by globalisation of international markets and the consequent need for international co-operation.

- The importance of making links between related policies and the need for policy coherence.
- The importance of anticipating systemic risks and risk management.

These issues are explored in Chapters 3 and 4.

Notes

1. Deregulation is not the main purpose of regulatory policy, which is about weighing up the costs and benefits of regulation in different settings. This may lead to the conclusion that regulations need to be removed, but it could also mean that they need to be reshaped, or that alternatives to regulation make more sense. Also, the term regulatory policy is preferred to the term regulatory reform, which can imply a narrower concept built around a "one-off" process, and a limited application to selected sectors.

2 The most fundamental power of the state is its military and administrative control of territory, without which the other powers cannot be exercised.

3. OECD (2010a).

4. The starting assumption is that most countries base their underlying institutional structure on an executive, a legislature and a judiciary.

5. Regulation, by contrast, is centuries old, dating back to the emergence of organised societies and the exercise of political authority over these societies to define the duties and responsibilities of rulers and the ruled. The critical difference of recent times, from the 19th century onwards, is the growing use of regulation by modern states, which is reflected in a growing number of rules.

6. A term used to define the objective of the reforms of the United Kingdom economy in the 1980s.

7. This was often, misleadingly, called deregulation.

8. Codification in systems of civil law means consolidating all the amendments made over time to a set of related laws. It may also mean assembling an original legal act plus all subsequent modifying acts into one new legal text.

9. Australia is a notable exception, where several Australian states have pioneered the use of RIA.

10. See the European Risk Forum (2008).

11. APEC – Asia-Pacific Economic Co-operation. Member economies are: Australia, Brunei Darussalam, Canada, Chile, People's Republic of China, Hong Kong, China, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, The Philippines, Russia, Singapore, Chinese Taipei, Thailand, The United States, Viet Nam.

12. The MENA member countries are: Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestinian territories (the West Bank and Gaza Strip), Qatar, Saudi Arabia, Ethiopia, Sudan, Syria, Tunisia, United Arab Emirates, and Yemen.

13. In the rush of some commentators to equate regulation overall with financial regulation, and to identify its failings as a main cause of the financial crisis, it is also important to remember that other factors have, and continue to, contribute to the current unsustainable public deficits of many countries. For example, in much of Europe, the financial crisis revealed underlying structural problems, such as failures to reform labour markets, or pensions systems. In fact, regulatory policy has a major role to play in supporting necessary structural reforms as countries emerge from the crisis.

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