The OECD Report on Regulatory Reform

Synthesis

Organisation for Economic Co-operation and Development
Paris, 1997

FOREWORD

This Report responds to the 1995 request by OECD Ministers that the OECD examine the significance, direction, and means of reform in regulatory regimes in Member countries. Its policy conclusions and recommendations are derived from the experiences and challenges faced by Member governments in their drive to reform regulatory regimes. Those experiences have been researched and analysed in depth by the OECD over the past two years.

We believe that the extensive work done by the OECD, as distilled in this Report to Ministers**,** and the accompanying Summary Report and sectoral and thematic chapters published separately, amply demonstrates the many benefits that can flow from a successful reform programme. Regulatory reform that enhances competition and reduces regulatory costs can boost efficiency, bring down prices, stimulate innovation, and help improve the ability of economies to adapt to change and remain competitive. Properly done, regulatory reform also can help governments promote other important policy goals, such as environmental quality, health, and safety. Finally, country experience convinces us that the unavoidable disruptions which can accompany reform can be addressed by complementary policies and actions.

The recommendations in this Report constitute a plan for action. In May 1997, Ministers welcomed this Report and agreed to work to implement its recommendations in their countries. Ministers asked the OECD to conduct reviews of regulatory reform efforts in Member countries beginning in 1998, based in part on self-assessment, and noted that further work will be carried out in sectoral and policy areas.

One conclusion that emerges from our work is that the most important ingredient for successful regulatory reform is the strength and consistency of support at the highest political level. Ministers have a direct role to play in assuring that strong political leadership will overcome vested interests in both public and private sectors which benefit from the status quo and resist beneficial change.

But Ministers and elected leaders cannot accomplish the necessary changes alone. Open dialogue and communication is also an indispensable part of the process. It can strengthen the voices of those who support and will benefit from reform. Important allies in the reform process include businesses which will gain from low cost, high quality goods and services inputs; consumers; and employees and their representatives in fields in which job creation and wage growth are constrained by unnecessary regulatory restrictions.

I would like to thank the many dedicated staff members of the OECD Secretariat who devoted long hours to compiling, analysing, and synthesising the wealth of material that went into this Report. I also thank our many outside advisors -- representatives of Member governments, particularly members of the Ad Hoc Advisory Group on Regulatory Reform; and members of the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) -- who contributed important suggestions for additions and improvements.

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OECD REPORT ON REGULATORY REFORM: SYNTHESIS

I. WHY REFORM REGULATIONS?

A central function of any democratic government is to promote the economic and social well-being of its people. Governments seek to meet that objective in a wide variety of ways, including through policies aimed at macroeconomic stability, increased employment, improved education and training, equality of opportunity, promotion of innovation and entrepreneurship, and high standards of environmental quality, health, and safety. Regulation also is an important tool that has helped governments make impressive gains in attaining these and other desirable public policy goals.

Governments have long used economic, social, and administrative regulations (see Box 1) to align better public and private interests in markets. Regulations will continue to be an important tool for preserving and advancing public interests. There is a real risk, however, particularly in a time of profound and rapid change in economic and social conditions, that regulations can become an obstacle to achieving the very economic and social well-being for which they are intended. Regulations which impede innovation or create unnecessary barriers to trade, investment, and economic efficiency; duplication between regulatory authorities and different layers of government, and even among governments of different countries; the influence of vested interests seeking protection from competition; and regulations that are outdated or poorly designed to achieve their intended policy goals are all part of the problem.

It is difficult to measure the precise cost of failure to reform, but it can be substantial. Delay heightens the cost of change in many cases. The hidden costs of inefficient regulation are increasing as competition in global markets intensifies. In sectors characterised by rapid technological change or high international mobility, failure to reform can disadvantage entire economic sectors or lead to pressure for costly supports and protectionist policies.

All governments have a continuing responsibility to review their own regulations and regulatory structures and processes to ensure that they promote efficiently and effectively the economic and social well-being of their people. A growing number of countries -- OECD and non-OECD alike -- have embarked in recent years on ambitious programmes to reduce regulatory burdens and improve the quality and cost-effectiveness of regulations that remain. The difficulties and complexities have sometimes been greater than expected and there are many questions about the risks and costs of further reform, as well as continued strong opposition from vested interests. Yet much has been learned about how to reform, and it is clear that the risks and difficulties of *not* reforming are often greater. The OECD Report on Regulatory Reform, requested by OECD Ministers in 1995 and based on extensive work that includes a Summary Report and several sectoral and thematic chapters published separately, [1] aims to help governments assess, and improve, the quality of their regulatory regimes.

Regulatory reform is more urgent than ever.

A fundamental objective of regulatory reform is to improve the efficiency of national economies and their ability to adapt to change and to remain competitive. Reform that sharpens competitive pressures provides powerful incentives for firms to become more efficient, innovative and competitive.

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These improvements can boost the productivity of entire industries and often bring sharp and swift price reductions and improvements in the quality and range of products and services, to the benefit of consumers and user industries. For example, in the United States, reform in several sectors is providing annual benefits to consumers and producers of between $42 billion and $54 billion. The European single market, by promoting competition and replacing many separate national requirements by single Europe-wide requirements, is estimated to have increased European GDP by up to 1.5 percent between 1987 and 1993. In Japan, efficiency gains from deregulation are estimated to boost consumer income by about 0.3 per cent per year, or $36 billion annually.

Reform that reduces business burdens and increases the transparency of regulatory regimes supports entrepreneurship, market entry, and economic growth that, in turn, should produce high-paying, high-quality jobs. Reform that reduces “red tape” and paperwork burdens for ordinary citizens -- particularly in their role as taxpayers -- frees up valuable time and individual initiative.

In turn, more productive, innovative, and flexible economies are in a better position to meet other public interests and to help governments deal with issues such as social cohesion, environmental quality, and the rapid ageing of populations.

Box 1: *What is regulation and regulatory reform?*

There is no generally accepted definition of regulation applicable to the very different regulatory systems in OECD countries. In the OECD work, **regulation** refers to the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers. Regulations fall into three categories:

- ***Economic regulations*** intervene directly in market decisions such as pricing, competition, market entry, or exit. Reform aims to increase economic efficiency by reducing barriers to competition and innovation, often through deregulation and use of efficiency-promoting regulation, and by improving regulatory frameworks for market functioning and prudential oversight.

- ***Social regulations*** protect public interests such as health, safety, the environment, and social cohesion. The economic effects of social regulations may be secondary concerns or even unexpected, but can be substantial. Reform aims to verify that regulation is needed, and to design regulatory and other instruments, such as market incentives and goal-based approaches, that are more flexible, simpler, and more effective at lower cost.

- ***Administrative regulations*** are paperwork and administrative formalities -- so-called "red tape" -- through which governments collect information and intervene in individual economic decisions. They can have substantial impacts on private sector performance. Reform aims at eliminating those no longer needed, streamlining and simplifying those that are needed, and improving the transparency of application.

Regulatory reform is used in the OECD work to refer to changes that improve regulatory quality, that is, enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities. Reform can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform. Deregulation is a subset of regulatory reform and refers to complete or partial elimination of regulation in a sector to improve economic performance.

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There is enormous scope for further progress. Continuing changes in the conditions for economic success make further regulatory reform more urgent than ever:

- *Succeeding in global markets* requires more competitive and open domestic markets. National governments are not isolated actors. Their actions and policies must increasingly take into account what is happening in other countries and, more particularly, the impact of their policies and actions on the ability of domestic firms and workers to adapt, compete, and exploit new opportunities. As tariffs and other border restrictions fall, and as services increase their share of tradeables, domestic regulations often remain as major impediments to an open, competitive market economy. Regulatory reform promotes the free flow of goods, services, investment and technology that benefits consumers, brings domestic firms up to international standards of performance, allows more efficient allocation of resources, and boosts GDP. It also enhances the capacity of national economies to adapt more quickly to fast-changing global markets, and to shift resources from declining industries into high-growth activities.

- *Technological innovation* is changing the nature of economic activity, creating new industries, expanding the scope for competition, and quickening product development. Rigid and out-dated regulations stifle the pace and diffusion of innovation and long-term growth, thereby reducing quality and choice in goods and services, keeping costs high for consumers and industries, and hindering the emergence of new industries.

- SMEs are important sources of innovation, new jobs, and flexible supply to larger firms in today’s environment, yet growing regulatory complexity and costs disproportionately inhibit *SME start-up and expansion*. Reforms that reduce business burdens and increase the transparency of regulatory regimes support entrepreneurship and market entry.

Improving government credibility and effectiveness in achieving important public policy goals through more effective and lower cost regulatory approaches or alternative policy tools is another core objective of regulatory reform. Here, too, there is a sense of urgency. In an era of fiscal consolidation in which public finances are increasingly constrained, governments must seek innovative and more efficient ways to protect and promote policy goals. Citizens in many countries feel that governments are losing credibility and effectiveness in the face of pressing economic, social, and environmental problems, and economic insecurity. In some countries, excessive regulation and unaccountable application has allowed corruption to flourish.

Successful regulatory reform does not erode but, rather, enhances the capacity of governments to promote public interests. If governments are to maintain credibility and effectiveness, they must use their regulatory powers no more than the minimum necessary to protect important public interests; apply rules transparently; use market incentives, goal-based regulation, and other policy tools that work within competitive markets to advance social goals; and build capacities for continuing reform and quicker response to change. Reform can also contribute to harmonious relationships between national governments by deepening socio-economic integration and improving mutual confidence across borders.

Yet reform that is badly-designed or implemented can worsen economic performance and undermine public interest objectives. Because it takes place within complex political, economic, social, and administrative environments, reform can involve significant costs, risks, and policy trade-offs. A key lesson from OECD countries is that governments, by developing a more coherent and co-ordinated

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programme of policy reform, can assess and manage the costs of change, and better protect social values and other public interests in the process. A co-ordinated and planned process of regulatory reform is not simply a concession to stronger markets that accelerates painful structural change, but a means of managing necessary change so as to ease disruption and develop new opportunities for economic and social progress.

Reform means deregulation AND better regulation.

Regulatory reform is not, of course, new, and is itself evolving. Modern reform involves a mix of regulation, deregulation, and re-regulation across the entire economy, backed up by institutional reform where necessary. In general, deregulation strategies are applied to economic regulation, while various means of improving regulatory quality and reducing burdens are used for social and administrative regulation (see Box 1).

Economic regulation. In recent years, there has been significant deregulation as many countries have moved to replace monopolies with competitive markets, often accompanied by privatisation. This trend is backed by strong evidence that vigorous competition is the best way to produce dynamic and innovative industries that can meet consumer needs and compete in expanding global markets, and is further reinforced by trends toward European integration and freer trade. More progress has been made in some sectors, such as financial services and telecommunications, than in others, such as energy and transport, but the need for more competition is today accepted almost everywhere.

Just as important as the need to maintain the momentum of de-monopolisation is the need for transitional regulatory frameworks in some sectors to ensure access to networks and to promote the emergence of effective competition; for new prudential regulations to oversee more competitive markets; and for an effective competition policy framework. For example, prudential banking regulation reduces risks of systemic failures that affect economic stability; countries that have failed to get prudential regulation right before reform have suffered costly crises. The most far-reaching application of such reforms has been in the newer Members in Central and Eastern Europe, who have combined massive deregulation with construction of legal systems and institutions to support markets. There is tremendous experimentation underway today, and continued monitoring will be useful in reducing the risks of major structural reforms.

Many countries have moved on today to regulatory reforms that apply across the economy and to a broader range of policy areas, and that involve many thousands of existing and proposed regulations at multiple layers of government. Like de-monopolisation, these reforms require long-term political commitment in the face of sustained opposition from vested interests inside and outside governments.

One such reform is the systematic identification and elimination of the wide variety of economic regulations -- such as barriers to entry and exit, pricing controls, restrictions on normal commercial practices -- that restrict national and international competition throughout the economy. Although important gains can be made through accumulation of many individual reforms, institutional and procedural difficulties have slowed concrete progress.

Social and administrative regulation. An increasingly high priority is reform of social and administrative regulations, which are expanding rapidly in OECD countries. Because markets do not properly value some public interests that citizens deem important, social regulations will continue to be

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essential in preserving the environment, saving lives, and protecting consumers and vulnerable social and economic groups. More competitive markets will justify in some cases more government action. For example, as they are faced with more choice, consumers may require better information and confidence-building measures.

Nevertheless, the cumulative impact of such regulations imposes substantial compliance costs on businesses, and can act as a barrier to competition, innovation, and trade. The focus of reform is on improving regulatory quality, a multi-faceted economic and legal concept aimed at improving the capacity of governments to act effectively at lowest cost within innovative, competitive, and global markets. Reform is based on screening out regulations and formalities that are outdated or ineffective; streamlining and simplification of those that are needed; use of a wider range of market incentives and more flexible and international regulatory approaches; and introduction of greater discipline, co-ordination, and transparency within regulatory processes. The Canadian government has called this "regulating smarter," while the European Commission has announced "less action, but better action." In the longer-term, the goal is to move governments from a culture of "control" to a culture of " client service."

Box 2*: The Roots of the Problem*

The history of regulatory reform is not one of coherent government strategy, but rather of reactions to changing crises and opportunities across countries, industries, and policies. Oil shocks in the 1970s, currency volatility and declining tariffs, growing awareness of the complexity of environmental degradation, rapid regulatory inflation -- these revealed the previously hidden costs of out-dated, rigid, and expanding regulation. Yet in all of these cases reform was delayed or blocked. Future use of regulation must be based on an understanding of why OECD countries have found themselves in need of reform, that is, why governments have found it difficult to control the quality and quantity of regulation and to take corrective action:

- The complexity of reform and uncertainty about its consequences has blocked progress. This is in part due to policy fragmentation in the structure of government. Governments have often lacked the co-ordination and planning capacities necessary to move forward with coherent packages of policies and reforms.

- Vested interests have often been able to install regulations that benefit them, and to block needed reform even when broad or longer-term benefits are vastly larger than concentrated costs. In some countries, a "regulatory culture" has emerged, as businesses have come to look to government protection for survival rather than to their own performance. Lack of transparency is a key problem here. Vested interests are strengthened by opaque decision processes and unaccountable administrative discretion.

- Incentives inside regulatory bureaucracies have not encouraged effective and accountable use of discretion. Incentives have too often favoured vocal rather than general interests, short-term over long-term views, pursuit of narrow mission goals at any cost, and use of detailed and traditional controls rather than flexible and innovative approaches. Most regulators are not equipped to assess the hidden costs of regulation nor to ensure that regulatory powers are used cost-effectively and coherently.

- Good regulation can become bad regulation over time. Governments give too little attention to reviewing, updating, and eliminating unnecessary or harmful regulation. Many regulations currently on the books date from periods earlier in this century when economic and social conditions were very different from what they are today. Governments must find means of responding more quickly to changing environments.

- Controlling regulatory and legislative inflation is essential. The volume and complexity of laws, rules, paperwork, and administrative formalities now reach an all-time high in OECD countries, over-whelming the ability of regulators in implementing the total load, the private sector in complying, and elected officials in monitoring action. Too often, legislators issue laws as symbolic public action, rather than as practical solutions to real problems. Regulatory inflation erodes the effectiveness of all regulations, disproportionately hurts SMEs, and expands scope for misuse of administrative discretion and corruption.

- All these problems risk being exacerbated where different layers of government can impose duplicative, conflicting, or excessive regulations.

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II. EFFECTS OF REGULATORY REFORM

A growing body of country experiences shows that reform of economic, social, and administrative regulations can produce substantial and long-lasting benefits, although it is often difficult to isolate the effects of regulatory reform from the many other factors that affect economic performance and policy effectiveness. At its most broad-ranging, reform of economic, social, and administrative regulations often brings major changes in the attitudes and behaviour of firms, workers, and individual citizens. This changed "culture" reinforces the effect of regulatory reform by freeing up entrepreneurial and innovative energies within an economy.

Reform can also have transition costs and longer-term effects, such as business disruptions and failures (particularly where businesses have been heavily protected for many years), job losses in specific sectors, effects on public services, and financial liabilities, such as stranded costs or funding of pension funds of privatised enterprises. These impacts must be assessed and weighed against benefits of reform. In most cases, governments can reduce the magnitude and duration of costs of reform by designing a comprehensive programme that includes co-ordinated policies that preserve public interests within competitive markets. The fact that the benefits of reform are often widespread and diffused, while many of the costs are concentrated and more visible, increases the importance of skilled political leadership in pushing forward with reform.

Regulatory reforms increase productivity, lower prices, and eliminate shortages...

By sharpening competitive pressures, elimination of economic regulations has encouraged firms to become more efficient and helped to boost the productivity of entire industries:

- In Europe, labour productivity growth in the *manufacturing sectors* most affected by competition-enhancing reforms in the Single Market Programme were double those of other sectors (14 percent versus 7.5 per cent for the period 1986-91).

- In *air transport* in the United States, real fares dropped by one-third between 1976 and 1993; more than half of this decline is attributed to deregulation. Following airline liberalisation in 1993 under the European Single Market, 800 new licences were granted in Europe, and more people are using lower-cost economy fares.

- *Road haulage industries* in the United States and United Kingdom enjoyed increases in capital productivity of around 50 per cent after relaxation or elimination of out-dated operational controls. Capital productivity was also boosted in these industries in France and Germany following liberalisation.

- Market liberalisation in *telecommunications* and technological advances led to new services and striking improvements in efficiency. Elimination of monopolies helped stimulate new technologies and increase the number of subscribers of cellular phones in OECD countries from 700,000 in 1985 to 71 million in 1995. After reform, average prices for telephone services fell by 63 per cent in the U.K. and 41 per cent in Japan; long distance prices fell by 66 per cent in Finland.

Increased efficiency means lower prices for consumers and businesses. Prices have fallen significantly and often swiftly where regulatory reforms strengthened competition or imposed efficiency-

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enhancing price regulations (Table 1). Not all of the price reductions reported in Table 1 can be attributed to regulatory reform only. Part of the decline in prices of telecommunications services, for example, is likely to reflect technological progress rather than regulatory reform.

There is great scope for increasing productivity and lowering prices through further elimination of economic regulations. Striking differences in levels of output per worker and capital productivity in similar sectors across Member countries are only partly explained by different natural endowments and population densities, and may reflect different regulatory practices and intensities of competition. Based on past experience, reform should raise efficiency levels substantially.

Table 1. Price reductions after elimination of economic regulation
(Price reductions may be in part attributable to factors other than regulatory reform)

Sector		Price reductions in real terms (per cent)
Road transport	Germany	30
	Mexico	25
	France	20
	United States	19
Airlines	United Kingdom	33
	United States	33
	Spain	30[1]
	Australia	20
Electricity	Norway (spot market)	18-26[2]
	United Kingdom	9-15[3]
	Japan	5
Financial services	United Kingdom	70[4]
	United States	30-62[4]
Professional services	United Kingdom (conveyancing)	33
Telecommunications	Finland	66 [5]
	United Kingdom	63[6]
	Japan	41[6]
	Mexico	21[5]
	Korea	10-30[7]

1. Refers to discount fares on the highest density route. Larger drops have been registered on other routes
2. The former figure refers to reductions for industrial customers who renegotiated contracts with their traditional suppliers, the latter refers to industrial customers shifting to new suppliers.
3. The former figure refers to electricity rates for households, the latter for industrial customers.
4. Refers to stock exchange commissions. In the U.S. case, the former figure refers to rates for small transactions, the latter to rates for large transactions.
5. Prices of long distance calls.
6. Average prices of telephone services.

7. The former figures refers to domestic long distance calls, the latter to international calls.

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Upgrading the quality of social and administrative regulations also holds considerable promise for raising productivity across the economy and lowering prices. Social and administrative regulations are estimated to cost American businesses US$ 500 billion/year (about 10 per cent of GDP). Administrative burdens alone are estimated to cost European businesses 540 billion ECUs/year (3 to 4 percent of GDP). SMEs are particularly hard hit by the cumulative impact of administrative and other regulations. They have less capacity than larger firms to navigate through the complexities of regulatory and bureaucratic networks; and the relative cost of compliance is higher than for larger enterprises. In France, SMEs spend an average of 100,000 FF/year on administrative formalities. In Canada, very small firms spend 8 percent of revenues complying with government paperwork, while larger firms spend 2 per cent, while in the Netherlands small firms spend six times more per employee to comply with government paperwork than do large firms. Streamlining and reducing these burdens can free up scarce human and financial resources for more productive activities, and open opportunities for new businesses.

Increased productivity and lower prices in one sector or firm can have ripple effects throughout the economy. By producing the same outputs with less resources, sectors and firms affected by reform can release labour and capital to other parts of the economy, enhancing their output potential. Local and domestic producers face more competition as lower transportation and telecommunications costs increase the integration of domestic and international markets.

But market liberalisation may also result in higher prices when directed at eliminating chronic shortages of goods and services. Deregulation of interest rates in Member countries was often accompanied by higher borrowing costs for some customers, but at the same time made it easier for them to get access to credit. Similarly, relaxation of rent controls in the housing market has at times led to higher prices, but also to increased supply and better standards of rental accommodation.

...while stimulating innovation and consumer choice...

There is abundant evidence that reform of economic, social, and administrative regulation can stimulate the creation and diffusion of new products, resulting in increased convenience and choice for households and businesses. Innovation is encouraged when companies have incentives and opportunities to compete on the basis of product variety as well as on price.

- In the financial sector, market liberalisation has been followed by a striking increase in the variety of financial instruments available to households and businesses, such as flexible savings accounts with interest rates close to market rates, more flexible mortgage instruments, and financial derivatives.
- In telecommunications, new products and services, such as mobile telephones and Internet access, have appeared much more quickly in competitive environments than in countries with telecommunication monopolies.
- In the European pharmaceutical sector, the time taken to grant marketing authorisation for new drugs was reduced from five years per country to one year for 15 member countries under the centralised procedures of the European Medicines Evaluation Agency. This savings in time-to-market has improved incentives for research and development of new pharmaceutical products.

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- Privatisation of building approvals in Australia opened a government monopoly to qualified and insured private services. Consumer services have improved through reductions in approval times and more choice (such as weekend inspections), while shorter delays have reduced building costs.

Regulatory reform in the financial sector can play an important role in stimulating innovation throughout the economy. Reducing excessively strict limits on the ability of pension funds and other institutional investors to hold stakes in small non-quoted companies could increase the availability of much-needed funds to young innovative firms. Similarly, facilitating listing on second-tier stock markets can help make small innovative firms more attractive to investors. The much greater use of the stock exchange by companies in the United States than elsewhere is partly related to easier listing conditions on the second-tier market (NASDAQ).

The shift from excessively detailed social regulation to market and goal-based approaches also encourages the creation and diffusion of new knowledge. "Command and control" regulation in the environmental area has often aimed at the adoption of "best available technology", which favours the use of existing control devices and discourages innovative responses to pollution problems. The current shift toward market incentives and goal-oriented regulations encourages creation of new, less costly means to reduce environmental degradation. In the agro-food sector, introduction of goals-oriented safety regulations encourages innovation, as food processors gain some discretion in how to comply with the standards. In Canada, a new approach in which railways set safety standards under government oversight has speeded up rulemaking and allowed the rail industry to keep pace with technologies that reduce service costs. Goal-oriented regulations for nuclear power plants has encouraged the nuclear industry to adapt technological innovations and resulted in a significant improvement in plant performance.

...and ultimately boosting GDP.

Effects on economic growth rates and output levels for the overall economy are more difficult to assess. This is particularly true for the dynamic gains stemming from reform: innovation and job creation in other sectors resulting from reform in, for example, telecommunication or energy. Nonetheless, an illustrative modelling exercise conducted by the OECD suggests that, over time, the gains from far-reaching market liberalisation in five key sectors (electricity, telecommunications, air transport, road haulage and retail distribution) can be significant. More heavily regulated countries, which include some European countries and Japan, can expect to see increases in real GDP levels on the order of 3 to 6 percent after ambitious reform programmes. Countries well-advanced on the path of regulatory reform already have reaped some of those benefits and so stand to gain less from further reform. Some of the reforms necessary to achieve these gains are currently underway, such as telecommunications liberalisation under the European Single Market Programme. The OECD work also indicates that real wages would increase in all countries as a more efficient workforce is rewarded by higher earnings. Indeed, in all cases analysed, average real wages increased following reform.

Studies conducted in countries which have embarked on reform reinforce these estimates Australia assesses its gains from reform to be around 5.5 per cent of GDP. The European Single Market increased EU income by an estimated 1.5 per cent from 1987 to 1993; and Commission estimates project even greater future gains. Japan estimates that reducing price and productivity gaps with the United States, primarily through regulatory reform, should increase GDP by several percentage points.

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The OECD estimates may understate potential benefits of reform. The OECD study was based on reform in only five sectors, which together account for 15 - 20 per cent of GDP. There is substantial scope for additional benefits from other sectors where reform may be less amenable to measurement. For example, reform of regulations on professions such as lawyers and doctors that restrict competition have substantial potential to reduce costs without loss in the quality of services. Too, the benefits of innovation are impossible to predict. Where competition is introduced, unexpected and welfare-enhancing new ways of doing business emerge.

Moreover, the study did not consider the possibility that sustainable output growth rates would increase after reform. The long-term dynamic effects of regulatory reform are harder to measure, because so many factors come into play, but, in general, reforms that increase competition and improve the capacity of the private sector to adapt and innovate are likely to be beneficial in terms of resource allocation and in raising potential growth rates. The effects of non-reform are easier to see -- lower relative productivity, less innovation, slower responsiveness to global markets, declining investment, dampened entrepreneurship -- all of which reduce overall growth prospects.

The benefits of reform are substantially improved by the overall policy environment within which reform takes place, including in particular macroeconomic stability and labour market flexibility combined with active labour market policies. Waiting to get the broader policy settings “right” is not a reason, however, to delay the reform of existing regulations.

These benefits are increased by opening opportunities for trade and investment.

The benefits of more efficient and innovative economies are more fully realised in an expanding global economy, and are shared by both domestic and foreign producers of goods and services, as well as investors. As the world economy becomes more closely integrated through trade and investment, fuller use of scale economies and innovative combinations of technologies is possible. After the introduction of harmonised or mutually recognised standards, producers are no longer constrained to set up small production lots for every national market. This reduces prices and increases competition (more stringent car emission standards, for example, segmented the Swiss auto market from the European market, and permitted car manufacturers to increase retail prices by an estimated $0.4 billion/year over prices in the most favourable EU countries). These international benefits have become increasingly visible in the European Single Market and helped motivate the successful conclusion of the recent WTO Agreement on Basic Telecommunications, which is expected to greatly expand output and benefit consumers in all participating countries. There is, therefore, a *shared interest* in reducing the cost and diversity of economic, social, and administrative regulations that should give further impetus to reform efforts in individual countries.

Regulatory reforms co-ordinated across borders have produced further benefits. Abolition of customs documentation and formalities produced savings of about ECU 5 billion/year (0.7 per cent of the total value of intra-EU trade). Prices of telecommunication equipment dropped by approximately 7 per cent from 1985 to 1995 as a result of harmonisation and mutual recognition initiatives. The number of cross-border branches in the banking sector increased by 58 per cent between 1993 and 1995, following introduction of "home control principles” giving banks a single license to operate across the EU. In the road transport sector, reduced road haulage quotas and border delays produced average savings of 5-6 per cent of total costs. Volume of deliveries by transporters from other Member States increased by 300 per cent between 1990 and 1995.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

Box 3: ***How Long is Long-Run?***

The length of time necessary to see concrete benefits is critical, particularly since the transition costs of reform usually begin in the short-term. Where competition is strengthened, price reductions are rapid. In some cases, businesses begin cutting prices and boosting efficiency before reform to prepare themselves for competition. Pre-tax prices of gasoline in Japan declined by 21 per cent in the two years before the ban on imports of refined petroleum was lifted, as companies prepared for a more competitive environment. The period for complete adjustment will vary across sectors and countries, but can be expected to last several years. New Zealand and the United Kingdom are arguably still adjusting to radical product market reforms initiated in the 1980s.

In general, the period of time needed to see benefits depends on how quickly targeted sectors respond to the new environment, and on how quickly the rest of the economy adjusts to changes in targeted sectors. By carefully co-ordinating policy reforms, governments have some control over the length of the adjustment period:

- Benefits of reform can be delayed if competition policy is not effective in preventing private restrictive practices after reform. Following airline deregulation in the United States, the Department of Transportation permitted 27 airline mergers during 1985-88. Some of these mergers resulted in increased market power that outweighed efficiency gains and made consumers in particular markets worse off after reform. In 1988, control over airline mergers was moved to the Antitrust Division of the Department of Justice.

- Adjustment will be slowed if reform is not credible, and seen as likely to be reversed in the future.

- Speed of adjustment to regulatory reform can also depend on macroeconomic policy. Excessive macroeconomic fluctuations in the United Kingdom in the late 1980s and early 1990s may have delayed the full benefits of structural reforms.

- Economy-wide benefits will take longer if product and labour markets are not flexible enough to allow rapid reallocation of capital and human resources across sectors. Movement of labour after regulatory reform began in New Zealand in the 1980s was arguably slowed by an inflexible labour market. Indeed, more competition in product markets combined with a rigid labour market contributed to mounting unemployment, which forced authorities to undertake radical labour market reform in the early 1990s, after which structural unemployment rate started to drop.

Government effectiveness in protecting public interests can be enhanced.

Regulatory reform has directly improved government capacity to get better results from public policies by using regulatory resources more effectively, exploiting private sector innovativeness in the public interest, putting into place powerful market incentives, and improving responsiveness to change.

- Market incentives and goal-based approaches can be powerful. In Sweden, a tax on sulphur content of fuel oils was imposed to supplement regulatory measures. The result was a reduction in sulphur content of fuel oils by almost 40 percent beyond the regulatory requirements. In Denmark, a tax on nonhazardous waste doubles the cost of dumping and incineration. As a result, between 1985 and 1995, the share of waste dumping was halved and the rate of re-use and recycling almost doubled. Regulations that give businesses more flexibility in assuring seafood safety is expected to prevent 20,000 to 60,000 food poisonings each year in the United States. Replacement of rigid command-and-control rules with a single "plant safety" standard was estimated to reduce by one-fourth deaths and injuries in those plants in Australia. Governments have not yet exploited the full potential of

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

incentive approaches. There is great scope for wider use of market incentives in meeting policy goals.

- Better information on benefits and costs can help governments set more effective priorities for action. Governments can waste considerable resources and permit unnecessary risks by regulating tiny risks while leaving important risks untouched. A recent study in the United States found that if existing regulations were re-targeted at those risks where lives could be saved at lowest cost, some 60,000 more deaths could be avoided each year without increasing regulatory costs.

- Voluntary and co-operative approaches can exceed regulatory results because solutions are better fitted to practical realities and the speed of response and updating can be faster. An education and training programme on major industrial accidents has helped Canada to achieve higher levels of safety and environment protection at lower cost, compared to other countries. When computerised scanning was introduced into supermarkets in Australia, consumers were concerned about over-charging, since prices were not marked on individual items. A voluntary code adopted by the industry gave consumers a higher level of protection and faster redress for problems than was possible under traditional regulatory enforcement. In the Netherlands, over 40 environmental covenants have been developed to make environmental protection a co-operative rather than adversarial goal between government and industry. However, these approaches must be carefully assessed and structured to avoid problems with competition, free riding, regulatory capture, transparency, and accountability.

Reform can also enhance the legitimacy of government. Reducing unaccountable administrative discretion and undue intervention into business decisions can reduce opportunities for corruption. In addition, business-friendly regulatory regimes can reduce the size of the underground economy which operates completely outside the regulatory system. In Mexico City, a regulatory reform programme has brought 10,000 SMEs into the formal sector since 1995.

Dynamic economies will create jobs, but jobs can be lost in individual sectors.

The effects of regulatory reform on jobs, a key consideration, depend to a great extent on the wider environment in which reform takes place, and the timeframe under consideration. Though increased competition may initially result in sectoral job losses as businesses are forced to become more efficient, more dynamic and innovative economies will create more and higher-paying jobs. Increases in productivity in one sector can increase demand in other sectors. Reforms that remove barriers to entry, lower prices, reduce regulatory and administrative burdens on businesses, open trade, and promote innovation create new business opportunities and job prospects. In some sectors, reforms have increased employment:

- In Japan and Finland, reform has produced net job gains in telecommunications, due to large output increases, though jobs were lost in the dominant operators. In the United States, jobs in the traditional telecommunications sector are at the same level today as before reform, but jobs in related information and copyright industries grew from 3 million in 1977 to 5.9 million in 1994, and these sectors are among the fastest growing job creators. Elimination of further telecommunication restrictions is expected to add 3.6 million new jobs over ten years.

Harmonisation of standards for mobile telephony in Europe contributed to creating an estimated 80,000 new jobs between 1990-1995, as output increased.

- Relaxation of *shopping hours* in Sweden boosted employment by 1.5 per cent in the sector, and in the Netherlands was predicted to create up to 15,000 new jobs. In the Netherlands, increased flexibility in the business establishment law, which required permits for the activities of individual businesses, mostly retailers, is predicted to increase market entry by 4.3 per cent, and market exit by 2.6 per cent.

- Reform of the *airline industry* in the United States led to initial job losses, but by 1996 total employment had increased by close to 80 per cent over initial levels as output soared in response to lower fares. In the United Kingdom, employment in the sector fell by more than a third, but has returned almost to its earlier levels.

- Reducing barriers for *SMEs* can be particularly important, since SMEs are the source of 40 to 80 percent of all employment (depending on the country), and provide a large share of new jobs. In Europe, SMEs have accounted for almost all net job creation in recent years, though accounting for only 65 per cent of total employment. In Australia, small businesses accounted for almost all of the 1.2 million net increase in jobs in the decade to 1994-95, while accounting for less than of half of total employment. SME growth can also support equal opportunity policies, since women make up a rising proportion of entrepreneurs in OECD countries.

Although experience shows that reform increases demand for labour in other firms and sectors, and that these jobs are more sustainable, displacement individual sectors can be costly for both affected workers and society. Workers may suffer temporary or protracted unemployment, uprooting from communities, and/or lower wages in new jobs. For society, unemployment represents a waste of productive resources. Costs will be particularly high if job losses are concentrated on vulnerable groups. For example, restructuring of existing firms has often led to disproportionate job cuts for low-skilled workers, undermining their position in labour markets. There is a risk that such workers will withdraw from the labour market, and, if this were to occur on a large scale, the macroeconomic benefits of reform would be reduced. In addition, the cost to society of early retirement systems must not be underestimated.

Well-functioning labour markets and a stable macroeconomic environment geared to sustainable growth help ensure that new job opportunities translate into actual increases in aggregate employment and reductions in unemployment. Higher growth will ease the stress of structural dislocations. Effects of reform on jobs also depend on the capacity of workers and enterprises to adjust and take advantage of new job opportunities. Active labour market policies, including education and training, have never been more important. By increasing the capacity of the economy to adjust and to adapt, government policies can make it less likely that regulatory reforms have adverse consequences on employment. The OECD Jobs Study set out in 1994 a broad programme of action intended to enhance the ability of the labour market to adjust, as well as to increase the capacity of the economy to create knowledge and to innovate. The recommendations were grouped under nine broad headings:

- Set macroeconomic policy such that it will both encourage growth and, in conjunction with good structural policies, make it sustainable, i.e. non-inflationary.

- Enhance the creation and diffusion of technological know-how by improving frameworks for its development.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

- Increase flexibility of working-time (both short-term and lifetime) voluntarily sought by workers and employers.
- Nurture an entrepreneurial climate by eliminating impediments to, and restrictions on, the creation and expansion of enterprises.
- Make wage and labour costs more flexible by removing restrictions that prevent wages from reflecting local conditions and individual skill levels, in particular of younger workers.;
- Reform employment security provisions that inhibit the expansion of employment in the private sector.
- Strengthen the emphasis on active labour market policies and reinforce their effectiveness;
- Improve labour force skills and competencies through wide-ranging changes in education and training systems;
- Reform unemployment and related benefit systems - and their interaction with the tax system - such that societies' fundamental equity goals are achieved in ways that impinge far less on the efficient functioning of labour markets.

Follow-up to this work indicates that countries making the most progress in implementing the recommendations have succeeded in making labour markets more flexible, but it also shows the reluctance of many countries to embark on significant labour-market reform. Reform programmes in the United Kingdom, Ireland, and the Netherlands, all initiated in the 1980s, have brought down structural unemployment rates, and enhanced the ability of these economies to deal with possible job losses in the wake of regulatory reform. The hesitancy of other Member countries to reform social benefit systems and to make labour conditions more flexible is related to concerns about the impact of such measures on strongly-held equity goals. In the absence of wage flexibility and strong incentives for the unemployed to find jobs, other adjustment mechanisms have to be relied upon to facilitate labour reallocation following regulatory reform, notably active labour market policies and skill-improvement systems. Experience of Member countries shows that such policies can help the unemployed to find jobs, but only if they are carefully targeted and designed.

Maintaining universal access to essential services may require offsetting measures...

It is sometimes feared that competition in vital services such as communications, energy, and public transport will conflict with equity objectives (often expressed as equal access, or "universal service"). This is because prices in these sectors have typically reflected massive hidden cross-subsidies. In telecommunications and energy, businesses have traditionally subsidised households; and in transportation, customers on high-density routes have subsidised customers on lower density routes. Although little is known about the effects of these cross-subsidies on overall income distribution, competition can harm vulnerable groups by ending hidden subsidies. In Italy, accounting separation of utility networks from competitive activities in telecommunications, the subject of a bill currently before Parliament, is intended to improve transparency and end hidden cross-subsidies. Deregulation of financial services in Australia was accompanied by new fees and charges on basic services, with disproportionate impacts on low income groups.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

Such concerns should not stand in the way of market liberalisation, however. Markets may work better in providing universal service. Germany in its 1996 telecommunications law and New Zealand in utility sectors have judged that, as a general rule, competitive markets will provide universal services of adequate quality without government intervention. Many pro-competition reforms have included additional measures to assess the costs and ensure access to public services in competitive markets. In some countries, public procurement is used. In Norway, subsidised air travel services are auctioned every three years to the company willing to operate the routes with the lowest subsidy; this competition has considerably reduced costs. In France, consumers of airline and telecommunication services are taxed and transparent funds established to subsidise service obligations. Direct subsidies were used after liberalisation of domestic air travel in several countries (e.g. United States, Australia and Canada). In the United Kingdom, where licenses to compete in the power market set standards for disconnection, disconnections of residential customers fell by 98 per cent in five years.

...but competition has not generally reduced quality of services.

There are also fears that increased competition can reduce service quality and reliability due to relentless downward pressure on costs and replacement of the "public service ethic" with profit motives. In general, experience does not support concerns about deteriorating quality in more competitive markets, though situations are still evolving and much depends on the type of incentive structure in place and conditions in specific sectors. Indeed, regulatory reform has meant that service quality is generally monitored more closely than before:

- Competitive telecommunication markets tend to have superior service provision than markets dominated by monopoly: density of payphones is higher, waiting time for new connection is shorter, and domestic call failure rates and fault incidence are lower. Comparisons of quality before and after regulatory reform suggest that quality improved after.

- Experience with airline deregulation has been mixed. Liberalisation in the United States resulted in increased number and scope of direct flights, and a substantial drop in transfers involving a change of airlines and loss or misplacement of baggage. However, total travel time has increased due to greater airport congestion, but some of that congestion could have been reduced if airport slot allocation arrangements had been adjusted to the new environment.

- Quality of some professional services in the United States has been unaffected by easing of licensing requirements and advertising restrictions. The decline in prices in some states that permit advertising in attorney and optometric services has not been bought at the cost of lower service quality.

While competition tends to improve service quality in structurally competitive industries, public monitoring or regulations can encourage good quality, particularly in transition periods. Possible approaches include:

- By providing the public with comparative information about service quality, public authorities or consumer groups can strengthen incentives for improvement. In the United Kingdom and Australia, telecommunications regulators publish periodic reports tracking quality of service performance of dominant operators. This approach requires that regulators have the legal power to obtain information on service quality.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

- Alternatively, regulation may be required to maintain or increase quality. Regulators of telecommunications, gas supply, electricity supply and water services in the United Kingdom can set quality of service standards as a condition of business, and law requires payment to customers in event of non-performance. A note of caution: over-regulation can reverse the gains from reform. The United Kingdom set up three new agencies to monitor the quality of privatised water services, leading to overlap, confusion, and high regulatory costs.

III. SUPPORTING PUBLIC POLICY GOALS

In a changing world, government action remains essential to protect and promote public policy goals such as health, safety, environmental quality, and other objectives. Indeed, as economies develop, public expectations in such areas tend to increase. Experience shows that reform, if properly carried out, should not adversely affect, and can often promote, such objectives. More efficient and dynamic economies will also help governments serve these public interests, but governments will need to monitor carefully the effects of more competitive markets on such policy goals; and they may need to take additional steps to protect them.

Economic and social policies should be mutually supportive. Restrictions on competition -- such as limitations on entry, price, output, or production methods -- are very costly ways to promote such public interests; have often been ineffective; and therefore should be avoided. There may be lower-cost approaches such as market incentives or approaches that are competition-neutral that work better within competitive markets. Whatever approach is taken should be evaluated for effectiveness. Reasonable standards applicable to all producers, based on benefit-cost analysis, scientific criteria, and risk assessment techniques, and underpinned by effective enforcement, are crucial to sound regulation.

Safety, health, and consumer protection can be promoted in more competitive markets, but vigilance is warranted.

It is important to address public concerns about the potential negative effects of regulatory reforms on safety, health, and consumer protection. The increase in road accidents in some countries has been blamed on fiercer competition in the wake of reforms. In the United Kingdom, aggressive selling of some financial services to the detriment of consumers followed the freeing up of the market. In globalised markets, concerns that entry of foreign products and services may lead to reduced levels of safety or consumer protection must be addressed. Several methods to deal with this problem exist, including Mutual Recognition Agreements (MRAs).

Evidence from countries where reform has taken place, however, suggests that strong competition is not inconsistent with a good safety record.

- Airline safety in the United States has increased since deregulation. Fatalities per million passenger miles dropped by 75 percent from 1974-76 to 1993-95.

- Safety improved in trucking in the United States, where, since deregulation, fatalities for the biggest trucks dropped by two-thirds from 1975 to 1992. The safety record of road freight transport also improved in the United Kingdom after reform.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

- Competition has caused professionals such as dentists, optometrists, pharmacists, physicians and veterinarians to lower prices, but has not increased safety risks for customers.

Notwithstanding this evidence, a more competitive environment may increase the risk for consumers as firms look for ways to lower costs. Governments clearly have a continuing role in regulating safety, health and consumer protection aspects of economic activity. Such protection in a vigorous competitive environment is best guaranteed by market incentives or by reasonable government standards, applicable to all producers. To gain and maintain credibility with the public, such standards should be set by benefit-cost and scientific criteria, and risk assessment techniques, and need to be effectively enforced. Such methods, properly carried out, can increase the capacity of the government to develop targeted and effective protections, while reducing their costs. Regulators should also be prepared to move quickly with well-designed interventions to respond to rapid market developments to protect health, safety, or other values. Voluntary codes of conduct to protect consumers are proving in some cases to be effective in innovative markets. For example, banks in some countries have adopted voluntary arrangements that limit liability to transactions via automatic tellers and establish clear appeals and complaint processes.

...with expansion of market incentives and goal-based approaches to improve environmental quality

The impact of regulatory reform on environmental quality depends on how well governments anticipate and address these impacts, and on their effects throughout the economy. New regulatory and non-regulatory techniques, based on market incentives and goal-based standards, hold the promise of a cleaner environment at lower cost:

- In Sweden, cleaner types of diesel fuels were taxed more favourably from 1991. The percentage of diesel fuel used that was the cleanest type rose from 1 per cent in 1990 to 76 per cent in 1996.

- In the Netherlands, water effluent charges to industry increased by over 100 per cent (in real terms) in the 20 years to 1994. Between 1980 and 1994, waste water discharges by the manufacturing sector declined 80 percent. Most firms cited the charges as the reason for their reductions.

- In the United States, the sulphur emission trading programme is expected to provide 20-50 per cent savings in emissions abatement costs over the period 1995-2010.

Regulatory reform that increases competition can trigger far-reaching changes in economic structure and output that can substantially affect environmental conditions, and thus the design and choice of environmental tools. Some current regulatory structures simultaneously block competition and increase environmental degradation, and priority should be given to reform in those areas.

- Deregulation of cabotage in the transport sector should reduce highway congestion and air pollution, given that runs by empty trucks today account for 30 percent of total vehicle kilometres for freight hauliers. At the same time, trade liberalisation will increase the number of trucks by increasing the volume of freight carried. Reform in road freight transport may increase road transport at the expense of rail freight. In France, road transport increased by over 50 per cent in the decade after road freight deregulation, while rail freight shrank by 15 per cent.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis*, Paris.

- Reform in the electricity industry can trigger changes that affect the quality of the environment directly and indirectly. For example, whether reform will promote the introduction of less-polluting renewable energy, or increase emissions of pollutants from fossil fuelled power plants will depend largely on the goals and quality of the broader regulatory regime.

- In agriculture, both regulations and economic incentives are being used to address environmental concerns such as excessive use of harmful chemicals and cultivation of marginal lands. Reform of agricultural policies to de-link support from production would further contribute to improving environmental quality.

These examples show that environment-economic linkages should be carefully assessed by regulatory reformers and environmental regulators. This constitutes an important aspect of the integration between economic and environmental policies. For instance, work in the OECD on trade and environment has called for a systematic review of the environmental impacts of trade measures and vice versa.

IV. STRATEGIES FOR SUCCESSFUL REFORM

The challenges of initiating and completing regulatory reform are familiar. Vested interests in public and private sectors, fears of the consequences of change, and the complexity and uncertainty of reform in dynamic economic and social environments must be dealt with effectively if reform is to succeed. Optimal approaches to structuring reform are as yet inadequately understood and highly variable according to context, but experiences in OECD countries suggest common themes.

Political leadership is essential.

Opportunities for genuine reform come rarely, often only when crises and external pressures make clear the costs of non-action. Unfortunately, countries find it hard to reform before problems become crises. Relative economic decline was a trigger for reform in New Zealand, which had fallen from fourth highest GDP per capita among OECD countries in the 1960s to twentieth by the early 1980s. Reform, when it came, was far-reaching and painful. Concrete evidence of rapid "hollowing-out" of Japan's financial sector due to competition from financial centres in other parts of Asia, Europe, and North America has today stimulated far-reaching reform. These problems, although foreseen years before, could not be addressed until they became acute. Skilful political leadership is needed to improve the capacity for change in the absence of crisis, and to design and implement strategies for reform earlier to reduce the cost of lost opportunities and the pain of transition. Reform is not, however, a task only for governments; other stakeholders such as firms and workers have roles in helping to build support for reform and in sharing information across borders.

The need for reform must be communicated.

A crucial stage in reform comes before reform starts: communicating and selling reform to an often-sceptical citizenry. The public needs to be informed as to why reform is considered so important to their future well-being and that of their children. Open dialogue and communication involving all major stakeholders on the benefits and costs of reform can improve understanding on all sides of short and long-term effects of action and non-action, and on the distribution of costs and benefits. In most countries,

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

reform would benefit from wider and more informed debates less dominated by concentrated interests who stand to lose the most.

Development of an articulated and transparent regulatory reform policy -- either government-wide or for individual sectors -- can underpin political commitment, result in more coherent and carefully planned reform, mobilise constituencies for reform, and focus a public debate on benefits and costs. The credibility of reform is heightened by clearly laying out the path forward, which is vital if the private sector is to invest and workers are to accept that they will reap some of the benefits rather than simply bearing the risks. Communication can strengthen the voices of those that support and will benefit from reform. Important allies in the reform process include businesses who will gain from low cost, high quality goods and services inputs; consumers; and employees and their representatives in fields in which job creation and wage growth are constrained by unnecessary regulatory restrictions.

To the extent possible, all interested parties should be given opportunity to express their views in developing the reform policy, though consultations must be carefully structured to avoid undue delays or giving affected parties too much influence in blocking needed reform. In Norway, reorganisation of several state-owned enterprises was preceded by creation of special bodies representing employees and employers. With the involvement of these bodies, the government cut costs and increased competition in postal services. While 1400 out of 2300 post offices will be closed, no employees will be fired. Instead, employees will be placed in a new corporation that will compete for business such as country-wide mail delivery, or re-allocated to other parts of government.

Comprehensive reform works better than piecemeal reform.

Comprehensive reform is based on a complete and transparent package of reforms (aimed at a single policy area, sector or multiple sectors) designed to achieve specific goals on a well-defined timetable. Comprehensive reform does not mean that all changes occur immediately; rather, it is consistent with sequencing strategies and transitional steps as long as they are temporary and steps and timing are clear. There are several advantages to comprehensive reform: benefits appear faster (which means that pro-reform interests are created sooner); affected parties have more warning of the need to adapt; vested interests have less opportunity to block change; and reform enjoys higher political profile and commitment. Producing an integrated package of reforms also facilitates balancing of multiple policy objectives and interests. Comprehensive reform still requires an effective mechanism for monitoring and implementing reform, because reform may produce unforeseen results that will require adjustment and response.

In contrast, piecemeal approaches tend to be unplanned and hence unpredictable. They usually address easy reforms first, even if the more difficult have the most impact. Hence, benefits are delayed. The result is delayed or even lost benefits, a rapid exhaustion of the political resources needed to sustain the process, and vulnerability to blocking or delaying by vested interests. Moreover, some reforms are nearly impossible to introduce in gradually without careful and transparent advance planning. For example, it is difficult to manage a gradual evolution to full competition because that generally means there will be a mix of competitive and monopoly elements during the transition. Large investments in regulatory oversight and information will be needed. And private investors are usually reluctant to enter the market when reform is unpredictable and there are risks of reversals and delays.

Box 4*: Comprehensive regulatory reform*

New Zealand abolished virtually all support to agriculture in the mid-1980s. Price stabilisation measures and input subsidies were eliminated, tariffs reduced and restrictions on imports removed. The reforms were provoked by serious economic imbalances, adverse developments in international trade for New Zealand's agricultural exports, and a foreign exchange crisis, and resulted in re-alignment of farm product prices with world market prices. After an initial rise in farm profits due to a 20 percent devaluation, there was a substantial decline in the profitability of farming as exchange rates recovered. The decline in farm profitability was accompanied by a drop of more than 20 percent in the average sale price of farm land, a reduction of agriculture's contribution to GDP, adjustment in farm enterprise mixes, closing down of some businesses related to agriculture, and loss of jobs (employment in the agro-food sector declined by more than 10 percent). Adjustments in upstream and downstream sectors have also been substantial. The Government provided limited assistance during the period of adjustment, including changes in general economic policies (including the 20 percent devaluation), a write off of the deficit in price stabilisation accounts, and assistance to some farmers with debt restructuring and servicing. The general welfare programme was used to provide income support to some farm families. Under intense pressure to become more efficient and innovative in order to survive, farmers diversified into new products and non-farming activities, meat processors were forced to seek efficiencies and add value, and product development in the dairy industry and new crops resulted in a much wider variety of products, exported to new markets. Currently, the agro-food sector is internationally competitive, more responsive to international market changes and opportunities, and operates with very little government support. A decade on, agriculture's contribution to GDP exceeds its pre-reform peak; employment in the agro-food sector has almost recovered to pre-reform levels; quality has improved; variety of products has increased; average land sale prices have rebounded to exceed pre-reform levels; and generally farmers have improved farm equity and profitability.

Carefully consider sequencing, but don't give up opportunities while waiting.

There is much debate on how reforms can be sequenced, and how important sequencing is. The optimal sequencing from an economic point of view, in the sense of reducing transition costs and achieving benefits quickly, may differ from the optimal sequence from a political perspective, in the sense of maximising the political momentum of reform. Most countries have approached sequencing very pragmatically, since waiting for the optimal sequence of reforms can delay reform for a long time. While sequencing decisions will depend on a case-by-case assessment, some points should be considered:

- Benefits can be increased and the pain of transition reduced if regulatory reform is preceded by measures to eliminate pre-existing distortions that will become more harmful after regulations are changed. Increasing the capacity of labour markets to adapt, for example, will make labour reallocation more efficient and ease the transition to more competitive environments. Reduction of banking debts in advance might be needed to reduce the number of bank failures under competition. Re-structuring of monopolies is often necessary to establish the conditions for competition.

- Strategic sequencing can result in a self-sustained and expanding reform movement. Where consumers see tangible benefits early, they often strongly support continued reform. New interests can increase pressure for reform in other areas. Reform in one area can make the costs of regulations in other areas more visible and painful. Tariff reform has stimulated reform of national product markets under pressure from import competition. New Zealand initiated labour market reforms in the early 1990s only after radical regulatory reform in product markets in the 1980s contributed to high unemployment because the labour market could not adapt to the new environment.

- Prudential oversight and assessment of incentives in new environments may be needed as a first step to avoid costly failures. The history of financial market reform in several countries shows how failure to prepare the ground can have serious consequences. In some Nordic countries, reform

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

resulted initially in overheating and subsequently in a banking crisis because constraints on lending were relaxed at a time when interest payments were deductible from income for tax purposes and when marginal tax rates were very high, effectively making for negative real after-tax borrowing rates. Safety and health considerations and consumer protection may require strengthening of government capacity to oversee expanding and innovative market activities. In cases where the effects of market liberalisation are not clear from the outset, reform can be accompanied by monitoring. This is currently the case with respect to security of supply in energy markets, where the effect of competition on long-term investments and diversity of fuel inputs is under observation.

International co-operation and co-ordination can promote reform.

All governments have a significant stake in regulatory reform and the benefits it can bring, including increased trade and investment. Selling reform is easier today thanks to a growing body of evidence and experiences from many countries, and the impact of international benchmarks in highlighting the need for reform. Such information can reassure people that the risks of moving in unfamiliar directions are acceptable, given demonstrated benefits.

Putting reform into the international arena attracts higher levels of political attention. Peer pressures enhance transparency of the reform process and can help countries to sustain momentum. The perceived "fairness" of multilateral action can help to reduce resistance to reform, compared to going it alone, and co-ordinated reform can help avoid "spillover" effects and impacts on other countries. International rules and disciplines aimed at improving regulations and regulatory processes help promote reform at the national level. International co-operation; and commitments reached under OECD guidelines and policy recommendations, and WTO agreements; and other international approaches, including bilateral initiatives for mutual recognition, both reflect but also stimulate reform at national levels.

V. POLICY RECOMMENDATIONS FOR REGULATORY REFORM

The seven recommendations which follow are drawn from OECD country experiences, as elaborated in the sectoral and thematic background reports which formed the basis for this Report. The recommendations are intended to provide governments with steps they can take to improve regulations themselves and regulatory processes within public administrations. The recommendations, which should be viewed as an integrated package, apply broadly across sectors and policy areas, and implementation will differ among countries, depending on differences in public policies, policy trade-offs, reform priorities and needs, and legal and institutional systems. If adopted, they can help governments to update and streamline the regulations and formalities that have accumulated over years, and to set into motion a continuing process of regulatory disciplines inside public administrations that will protect the gains of reform in the future. By establishing a common set of disciplines, they will improve international transparency and understanding of national regulatory systems.

Recommendations

1. Adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis*, Paris.

- *Establish principles of "good regulation" to guide reform, drawing on the 1995 OECD Recommendation on Improving the Quality of Government Regulation. Good regulation should: (i) be needed to serve clearly identified policy goals, and effective in achieving those goals; (ii) have a sound legal basis; (iii) produce benefits that justify costs, considering the distribution of effects across society; (iv) minimise costs and market distortions; (v) promote innovation through market incentives and goal-based approaches; (vi) be clear, simple, and practical for users; (vii) be consistent with other regulations and policies; and (viii) be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.*

- *Create effective and credible mechanisms inside the government for managing and co-ordinating regulation and its reform; avoid overlapping or duplicative responsibilities among regulatory authorities and levels of government.*

- *Encourage reform at all levels of government and in private bodies such as standards setting organisations.*

Regulatory reform should be guided by coherent and transparent policy frameworks that establish concrete objectives and the path for reaching them, and that enjoy sustained political commitment. Different programmes may be needed, depending on the type of regulations being reformed and the objectives of reform. Such programmes will both enhance the credibility of reform, and reduce the costs of reform by signalling to the wide range of potentially affected interests what is to come. The emphasis on broad programmes is deliberate, since the likelihood of success is increased by including at the outset the full mix of policies needed to gain full benefits of reform. Programme effectiveness depends also on how well it is carried out, and here country experiences show that a well-organised and monitored process, driven by “engines of reform” with clear accountability for results, is essential.

Reform mechanisms with explicit responsibilities and authorities for managing and tracking reform inside the administration are needed inside and outside the administration to keep reform concrete and on schedule, and to avoid a recurrence of over-regulation. It is often difficult for regulators to reform themselves, given countervailing pressures. Also, reform must often be co-ordinated across multiple areas if it is to be effective. Governments have created wholly new bodies for this purpose, or have given existing bodies new duties. Such mechanisms will need to be supported by other reform-minded bodies, such as ministries of finance, and competition and trade authorities that develop advocacy capacities. Private sector engines of reform, such as advisory bodies or private initiatives, can also be helpful and should be encouraged. International co-operation on trade and investment, such as regional integration initiatives, can also be powerful in promoting reform.

Governments should develop familiarity with a broad range of new policy tools that can improve policy effectiveness and reduce costs, while promoting innovation. These tools, used alone or with regulation, are based on the idea that incentives are better than commands. They include information disclosure; economic incentives such as taxes and charges; voluntary agreements; and creation of new markets through tradable property rights. Where regulation is used, flexible performance-based approaches allow firms to find the most cost-effective solutions. However, the risks of self-regulation and voluntary approaches -- undue influence by private interests, barriers to competition, and lack of transparency and accountability -- need to be rigorously managed by programme design and application of competition policies.

Box 5: *Overseeing and promoting reform*

Many OECD countries have established specialised mechanisms for overseeing regulatory reform activities across the government. These seem most effective when responsibility for regulatory reform is at ministerial level or higher. The roles of these mechanisms in promoting reform vary widely:

- Some specialised bodies, such as the Office of Regulation Review in the Australian Industry Commission; the Office of Regulatory Affairs in Canada; the Working Group for Proposed Regulations in the Netherlands; the Deregulation Unit in the U.K. Cabinet Office; and the Office of Information and Regulatory Affairs in the U.S. Executive Office of the President can participate directly in the development of new regulations and review of existing regulations on the basis of mandatory quality standards. This enables them to intervene at an early stage when regulatory proposals are poor quality.

- Others, such as the Commission for Public Sector Reform in France, the Ministries of Economics and Interior in Germany, and the Ministry of Finance in Sweden act as advisors in setting the general framework policies for regulatory reform and encouraging the ministries to comply.

- Others, such as the ministerial-level Economic Deregulation Board in Mexico and Japan's Administrative Reform Committee, an advisory body to the Prime Minister, are deeply involved in reviewing existing regulations and in setting specific priorities for action by the ministries.

Experience shows that such capacities are most effective if they are *independent* from regulators (not tied to specific regulatory missions), *horizontal* across government, *expert* (have the capacity for independent judgement), able to *take the initiative* in promoting reform, and *linked to political authorities or existing centres of oversight authority* (such as centres of government and finance and trade ministries). Continuous experimentation is underway to improve the effectiveness of these bodies. Japan's Administrative Reform Committee recently began meeting with ministries to examine reform proposals in public, before the media, rather than behind closed doors, as was previously done. This has increased public attention to reform.

2. Review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively.

- *Review regulations (economic, social, and administrative) against the principles of good regulation and from the point of view of the user rather than of the regulator.*

- *Target reviews at regulations where change will yield the highest and most visible benefits, particularly regulations restricting competition and trade, and affecting enterprises, including SMEs.*

- *Review proposals for new regulations, as well as existing regulations.*

- *Integrate regulatory impact analysis into the development, review, and reform of regulations.*

- *Update regulations through automatic review methods, such as sunsetting.*

Governments should implement the concept of life-cycle management of regulations, in which principles of good regulation are applied in initial decisions on new regulations and in continuing reviews throughout the life of the regulation. Today's pace of change in technologies, economic opportunities, and social conditions means that outdated and unneeded rules penalise countries more and more. Systematic regulatory review according to standardised criteria of effectiveness and need can produce very large payoffs in terms of reduced costs and improved effectiveness. Automatic mechanisms, such as sunsetting, are used in some countries to ensure that periodic review takes place on schedule. The size and complexity of the task means that effective review is a long-term task requiring careful management and prioritisation. Suggested review priorities include technologically dynamic sectors; product standards that impede trade and investment; government formalities such as licenses and permits, particularly those that overload SMEs; and duplications and inconsistencies between levels of government.

Most countries have carried out partial reviews of existing regulations, but very few do this systematically or periodically. Some countries have adopted processes to review proposals for new regulations against consistent quality criteria. Yet it has been difficult to make real progress. One reason is that past review efforts have often been superficial and focused on marginal changes to complex regulatory regimes that have not significantly improved the total regulatory environment. To produce real change, comprehensive review and rebuilding of entire regulatory regimes is often necessary. This is called “scrap and build” in Japan, and “reinventing regulation” in the United States.

To add structure, rigor, and transparency to regulatory review, regulatory impact analysis (RIA) is essential. RIA should be used to assess benefits, costs and distributive impacts of regulations, alternative approaches, and proposals for reform; and disproportionate impacts on SMEs. Most OECD countries and the European Commission have implemented RIA programmes, and there is broad consensus that, properly done, RIAs can be effective in helping to produce the most effective, least cost instruments, though they require additional resources. An evaluation of 15 RIAs in the United States found that they cost $10 million to conduct but resulted in revisions to regulations with estimated net benefits of about $10 billion, or a benefit-cost ratio of about 1 000 to 1. The Canadian Business Impact Test has been judged effective particularly in assessing SME impacts. But RIA is very hard to do properly. More work is needed to strengthen the methods, procedures and practice of RIA, and to strengthen regulatory management to support its timely and effective use.

Box 6*: Regulatory Review in Australia*

From 1996 to 2000, Australian federal and state governments are undertaking a comprehensive review of regulations to eliminate unjustified anti-competitive effects. This review is unprecedented in its scope and ambition in OECD countries. A 1993 Report on National Competition Policy found that "Australia is facing major challenges in reforming its economy to enhance national living standards" and recommended "the reform of regulation which unjustifiably restricts competition." Since competition law could not itself correct regulatory barriers to competition, many of which stemmed from other laws, a new mechanism was required:

- acceptance by governments of the principle that any restriction on competition must be clearly demonstrated to be in the public interest;

- new and existing regulations should be subject to increased scrutiny, and significant restrictions on competition should lapse after five years, unless re-enacted after scrutiny through a public review process; and

- reviews of regulations should take an economy-wide perspective to the extent practicable.

In April 1995, the Council of Australian Governments signed the Competition Principles Agreement embodying these recommendations (except that regulations restricting competition will undergo review every ten years rather than automatically lapse). Review schedules were agreed to in 1996 and the process has commenced.

Financial incentives for reform were built into the Agreement, which is expected to increase federal tax revenues by A$6 billion per year. The Commonwealth will make "Competition Payments" to each state, unless the state fails to meet deadlines for regulatory review and for "effective implementation" of other commitments in the agreement, such as deregulation of gas, electricity, water, and road transport industries.

3. Ensure that regulations and regulatory processes are transparent, non-discriminatory and efficiently applied.

- *Ensure that reform goals and strategies are articulated clearly to the public.*

- *Consult with affected parties, whether domestic or foreign, while developing or reviewing regulations, ensuring that the consultation itself is transparent.*

- *Create and update on a continuing basis public registries of regulations and business formalities, or use other means of ensuring that domestic and foreign businesses can easily identify all requirements applicable to them.*

- *Ensure that procedures for applying regulations are transparent, non-discriminatory, contain an appeals process, and do not unduly delay business decisions.*

The content of regulations is important, but just as important is the accessibility and application of regulations. Transparency and fairness are essential to establishing a stable regulatory environment that promotes competition, trade and investment. The value of consultation with affected interests is clear. A well-designed and implemented public consultation programme that is not excessively burdensome can help identify more effective regulatory approaches, avoid costly and unintended impacts, improve compliance, and lower costs. Consultation can improve market access by increasing regulatory transparency, and it can reduce transition costs since affected parties have more time to plan. It can also improve the legitimacy and credibility of government actions. OECD governments have invested considerably in recent years in making more information available to the public, listening to a wider range of interests, and being more responsive to what is heard. A wide range of approaches has developed, including publication of future plans, hearings, advisory bodies, and publication of drafts.

Access to regulations is a continual challenge as rules become more technical, complex, and interlinked. In Norway, the regulatory system has been approached as an “information system” linking governments and citizens. “Textual clarity, high consistency among the provisions, and a structure easy to understand and to which the user may relate” are emphasised. To improve access and security, Mexico is currently establishing its first comprehensive Federal Register of Business Formalities. A new Legislative Instruments Act under consideration in Australia would establish a Federal Register of Legislative Instruments, where regulators will be required to register all existing regulations. The register will provide "positive security," that is, regulations not in the register could not be enforced. Information technologies add new possibilities. In 1995, Sweden was building a comprehensive electronic listing of regulations, with text on issues such as motives, magnitude of costs and effects. Many of the federal regulations in the United States are now available to affected parties over the Internet.

4. Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy.

- *Eliminate sectoral gaps in coverage of competition law, unless evidence suggests that compelling public interests cannot be served in better ways.*

- *Enforce competition law vigorously where collusive behaviour, abuse of dominant position, or anticompetitive mergers risk frustrating reform.*

- *Provide competition authorities with the authority and capacity to advocate reform.*

Exemptions from national competition laws have accumulated in numerous sectors, including energy and utilities, transport, communications, and agriculture. Such exemptions have reduced economic performance by allowing anti-competitive practices -- such as abuses of dominant position, cartel conduct, and anti-competitive mergers. An essential reform is to reverse such exemptions and apply the general competition law as widely as possible. This is particularly important in the period after regulatory reform, because such abuses can frustrate the emergence of competition by blocking entry or fixing prices. Vigorous enforcement of laws against cartels will be needed where years of regulation have taught firms to co-operate instead of compete. Without determined action, the benefits of reform can be lost.

Competition authorities can be valuable allies in the reform process. Through general advocacy and enforcement actions, they can attract attention to problems created by poor regulation. When reforms are implemented, they can use enforcement and publicity to ensure that the objectives of reform are achieved. To be effective, competition authorities must develop capacities for advocacy inside governments, be able to intervene where more competition would benefit consumers, and effectively enforce the law. Adequate resources are necessary if they are to be effective.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis*, Paris.

Box 7: ***Competition Enforcement and Advocacy Supports Regulatory Reform.***

Advocacy and Enforcement. Competition authorities have advocated or enforced reform in many sectors. Of the approximately 20 Member countries whose authorities have had active programs, all have been involved in telecommunications issues, most in professional services and financial services, and over half in electric power and agro-food sectors. Anecdotal evidence suggests that these efforts have had significant impact in promoting reform.

Competition authorities in Canada, the Czech Republic, Denmark, Finland, Hungary, Ireland, Italy, Korea, Mexico, and Poland report active advocacy programmes. In Italy since 1993, the competition authority accelerated liberalisation of telecommunication services through a series of enforcement actions. In the United States, advocacy and enforcement by the Department of Justice and the Federal Trade Commission promoted competition in such sectors as telecommunications, surface and air transport, securities trading, electric power generation and transmission. Their efforts led to reduced regulation of commercial practices, and stimulated price and quality competition, for professional services, including medical care, funeral services, engineering, accounting and law.

The European Union combines advocacy with legislative powers. The Commission plays an active role in liberalising sectors previously the exclusive preserve of State monopolies. The Commission started liberalisation in the telecommunications sector in the second half of the 1980's and progressively introduced full liberalisation, to be reached in January 1, 1998. Full liberalisation has also been realised in the air transport sector with effect from 1 April 1997. Progressive liberalisation is further under way in the energy sector.

Abolishing gaps in coverage: In Japan, the competition authorities have encouraged other government agencies to abolish competition law exemptions contained in other laws. The government has presented a bill to the Diet to abolish 35 exemptions in 20 laws.

5. Reform economic regulations in all sectors to stimulate competition, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests.

- *Review as a high priority those aspects of economic regulations that restrict entry, exit, pricing, output, normal commercial practices, and forms of business organisation.*

- *Promote efficiency and the transition to effective competition where economic regulations continue to be needed because of potential for abuse of market power. In particular: (i) separate potentially competitive activities from regulated utility networks, and otherwise restructure as needed to reduce the market power of incumbents; (ii) guarantee access to essential network facilities to all market entrants on a transparent and non-discriminatory basis; (iii) use price caps and other mechanisms to encourage efficiency gains when price controls are needed during the transition to competition.*

Despite the fact that almost all economic activity today occurs in markets where competition can work efficiently, economic regulations that reduce competition and distort prices are pervasive. They take many forms at various levels of government, ranging from legal monopolies that block competition in entire sectors, to a host of less visible restrictions on starting up and operating businesses, such as quotas on business licenses and shop opening hours. Yet economic regulations have often proven to be extremely costly and ineffective means of achieving public interest goals. In the absence of clear evidence that such regulations are necessary to serve public interests, governments should place a high priority on identifying and removing economic regulations that impede competition.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis*, Paris.

In general, public policies such as protection of health, safety, and environment are better served by using competition-neutral instruments, such as well-targeted social regulations and market incentives, to change behaviour in competitive markets, rather than using economic regulations to restrict competition. For example, governments need to ensure that providers of professional services are qualified in their fields; however, maintaining such protections does not require control of economic aspects such as the number of firms, or their size, services, and prices.

Replacing monopolies with competitive markets is a particularly complex task. In almost every country, the transition period from legally-created monopoly to effective competition has proven more difficult and protracted than anticipated. When legal monopolies are eliminated, governments must stand ready to use competition law, and price cap and quality of service regulations to prevent incumbents from abusing their initial dominant position. Regulatory reform should aim to create vigorous competition as quickly as possible to make such intervention unnecessary. Competition can and should be introduced into markets upstream and downstream from regulated distribution networks in public utilities (water, gas and electricity). Separating the monopoly network from competitive activities through either physical or accounting means is necessary to ensure non-discriminatory access by firms upstream and downstream to the monopoly facility and to prevent other distortions such as cross-subsidies.

Box 8*: Improving competition can benefit consumers*

Economic regulations that block competition and adjustment take many forms, and are pervasive in many sectors in OECD countries. Reform in a wide range of areas would lower prices and increase choice for consumers.

- Japan's large scale retail store law has traditionally provided for procedures to adjust floor space, number of holidays, closing hours, and opening dates for large stores. In the 1990s, Japan has taken a number of measures to streamline the procedures and ease operational regulations. Combined with changes in the environment for retail services, (such as changes in consumer behaviour and price consciousness), these reforms have increased the efficiency of the retail sector and lowered prices for consumers. The number of notifications to authorities for new openings of large-scale stores increased from about 800 in 1989 to over 2,200 in 1995.

- In the United States, restrictions on advertising and market entry in the field of eye care have caused consumers in some states to pay more for eye examinations and eyeglasses than they should. Eye examinations cost about one-third less in states with more liberal regulation. Comparative studies, which included actual eye examinations by trained testers and evaluations by impartial experts, found no support for claims that advertising and other commercial practices had led to lower quality service.

- In Korea, restrictions on the distance between gas stations were removed, and floor prices for gasoline eliminated in 1993. As a result, the number of gas stations increased by 75 per cent by in three years, leading to more price competition and higher quality of service.

6. Eliminate unnecessary regulatory barriers to trade and investment by enhancing implementation of international agreements and strengthening international principles.

- *Implement, and work with other countries to strengthen, international rules and principles to liberalise trade and investment (such as transparency, non-discrimination, avoidance of*

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

unnecessary trade restrictiveness, and attention to competition principles), as contained in WTO agreements, OECD recommendations and policy guidelines, and other agreements.

- *Reduce as a priority matter those regulatory barriers to trade and investment arising from divergent and duplicative requirements by countries.*
- *Develop and use whenever possible internationally harmonised standards as a basis for domestic regulations, while collaborating with other countries to review and improve international standards to assure they continue to achieve the intended policy goals efficiently and effectively.*
- *Expand recognition of other countries' conformity assessment procedures and results through, for example, mutual recognition agreements (MRAs) or other means.*

Rigid and discriminatory regulations and lack of transparency in regulatory procedures can impede the free flow of trade and investment and block access by efficient foreign firms. Reform in these areas is needed if countries and firms are to gain the benefits of expanding international trade, investment, and the spread of innovative and efficient business practices.

A range of unilateral, bilateral, and multilateral approaches can be used, but in each case transparency and other principles mentioned above are required so that these approaches evolve toward an open and non-discriminatory system. Regulatory reform that reduces regulatory costs and restrictions is inherently market-opening. Where countries share common regulatory goals, greater use of harmonised standards can create benefits from scale economies and transparency, though governments need to review vigorously the quality of international standards to assure that public policy goals are served. Market-based measures can also reduce trade distortions. Non-transparent and duplicative conformity assessment adds costs to international business, especially SMEs, and countries should take steps to mutually accept certification of products and allow free entry with no duplicative procedures. To solve this problem, abolishing regulation and changing third-party certification to suppliers' declarations is one of the most efficient approaches. If this is not possible, unilateral recognition is also efficient. MRAs can be another effective alternative. MRAs should ensure the competence of foreign assessment bodies so that the public maintains confidence in the quality of imported products and services.

Box 9: *International principles to facilitate trade and investment*

International principles for national regulations have been established that allow national regulatory objectives to be achieved at lowest cost to international trade and investment. While they vary in terms of coverage and effectiveness, principles established in WTO agreements include: *transparency* (regulatory procedures should be transparent and open especially for foreign entrants); *non-discrimination* (regulations must not discriminate among products or firms of different national origins); *avoidance of unnecessary trade restrictiveness* (regulations should not restrict trade and investment more than necessary to achieve policy objectives); *attention to competition principles* (private anti-competitive behaviour should not impede the benefits of reform for foreign service suppliers and investors); *mutual recognition* (other countries' conformity assessments should be recognised as equivalent). The Multilateral Agreement on Investment, presently under negotiation, would reduce barriers to international investment by establishing binding rules including national treatment and most-favoured nation, on treatment of investors and investments.

OECD countries should work together to ensure effective implementation of these principles, and to strengthen them. The WTO/TBT triennial review can be an important opportunity for this. WTO disciplines could be open to further developments. Transparency is still too limited to provide foreign producers with adequate notice of upcoming changes and easy access to current requirements. Avoidance of unnecessary trade restrictiveness requires clearer definition if it is to be applied effectively by national regulators.

7. Identify important linkages with other policy objectives and develop policies to achieve those objectives in ways that support reform.

- *Adapt as necessary prudential and other public policies in areas such as safety, health, consumer protection, and energy security so that they remain effective, and as efficient as possible within competitive market environments.*

- *Review non-regulatory policies, including subsidies, taxes, procurement policies, trade instruments such as tariffs, and other support policies, and reform them where they unnecessarily distort competition.*

- *Ensure that programmes designed to ease the potential costs of regulatory reform are focused, transitional, and facilitate, rather than delay, reform.*

- *Implement the full range of recommendations of the OECD Jobs Study to improve the capacity of workers and enterprises to adjust and take advantage of new job and business opportunities.*

Development of the broad reform programme suggested in Recommendation 1 is intended to locate regulatory reform within a wide and coherent policy framework involving the most beneficial mix of policies. Failure to identify policy linkages and trade-offs, costs, risks, and market incentives heightens the risk that regulatory reform can fail or damage other public policies. In most cases, governments can take steps to minimise the magnitude and duration of costs and risks, and thereby expand the scope for reform. When broad-based reform leads to deep structural change, stabilisation and transitional policies may be considered to ease the path to competitive markets. Costs of possible job losses in more competitive environments will be lessened if the macroeconomic environment promotes sustainable growth and if the capacity of workers and businesses to adjust and take advantage of new job opportunities is increased. The OECD Jobs Study set out a broad programme of action to improve labour market performance. Its implementation would reduce adverse employment effects in transition stages.

One barrier to reform is the fear that it will erode safety, health, and consumer protection. Governments should assess the potential for higher risks in more competitive markets, and should intervene as appropriate, using the substantive principles of good regulation to ensure both that social objectives are not jeopardised and that new regulations are efficient within competitive markets. In some cases, governments may need to allocate more resources to safety, environmental and consumer protection to maintain oversight of expanding markets.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

Box 10*: Improving the coherence of policy reforms*

A wide range of policies can assist in easing the difficulty of deep structural reforms. Japan was faced with dramatic adjustment as a result of the oil shocks of the 1970s. The aluminium smelting industry in particular lost international competitiveness as energy prices rose. In the ten years to 1988, assisted by a programme of incentives for adjustment, output from the industry fell by 97 per cent, and employment by 94 percent. The incentives, based on the OECD's Positive Adjustment Policies, included policies for discarding excessive facilities, for transferring employees to other companies, for research and development, and for new investments in other activities. Subsidies, tax incentives, and low interest rates were applied as policy measures. The programme was begun with an explicit timetable, and ended as scheduled. Japanese officials judge that the programme was successful in promoting adjustment in the industry.

In Sweden, deregulation of taxi markets led to a rapid increase in the number of taxis, reduced waiting times, and new services. But a number of other policies were needed in the new markets to control tax evasion, to vet taxi drivers more carefully, to increase the transparency of pricing for customers, and to improve enforcement against illegal taxis. Competition policy is being re-examined to find the right balance between price co-operation through central booking and price competition.

Failure to take into account the total regulatory picture can produce costly failures. In the United States, failure to adopt reforms such as optimal pricing to deal with airline congestion at airports reduced airline travel time performance after deregulation, and cut the benefits of reform for travellers by nearly $2 billion per year.

Removing existing distortions can be a prerequisite for regulatory reform. For example, green taxes are one possible alternative to regulatory measures to achieve policy objectives. Green taxes should start by removing existing tax provisions (distortionary taxes and subsidies, particularly in the agriculture, energy, and transport sectors) that have unintended but detrimental effects on the environment. In 1991, Sweden undertook major reform to reduce distorting taxes and make up revenue losses by introducing eco-taxes. This resulted in a re-allocation corresponding to six percent of GDP. Denmark is implementing by 1998 a comprehensive tax reform, with the objective of shifting tax burdens from income and labour to pollution and scarce environmental resources.

Ensuring food safety in more competitive and global markets is a continuing government concern. Pressures for more food safety regulation and stricter enforcement has risen with public concern over recent outbreaks of food-borne diseases. The challenge is to provide an acceptable level of food safety without imposing excessive compliance burdens on the food industry or unnecessarily increasing costs to consumers. A first step is to make a clear distinction between regulations providing a public good and those conferring private benefits. In Canada, the government continues to administer food health and safety regulations but has deregulated grading and quality assurance. Co-ordinating with more rapid standard-setting by the private sector is another option. Increasingly, government standards are less important because market-based voluntary regulations often exceed government food safety requirements. Multiple retailers in the United Kingdom, for example, impose higher product and process standards on suppliers of their own-label products. A trend in recent years has been for public regulation to follow the standards laid down by private regulations.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis,* Paris.

VI. FOLLOW-UP WORK BY THE OECD

Despite the significant increase in regulatory reform activity in recent years, the pace and depth of reform in Member countries varies considerably. Through multidisciplinary analysis and comparison of experiences to date and peer review processes, the OECD can assist Member governments in this area by engaging higher levels of domestic political attention; enhancing the transparency of the reform process; and equipping governments seeking to reform with the information they need to explain both the importance and implications of a sustained process of regulatory reform.

At their meeting at the OECD in May 1997, Ministers welcomed this Report on Regulatory Reform and endorsed its principles. They agreed to work to implement its recommendations, which focus on how governments can improve their regulations and regulatory processes. They noted the OECD's intention to undertake further work in sectoral and policy areas and requested the OECD to conduct reviews of regulatory reform efforts in Member countries beginning in 1998, based in part on self-assessment, with the goal of contributing to the steady improvement of regulatory practices in Member countries.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis*, Paris.

NOTES

1. A summary of the OECD Report on Regulatory Reform (8 pages) is available free of charge from the OECD's Public Management Service, and can also be found on the Internet at http://www.oecd.org/. The sectoral and thematic reports are published separately by the OECD in two volumes: **The OECD Report on Regulatory Reform: Sectoral Studies** and **The OECD Report on Regulatory Reform: Thematic Studies**. The 11 reports in these volumes are: "Regulatory Reform in Telecommunications Services"; "Regulatory Reform in the Financial Services Industry"; "Regulatory Reform and Professional Business Services"; "Regulatory Reform in the Electricity Sector"; "Regulatory Reform and the Agro-food Sector"; "Product Standards, Conformity Assessment and Regulatory Reform"; "Economy-wide Effects of Regulatory Reform"; "Competition, Consumers and Regulatory Reform"; "Regulatory Reform, Industrial Competitiveness and Innovation"; "Regulatory Quality and Public Sector Reform"; "Market Openness and Regulatory Reform". Information on how to obtain these reports can be found on the back cover.

OECD (1997), *The OECD Report on Regulatory Reform: Synthesis*, Paris.